ACCOUNTING POLICIES

FOR ALL

FUND TYPES AND ACCOUNT GROUPS

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Local Government Services Bureau

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ACCOUNTING POLICIES

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ACCOUNTING POLICIES

PREFACE

Governmental accounting and reporting continues to evolve rapidly. They will continue to do so, because of the increased attention being focused on them by the industry and the Governmental Accounting Standards Board (GASB).

While accountability remains an important objective, the purpose of these Accounting Policies is to provide specific guidance on selected governmental accounting topical areas. The policies focus on governmental accounting problem areas that local finance personnel are confronted with on a daily basis.

The Accounting Policies were developed with local finance personnel in mind; to be used by them as a reference tool for answering questions on governmental accounting problems of a recurring nature.

It is intended that these policies undergo continual change and revision based on changing needs and guidance issued by the GASB. Suggestions are encouraged and welcomed.

This edition of the Accounting Policies replaces the edition dated April 1992.

ACCOUNTING POLICIES

PRINCIPLES OF GOVERNMENTAL ACCOUNTING

SOURCES OF PRINCIPLES

Any discussion of governmental accounting principles should begin with the source of those principles. Formal standard setting in governmental accounting began in 1934, with the National Committee on Municipal Accounting and has evolved through the establishment of the Governmental Accounting Standards Board (GASB) in June1984. The GASB, like its private sector counterpart, the Financial Accounting Standards Board (FASB), functions under the auspices of the Financial Accounting Foundation (FAF). The GASB was established in accordance with a structural agreement, which sets forth the relative jurisdictions of the two boards. The structural agreement clearly establishes the GASB as the primary accounting and financial reporting standard - setting body for local governments. Moreover, the American Institute of Certified Public Accountants (AICPA) reaffirmed the GASB's authority by designating the GASB as the body to establish financial accounting principles for local governmental entities.

BASIC PRINCIPLES

There are twelve basic principles of accounting applicable to local governments. They are as follows:

Principle 1 - Accounting and Reporting Capabilities

A governmental accounting system must make it possible both: (a) to present fairly and with full disclosure the financial position and results of financial operations of the funds and account groups of the governmental unit in conformity with generally accepted accounting principles; and (b) to determine and demonstrate compliance with finance- related legal and contractual provisions.

Principle 2 - Fund Accounting Systems

Governmental accounting systems should be organized and operated on a fund basis. A fund is defined 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 or 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. Fund financial statements should be used to report additional and detailed information about the primary government, included its blended component units. The focus of governmental and proprietary fund financial statements is on major funds.

PRINCIPLES OF GOVERNMENTAL ACCOUNTING

BASIC PRINCIPLES - cont.

Principle 3 - Funds Types

In fund financial statements, governments should report governmental, proprietary, and fiduciary funds to the extent that they have activities that meet the criteria for using those funds. The following fund types should be used.

A. GOVERNMENTAL FUNDS (emphasizing major funds)

1. General Fund
2. Special Revenue Funds
3. Capital Projects Funds
4. Debt Service Funds
5. Permanent Funds

B. PROPRIETARY FUNDS

6. Enterprise Funds (emphasizing major funds)
7. Internal Service Funds

C. FIDUCIARY FUNDS (and similar component units)

8. Pension (and other employee benefit) Trust Funds
9. Investment Trust Funds
10. Private-purpose Trust Funds
11. Agency Funds

BASIC PRINCIPLES - cont.

Principle 4 - Number of Funds

Governmental units should establish and maintain those funds required by law and sound financial administration. Only the minimum number of funds consistent with legal and operating requirements should be established, however, since unnecessary funds result in inflexibility, undue complexity and inefficient financial administration.

Principle 5 – Reporting Capital Assets

A clear distinction should be made between general capital assets and capital assets of proprietary and fiduciary funds. Capital assets of proprietary funds should be reported in both the government-wide and fund financial statements. Capital assets of fiduciary funds (and similar component units) should be reported only in the statement of fiduciary net assets.

All other capital assets of the governmental unit are general capital assets. They should not be reported as assets in the governmental funds but should be reported in the governmental activities column in the government-wide statement of net assets.

Principle 6 - Valuation of Capital Assets

Capital assets should be reported at historical cost. The cost of capital assets should include ancillary charges necessary to place the asset into its intended location and condition for use. Donated fixed assets should be recorded at their estimated fair value at the time of acquisition plus ancillary charges, if any.

Principle 7 - Depreciation of Capital Assets

Capital assets should be depreciated over their estimated useful lives unless they are either inexhaustible or are infrastructure assets reported using the modified approach. Inexhaustible capital assets such as land and land improvements should not be depreciated. Depreciation should be reported in the government-wide statement of activities; the proprietary fund statement of revenues, expenses and changes in fund net assets; and the statement of changes in fiduciary net assets.

Principle 8- Reporting Long-term Liabilities

A clear distinction should be made between fund long-term liabilities and general long-term liabilities. Long-term liabilities directly related to and expected to be paid from proprietary funds should be reported in the proprietary fund statement of net assets and in the government-wide statement of net assets. Long-term liabilities directly related to and expected to be paid from fiduciary funds (and similar component units) should be reported in the statement of fiduciary net assets. All other unmatured general long-term liabilities of the governmental unit should not be reported as liabilities in governmental funds but should be reported in the governmental activities column in the government-wide statement of net assets.

PRINCIPLES OF GOVERNMENTAL ACCOUNTING

BASIS PRINCIPLES - cont.

Principle 9 – Measurement Focus and Basis of Accounting in the Basic Financial Statements

Government-wide Financial Statements

The government-wide statement of net assets and the statement of activities should be prepared using the economic resources measurement focus and the accrual basis of accounting. Revenues, expenses, gains, losses, assets, and liabilities resulting from exchange and exchange-like transactions should be recognized when the exchange takes place. Revenues, expenses, assets, and liabilities resulting from non-exchange transactions should be recognized in accordance with the standards relating to non-exchange transactions.

Fund Financial Statements

In fund financial statements, the modified accrual or accrual basis of accounting, as appropriate, should be used in measuring financial position and operating results.

a. Financial statements for governmental funds should be presented using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues should be recognized in the accounting period in which they become available and measurable. Expenditures should be recognized in the accounting period in which the fund liability is incurred, if measurable, except for unmatured interest on general long-term liabilities, which should be recognized when due.

b. Proprietary fund statements of net assets and revenues, expenses, and changes in fund net assets should be presented using the economic resources measurement focus and the accrual basis of accounting.

c. Financial statements of fiduciary funds should be reported using the economic resources measurement focus and the accrual basis of accounting, except for the recognition of certain liabilities of defined benefit pension plans and certain postemployment healthcare plans.

d. Transfers should be reported in the accounting period in which the interfund and receivable and payable arise.

PRINCIPLES OF GOVERNMENTAL ACCOUNTING

BASIS PRINCIPLES - cont.

Principle 10 - Budgeting, Budgetary Control, and Budgetary Reporting

a. An annual budget(s) should be adopted by every governmental unit.

b. The accounting system should provide the basis for appropriate budgetary control.

c. Budgetary comparison schedules should be presented as required supplementary information for the general fund and for each major special revenue fund that has a legally adopted annual budget. The budgetary comparison schedule should present both (a) the original and (b) the final appropriated budgets for the reporting period as well as (c) actual inflow, outflows, and balances, stated on the government's budgetary basis.

Principle 11 - Transfer, Revenue, Expenditures, and Expense Account Classification

a. At a minimum, the statement of activities should present:

(1) Activities accounting for governmental funds by function to coincide with the level of detail required in the governmental fund statement of revenues, expenditures, and changes in fund balances.

(2) Activities accounted for in enterprise funds by different identifiable activities.

b. Governmental fund revenues should be classified by fund and source. Expenditures should be classified by fund, function (or program), organization unit, activity, character and principal classes of objects.

c. Proprietary fund revenues should be reported by major sources and should identify revenues used as security for revenue bonds, and expenses should be classified in essentially the same manner as those of similar business organizations, functions or activities. Revenues and expenses should be distinguished as operating and non-operating.

d. Proceeds of general long-term debt issues should be classified separately from revenues and expenditures in the governmental fund financial statements.

BASIS PRINCIPLES - cont.
Principal 11 – Transfer, Revenue, Expenditure, and Expense Account Classification – cont.

e. Contributions to term and permanent endowments, contributions to permanent fund principal, other capital contributions, special and extraordinary items, and transfers between governmental and business-type activities should each be reported separately from, but in the same manner as, general revenues in the government-wide statement of activities. In the proprietary fund statement of revenues, expenses, and changes in fund net assets, these items should be reported separately after non-operating revenues and expenses. Transfers should be classified separately from revenues and expenditures in the governmental fund statement of revenues, expenditures, and changes in fund balances. Special and extraordinary items should be reported separately after "other financing sources and uses" in the governmental fund statement of revenues, expenditures, and changes in fund balances.

Principle 12 - Common Terminology and Classification

A common terminology and classification should be used consistently throughout the budget, the accounts and the financial reports of each fund.

Principle 13 - Annual Financial Reports

a. Appropriate interim financial statements and reports of financial position, operating results, and other pertinent information should be prepared to facilitate management control of financial operations, legislative oversight, and where necessary or desired, for external reporting purposes.

b. A comprehensive annual financial report should be prepared and published, covering all funds and activities of the primary government (including its blended component units) and providing an overview of all discretely presented component units of the reporting entity -- including introductory section, management's discussion and analysis (MD&A), basic financial statements, required supplementary information other than MD&A, appropriate combining and individual fund statements, schedules, narrative explanations, and statistical section. The reporting entity is the primary government (including its blended component units) and all discretely presented component units.

BASIS PRINCIPLES – cont
Principle 13 - Annual Financial Reports – cont.

c. The minimum requirements for MD&A, basic financial statements, and required supplementary information other than MD&A are:
   (1) Management's discussion and analysis
   (2) Basic financial statements. The basic financial statements should include:
      (a) Government-wide financial statements
      (b) Fund financial statements
      (c) Notes to the financial statements
   (3) Required supplementary information other than MD&A

d. The financial reporting entity consists of (1) the primary government, (2) organizations for which the primary government is financially accountable, and (3) other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity's basic financial statements to be misleading or incomplete. The reporting entity's government-wide financial statements should display information about the reporting government as a whole, distinguishing between the total primary government and its discretely presented component units as well as between the primary government's governmental and business-type activities. The reporting entity's fund financial statements should present the primary government's (including its blended component units, which are, in substance, part of the primary government) major funds individually and non-major funds in the aggregate. Funds and component units that are fiduciary in nature should be reported only in the statements of fiduciary net assets and changes in fiduciary net assets.

e. The nucleus of a financial reporting entity usually is a primary government. However, a governmental organization other than a primary government (such as a component unit, joint venture, jointly governed organization, or other stand-alone government) serves as the nucleus for its own reporting entity when it issues separate financial statements

GOVERNMENTAL FUND TYPES

INTRODUCTION

Nature and Purpose

Governmental fund types are those through which most governmental functions are typically financed. They are often called source and disposition or expendable fund types. The acquisition, use and balances of expendable financial resources and the related current liabilities, except those accounted for in proprietary funds, are accounted for through governmental fund types.

Governmental fund types are, in essence, accounting segregation of financial resources. Expendable assets are assigned to the various governmental funds according to the purposes for which they may or must be used. Current liabilities are assigned to the fund from which they are to be paid and the difference between governmental fund assets and liabilities, the fund equity, is referred to as fund balance.

The governmental fund measurement focus is on determination of financial position and changes in financial position (sources, uses and balances of financial resources), rather than on income determination. The statement of revenues, expenditures and changes in fund balance is the primary governmental fund operating statement. It may be supported or supplemented by more detailed schedules of revenues, expenditures, transfers and other changes in fund balance.

Governmental fund types are classified into five generic fund types:

1. General Fund - BARS - 1000
2. Special Revenue Funds – BARS - 2000
3. Debt Service Funds - BARS - 3000
4. Capital Projects Funds - BARS – 4000
5. Permanent Funds – BARS – 8000

Since the elimination of the special assessment fund type, special assessments that are used to finance certain service type activities may now be accounted for as a special revenue fund (maintenance), debt service fund (bond funds), or a capital projects fund (construction). Service type special assessments are for operating activities and do not result in the purchase or construction of fixed assets.

Each of the above governmental fund types is examined in more detail later in this discussion.

GOVERNMENTAL FUND TYPES

Basis of Accounting

Governmental fund type revenues and expenditures should be recognized on the modified accrual basis. Revenues should be recognized in the accounting period in which they become available and measurable. Expenditures should be recognized in the accounting period in which the fund liability is incurred, if measurable, except for unmatured interest on general long-term debt, which should be recognized when due.

Measurement Focus

The governmental fund type measurement focus is concerned with reflecting those revenues, expenditures, assets and related liabilities that identify the net financial resources available for subsequent appropriation and expenditures. (the flow of current financial resources.) Since the measurement focus is to determine the change in net financial resources, accounts such as fixed assets and long-term obligations are not reflected in (but short-term obligations are) the governmental fund type balance sheets, since these items will neither provide nor use financial resources of the current budgetary period.

Budgetary Systems

The budget is an essential element of the financial planning, control and evaluation process for governmental fund types. Every government should prepare an annual budget covering all governmental fund types. Budgets are categorized as either fixed or flexible. Fixed budgets provide estimates of specific (fixed) dollar amounts. Flexible budgets embody dollar estimates that vary according to demand for services provided.

Governmental fund type revenues are largely independent of their expenditures. Consequently, expenditures and service delivery levels must be tightly controlled through the use of fixed budgets. Counties, Cities and Towns are subject to the provisions of the Local Government Budget Act contained in Title 7, Chapter 6, Part 40. The budget act establishes a basis for the control and evaluation of activities financed through governmental fund types.

GENERAL FUND (BARS 1000)

Nature and Purpose

The general fund is used to account for all current financial resources not required by law or administrative action to be accounted for in another fund. It serves as the primary reporting vehicle for current governmental operations. GASB requires that governments report only one general fund.

GOVERNMENTAL FUND TYPES

SPECIAL REVENUE FUNDS – cont.

Nature and Purpose

Special revenue funds are used to account for the proceeds of specific revenue sources (other than expendable trusts or major capital projects) that are legally restricted to expenditure for specified purposes. A separate fund should be established for each such purpose. GAAP only requires the use of special revenue funds when legally mandated.

Revenue Sources

Special revenue funds derive their revenue from local, state and federal sources. Local sources include property taxes and special assessments, while state and federal sources include grants, entitlements and shared revenues. Revenue recognition of grants, entitlements and shared revenues is subject to and governed by NCGA Statement 2.

Under NCGA Statement 2, grants, entitlements, or shared revenues recorded in governmental funds should be recognized as revenue in the accounting period when they become susceptible to accrual, i.e., both measurable and available (modified accrual basis). In applying this definition, legal and contractual requirements should be carefully reviewed for guidance. Some such resources, usually entitlements or shared revenues, are restricted more in form than in substance. Only a failure on the part of the recipient to comply with prescribed regulations will cause a forfeiture of the resources. Such resources should be recorded as revenue at the time of receipt or earlier if the susceptible to accrual criteria are met. For other such resources, usually grants, expenditure is the prime factor for determining eligibility, and revenue should be recognized when the expenditure is made. Similarly, if cost sharing or matching requirements exist, revenue recognition depends upon compliance with these requirements.

For discussion and accounting treatment on pass-through resources, please refer to the section on Grants, Entitlements and Shared Revenues, pages L-1 to L-10.

DEBT SERVICE FUNDS - (BARS 3000)

Nature and Purpose

Debt service funds are used to account for the accumulation of resources for the payment of principal and interest on general long-term debt. Debt service funds are also used for the accumulation of resources for the payment of judgments and improvement district revolving fund loans. Debt service funds are sometimes referred to as sinking funds. A separate fund should be established for each general obligation bond issue, for each improvement district bond issue, for each judgment, and for each improvement district revolving fund.

GOVERNMENTAL FUND TYPES

DEBT SERVICE FUNDS – cont.

Revenue Sources

Debt service funds derive their financial resources primarily from local property taxes and special assessments. With respect to improvement district revolving funds, authority in Section 7-12-2182 (County), and Section 7-12-4222 (City), provides that a County or City may, in addition to support from the general fund, levy a tax each year not to exceed 5 percent of the principal amount of the outstanding improvement bonds for use by such revolving funds.

Amounts Available and Amounts To Be Provided (173000 and 174000)

Concept Discussion

With the implementation of GASB Statement #34, the reporting of the general long-term debt account group is no longer required. However, to facilitate the accumulation of the data necessary to prepare the government-wide statement of net assets and the statement of activities, the use of the account group will continue within the general ledger accounting of the local government.

It is virtually impossible to discuss debt service funds without discussing their relationship to the long-term debt account group (GLTDAG). Within the GLTDAG, the amounts available in the respective debt service fund for the retirement of general obligation bonds and/or special improvement bonds at year-end are recorded as an asset (amounts available for general obligation debt and/or special improvement debt) These amounts typically represent the fund (equity) balance of the respective debt service fund at year-end. However, the amount in any improvement district revolving fund is excluded since this amount is not considered available, as such, for debt retirement. It is important to reiterate that the amount available in the respective debt service fund for bonded debt retirement is actually recorded in the GLTDAG, and not in any debt service fund. Debt service funds are not affected, but their year-end fund (equity) balances are used as the basis for recording the amount(s) available in the GLTDAG.

The amounts to be provided represent the difference between the long-term liabilities reported in the GLTDAG and the amounts available in the GLTDAG. Please note that the amounts to be provided do not affect debt service funds only GLTDAG. It is discussed here to emphasize the relationship between amounts available and amounts to be provided and the need for their concurrent recording for proper effect.

The accounting entries normally associated with amounts available and amounts to be provided are illustrated in the GLTDAG section on pages H-3 and H-7.

GOVERNMENTAL FUND TYPES

DEBT SERVICE FUNDS – cont.

Illustrative Accounting Entries

A. On February 1, the County of XYZ received $3,750 of accrued interest on $500,000 of general obligation bonds sold on January 1.

B. The stated interest rate was nine percent and the issue term was 20 years.

C. The County expensed all underwriting costs because they were not considered significant.

D. The principal is to be repaid in 20 equal installments and is due and payable on June 30, each year ($500,000/20 = $25,000).

	Debit	Credit	Sub
(1)-3XXX-101000 - Cash	$3,750		
3XXX-242000 - Expenditures		$3,750	
3XXX-490100-620 - Bond interest			$3,750

(To record receipt of accrued interest on bonds sold. Ordinarily, this entry would be recorded as a part of the cash receipt process. <u>This entry is correct so long as the related interest payment is made in the same period or if the accrued interest payable is recorded at year-end</u>.)

	Debit	Credit	Sub
(2)-3XXX-242000 - Expenditures	$47,500		
3XXX-490100-610 - Principal		$25,000	
3XXX-490100-620 – Interest		22,500	
3XXX-205100 - Bonds payable			$25,000
3XXX-205200 – Accrued interest payable			22,500

(This entry records the appropriate expenditures and accruals. It requires the preparation of a General Journal Voucher.)

The recognition of expenditures in the debt service fund for unmatured debt service principal and interest is strictly optional. If a government elects to follow “early recognition”, it should do it on a consistent basis. Miller GAAP Guide on pages 25.14 and 25.15 discusses an example – if long-term debt was issued on January 1, 1999, and the first interest payment was due on July 1, 1999, there would be no accrual of interest as of June 30, 1999 (end of fiscal year). Likewise, if a bond repayment was due on July 1, 1999, the liability would not be recorded in the Debt Service Fund’s balance sheet as of June 30, 1999, even though the amount would be due the next day.

DEBT SERVICE FUNDS – cont.

Illustrative Accounting Entries – cont.

Parallel entry (3) to GLTDAG would also be required.

	Debit	Credit
(3)-9500-231100 - Bonds payable	$25,000	
9500-174100 - Amounts to be provided		$25,000

(This entry moves the principal amount of bonds due in the current fiscal year to debt service from GLTDAG, and records the appropriate offset to amounts to be provided. It requires the preparation of a General Journal Voucher.)

	Debit	Credit
(4)-3XXX-205100 - Bonds payable	$25,000	
3XXX-205200 – Accrued interest payable	22,500	
3XXX-102210 – Cash		$47,500

(To record liquidation of bonds and accrued interest payable and payment for them. Ordinarily, this entry would be recorded as a part of the cash disbursement process.)

CAPITAL PROJECTS FUNDS - (BARS 4000)

Nature and Purpose

Capital projects funds are used to account for financial resources utilized in the acquisition or construction of major capital facilities (other than those financed by proprietary funds or trust funds). Capital projects funds must also be used, for other than the acquisition or construction of major capital facilities, when mandated by law or stipulated by regulations or covenants related to the financing source. Normally, a separate fund should be established for each project. The determining factor is the legal provisions that surround the source and use of such financial resources.

Revenue Sources

Capital projects funds derive their financial resources primarily from the issuance of debt obligations, the levying of property taxes, the receipt of grants and shared revenues from other governments and the transfer of cash from other local funds.

CAPITAL PROJECTS FUNDS – cont.

Revenue Sources – cont.

Debt obligations include the sale of general obligation and improvement district bonds. Property taxes include those for capital improvement programs for cities, towns and counties. (7-6-616). Grants and shared revenues from other governments most often include federal and state grants and gas tax apportionment (15-70-101) for cities, towns and counties. (Regarding gas tax apportionment, a town or third class city may each year expend no more than 25 percent of the funds allocated to that town or third class city for the purchase of capital equipment and supplies to be used for the maintenance and repair of streets and alleys). The transfer of cash from other local funds includes county road and bridge capital improvement fund (7-14-2506), and city or county library depreciation reserves (22-1-305 and 22-1-306).

Capitalization of Interest

Concept Discussion

Capitalization of interest on capital projects also requires consideration. The Financial Accounting Standards Board's (FASB) Statement of Financial Accounting Standards (SFAS) No. 34, Capitalization of Interest Costs, requires that interest costs incurred during the construction phase of certain qualified assets be capitalized as part of their cost. According to the FASB Codification, the application of this standard to assets that are reported in the GFAAG appears optional. Interest capitalization when capital projects funds are used for construction undertaken on behalf of a proprietary fund remains questionable. Those favoring interest capitalization in such cases argue that the value of an asset should not depend upon the fund used to account for its construction. Because interest capitalization is required for asset construction reported in proprietary funds, they support extending the same treatment to assets constructed on behalf of proprietary funds. Such an approach, however, can lead to both practical and theoretical problems. Interest capitalization results in higher depreciation expense and can lead to higher user charges. Yet, when construction is reported in a capital projects fund, the responsibility for debt service remains with the general government, not with the proprietary fund. Therefore, a proprietary fund could recover a cost that is, in fact, borne by another fund. For this reason, it is recommended that interest not be capitalized on assets constructed on behalf of proprietary funds.

CAPITAL PROJECTS FUNDS – cont.

Capitalization of Interest – cont.

Concept Discussion – cont.

If a government determines that interest capitalization is appropriate for assets reported in the GFAAG, care should be taken that the amount of interest capitalized is computed correctly. In particular, governments must ensure that the provisions of SFAS No. 62, Capitalization of Interest Cost in Situations Involving Certain Tax Exempt borrowings and Certain Gifts and Grants are met. This pronouncement requires that interest costs be netted in certain instances against interest earned on the invested proceeds of tax-exempt borrowings when determining the amount of interest to be capitalized. For governments, this approach means that, in most cases, the information needed for the calculation must be drawn from two separate funds (the debt service fund and the capital projects fund). Accordingly, the calculation of interest to be capitalized normally is performed outside the government's accounting system.

Also, at no time should any amount of capitalized interest appear in the capital projects fund. Instead, the capitalized interest should be reflected in the GFAAG or proprietary fund, as appropriate.

Illustrative Accounting Entries

On January 1, the County of XYZ issued and sold $500,000 of general obligation bonds. The proceeds were received the same day.

	Debit	Credit	Sub
(5)-4XXX-101000 - Cash	$500,000		
4XXX-172000 - Revenue		$500,000	
4XXX-381010 - Bond proceeds			$500,000

(To record receipt of bond proceeds. Ordinarily, this entry would be recorded as a part of the cash receipt process.)

	Debit	Credit
(6)-9500-174100 - Amounts to be provided	$500,000	
9500-231100 - Bonds payable		$500,000

(To record issuance of general obligation bonds. It requires the preparation of a General Journal Voucher.)

CAPITAL PROJECTS FUNDS – cont.

Illustrative Accounting Entries – cont.

	Debit	Sub	Credit
(7)-4XXX-242000 - Expenditures	$500,000		
4XXX-420400-920 - Buildings		$500,000	
4XXX-101000 - Cash			$500,000

(To record construction costs. Ordinarily, this entry would be recorded as a part of the cash disbursement process.)

Closure to General Fixed Asset Account Group

	Debit	Credit
(8)-9000-182000 - Buildings	$500,000	
9000-280000 – Investment in General Fixed Assets		$500,000

(To record expenditures incurred in the capital projects fund for buildings at year-end. It requires the preparation of a General Journal Voucher.)

Closure to Enterprise Fund

	Debit	Credit
(9)-5210-189XXX - Utility plant	$500,000	
5210-343029 – Contributions from local government		$500,000

(To record expenditures incurred in the capital projects fund for buildings at year-end. It requires the preparation of a General Journal Voucher.)

GOVERNMENTAL FUND TYPES

PERMANENT FUNDS

Nature and Purpose

Permanent funds (BARS fund numbers 8000) were first introduced as part of the governmental financial reporting model established by the Governmental Accounting Standards Board (GASB) Statement No. 34. They are used to account for and report resources that are legally restricted to the extent that only the earnings from the investment of the principal can be expended, not the principal itself. The resources may be used for purposes that support the reporting government's programs, that is, for the benefit of the government.

Examples of such funds would include a cemetery perpetual care fund, endowments, or other funds donated to the government in which the donor has specifically identified a purpose for the use of the funds but has prohibited the expenditure of the principal of the bequest.

GOVERNMENTAL FUND TYPES

COMMON GOVERNMENTAL FUND TYPE APPLICATIONS

Nature and Purpose

Because some accounting situations are common to all governmental fund types (except generally for capital projects), they are discussed and illustrated accordingly, since they are equally applicable to the general fund, special revenue funds and debt service funds.

Revenue Recognition - Taxes/Assessments

Concept Discussion

Several factors affect when tax/assessment revenues and related receivables are recorded. Revenue recognition is based on the definition of the term “available”. Available means collected within the current period or expected to be collected soon enough thereafter to be used to pay liabilities of the current period. The collection period should not extend beyond 60 days after the end of the fiscal year. Those receivables, which do not meet these criteria, are recorded as deferred revenue which means they will be recorded as revenue in a future period.

GASB Interpretation No. 5, effective for financial statements for periods beginning after June 30, 2000, removes the “due” consideration from the definition of available. Available means collected within the current period or expected to be collected soon enough thereafter to be used to pay liabilities of the current period. The interpretation did not change the stipulation that the collection period after year-end shall not exceed sixty days.

Illustrative Accounting Entries

The County of XYZ transacted the following business during the current fiscal year:

A. Levied annual tax/assessment charges in the amount of $100,000.

B. Collected current taxes/assessments during the month of November in the amount of $25,000.

C. Collected delinquent taxes/assessments, including P & I, during the month of December in the amount of $6,100.

D. Adjusted (lowered) taxes/assessments receivable and corresponding deferred revenue accounts in the amount of $31,000, to recognize revenue from the collection of taxes/ assessments.

E. Collected miscellaneous revenue during June in the amount of $1,000.

GOVERNMENTAL FUND TYPES

COMMON GOVERNMENTAL FUND TYPE APPLICATIONS – cont.

Illustrative Accounting Entries - cont.

	Debit	Credit
(10)-XXXX-11XXXX - Taxes/assessments rec.	$100,000	
XXXX-223XXX - Deferred revenue		$100,000

(To record annual tax/assessment charges and offset to deferred revenue. It requires the preparation of a General Journal Voucher.)

	Debit	Credit	Sub
(11)-XXXX-101000 - Cash	$25,000		
XXXX-172000 - Revenue		$25,000	
XXXX-31XXXX - Taxes			$25,000

(To record collection of current year's taxes/assessments. Ordinarily, this entry would be recorded as a part of the cash receipt process.)

	Debit	Credit	Sub
(12)-XXXX-101000 - Cash	$6,100		
XXXX-172000 - Revenue		$6,100	
XXXX-31XXXX - Taxes			$6,000
XXXX-312000 - Penalty and interest			100

(To record collection of delinquent -year's taxes/assessments. Ordinarily, this entry would be recorded as a part of the cash receipt process.)

	Debit	Credit
(13)-XXXX-223000 - Deferred revenue	$31,000	
XXXX-11XXXX - Taxes/assessments receivable		$31,000

(To record adjustments for tax/assessment collections made. It requires the preparation of a General Journal Voucher.)

	Debit	Credit	Sub
(14)-XXXX-101000 - Cash	$1,000		
XXXX-172000 - Revenue		$1,000	$1,000
XXXX-362000 – Miscellaneous Revenue			

(To record collection of miscellaneous revenue. Ordinarily, this entry would be recorded as a part of the cash receipt process.)

GOVERNMENTAL FUND TYPES

PERMANENT FUNDS

Nature and Purpose

Permanent funds (BARS fund numbers 8000) were first introduced as part of the governmental financial reporting model established by the Governmental Accounting Standards Board (GASB) Statement No. 34. They are used to account for and report resources that are legally restricted to the extent that only the earnings from the investment of the principal can be expended, not the principal itself. The resources may be used for purposes that support the reporting government's programs, that is, for the benefit of the government.

Examples of such funds would include a cemetery perpetual care fund, endowments, or other funds donated to the government in which the donor has specifically identified a purpose for the use of the funds but has prohibited the expenditure of the principal of the bequest.

PROPRIETARY FUND TYPES

INTRODUCTION

Nature and Purpose

Proprietary fund types sometimes referred to as income determination, nonexpendable, or commercial-type funds are used to account for a government's ongoing organizations and activities that are similar to those often found in the private sector (enterprise and internal service funds). All assets, liabilities, equities, revenues, expenses, and transfers relating to the government's business and quasi-business activities where net income and capital maintenance are measured are accounted for through proprietary fund types. The generally accepted accounting principles here are those applicable to similar businesses in the private sector; and the measurement focus is on determination of net income, financial position, and changes in financial position.

Basis of Accounting

The (full) accrual basis of accounting is used by proprietary fund types. Under full accrual accounting, revenues are recognized in the accounting period in which they are earned and become measurable and expenses recognized in the period incurred, if measurable.

Measurement Focus

The measurement focus is concerned with the inflow and outflow of economic resources that affect the governmental unit. The flow of economic resources refers to all the assets available to proprietary fund types for the purpose of providing services. The balance sheet should reflect those resources that are available to meet current obligations and are to be used in the delivery of services in subsequent periods. The activity statement for the period should summarize those resources received and those consumed during the current period.

Budgetary Systems

The budget is an essential element of the financial planning, control and evaluation process for proprietary fund types. An annual budget should be prepared for each proprietary fund type. Budgets are categorized as either fixed or flexible. Fixed budgets provide estimates of revenue and expense in fixed dollar amounts based on estimated activity. Flexible budgets include dollar estimates that vary according to demand for services provided. There is wide recognition that the nature of budgeting is different between governmental fund types and proprietary fund types.

PROPRIETARY FUND TYPES – cont.

INTRODUCTION – cont.

Budgetary Systems – cont.

Governmental fund type revenues are largely independent of their expenditures. Consequently, expenditures and service delivery levels must be tightly controlled through the use of fixed budgets. Proprietary fund type service delivery levels, on the other hand, are determined by the extent of consumer demand. Increased service delivery levels usually increase expenses, but may also result in higher revenues. Because proprietary fund type revenues and expenses fluctuate with changing service delivery levels, the use of flexible budgets for proprietary activities is, logically, preferential for budgetary planning, control and evaluation purposes.

Any modification to proprietary fund type budgets should be approved by the respective governing body, through the normal resolution process. In the case of appropriation increases, sufficient resources should be available or become available to finance such increases in the period in which the appropriation applies.

Allocation of Costs

Often times, certain costs incurred by a government actually effect more than a single fund. In that event, such costs should be allocated to each fund in the proportion that it is benefited. This applies to proprietary funds as well, but may affect enterprise funds more often than internal service funds. Cost types common to this description include those for:
audit, association membership, PERS, computer hardware and software, and health, comprehensive and liability insurance premiums.

Proprietary Activity Accounting and Financial Reporting

Proprietary activities should apply all applicable GASB pronouncements (including all NCGA Statements and interpretations currently in effect) as well as the following pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements:

- Financial Accounting Standards Board (FASB) Statements and Interpretations
- Accounting Principles Board (APB) Opinions
- Accounting Research Bulletins (ARBS) of the Committee on Accounting Procedures

In addition to applying those provisions listed above, a proprietary activity may also apply all FASB Statements and Interpretations issued after November 30, 1989, except for those that conflict with or contradict GASB pronouncements.

PROPRIETARY FUND TYPES – cont.

INTRODUCTION – cont.

Proprietary Activity Accounting and Financial Reporting – cont.

Proprietary activities that apply the provisions of this paragraph should apply only those FASB Statements and Interpretations issued after November 30, 1989 that are developed for business enterprises and not those whose provisions are limited to not-for-profit organizations such as FASB Statement No. 117, *Financial Statements of Not-for-Profit Organizations,* or those that address issues concerning primarily such organizations, such as FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made.*

A proprietary fund should apply either all or none of the FASB pronouncements issued after November 30, 1989. The same application of FASB pronouncements is encouraged to be used for all proprietary funds, including component units, in the basic financial statements of the reporting entity.

Most local government entities in Montana have elected to adopt only those pronouncements issued by FASB on or before November 30, 1989, except those which conflict with or contradict GASB pronouncements.

ENTERPRISE FUNDS

INTRODUCTION

Nature and Purpose

Enterprise funds are used to account for operations (a) that are financed and operated in a manner similar to private business enterprises where the intent of the governing body is that costs (expenses, including depreciation) of providing services to the general public on a continuing basis be financed or recorded primarily through user charges; or (b) where 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.

Certain governmental services traditionally have been financed through user charges. The most common of which have been water, sewer, solid waste, ambulance, airport, hospital and nursing home activities.

Municipally Owned Utilities - PSC Jurisdiction

Public Service Commission regulatory jurisdiction over the rates set by municipal utilities was repealed from Montana law in the 1995 Legislative Session. Municipalities may increase utility rates at their discretion after holding public hearings.

Accounting Issues

There are several accounting issues or problem areas commonly associated with enterprise funds. Those, which are most problematic and recurring, are identified, discussed and illustrated on the following pages. Many of these illustrated concepts relate specifically to water utilities, but they are generally applicable to other enterprise activities in like circumstances.

UNRESTRICTED CASH AND CASH EQUIVALENTS/INVESTMENTS - (BARS 101000)

Concept Discussion

Unrestricted cash and cash equivalents/investments are not restricted to specific purposes and are available for use by the enterprise system for any legal expenditure purpose. Its composition includes cash, short-term investments (cash equivalents), and long-term investments as defined in GASB Statement No. 9.

RESTRICTED CASH AND CASH EQUIVALENTS/INVESTMENTS- (BARS 102100 – 102300 Series)

Concept Discussion

Restricted cash and cash equivalents are restricted by legal or contractual requirements. Accounts often associated with these restricted assets are those for construction, customer utility deposits and those for revenue bond indenture requirements. These assets may include cash, short-term investments (cash equivalents) and long-term investments as defined in GASB Statement No. 9.

Construction Grant - (BARS 102110)

Concept Discussion

Enterprise capital expenses are often financed in part by construction grants. A grant from another government is generally defined as a cash contribution to be used for a specified purpose. Each construction grant should be maintained in a separate restricted construction cash account. When a grant is provided to finance a capital expense, it is recorded as revenue but is reported after income (loss) before transfers as capital contributions. This is a change from the way such transactions were recorded prior to the effective date of Governmental Accounting Standards Board (GASB) Statement No. 33. Contributed capital accounts in existence may either be continued until the assets which they were used to purchase are fully depreciated or the account can be closed to retained earnings.

Revenue Bond Indenture Requirements - (BARS 102200 & 102300)

Concept Discussion

Revenue bond indentures usually mandate that separate accounts be established within the enterprise fund to report cash restricted to specific purposes. Four separate cash accounts are normally associated with each revenue bond indenture: Bond Sinking and Interest (current year); Reserve (Future years); Surplus Reserve; and Replacement and Depreciation.

Policy and/or Procedural Steps

Restricted debt service cash accounts for revenue bonds should be established and maintained in accordance with each respective revenue bond indenture agreement.

RESTRICTED CASH AND CASH EQUIVALENTS/INVESTMENTS - cont.

Illustrative Accounting Entries

A. The City of XYZ sold an issue of water bonds.

B. All water revenue collected is now placed in the water operating cash account.

C. The water bond indenture requires that the City establish and maintain the four named restricted cash accounts.

D. The water bond indenture further stipulates that each month specified sums must be allocated from water operating cash ($10,000) to bond sinking and interest cash ($4,000), reserve cash ($3,000), surplus reserve cash ($2,000) and replacement and depreciation cash ($1,000).

E. The City Council wishes to comply with the revenue bond indenture and instructs the Clerk to establish and maintain the appropriate restricted cash accounts.

	Debit	Credit
(15)-5210-102210 - Bond sinking & interest cash	$ 4,000	
5210-102220 - Reserve cash	3,000	
5210-102230 - Surplus reserve cash	2,000	
5210-102240 - Replacement & depreciation cash	1,000	
5210-101000 - Water operating cash		$10,000

(To record the movement of cash from water operating cash to the four restricted cash accounts in conformity with the revenue bond indenture. This would require the preparation of a General Journal Voucher.)

Customer Deposits

Concept Discussion

Utilities often require a deposit from customers to insure against nonpayment of bills. Those deposits remain the customer's property. To demonstrate the agent/customer relationship associated with these deposits, a restricted cash account is generally maintained. The decision to require customer deposits and whether to pay interest on them is entirely within the realm of local rule making.

RESTRICTED CASH AND CASH EQUIVALENTS/INVESTMENTS - cont.

Customer Deposits – cont.

Policy and/or Procedural Steps

1. The decision to secure utility payments through customer deposits should be instituted by ordinance. As a minimum, it should include the amount of deposit, the rate of interest to be paid, if any, and the circumstances under which deposits will be refunded.

2. Customer deposits should be maintained in a restricted cash account and offset by a liability payable account.

3. Subsidiary accounts should be maintained for all customer deposits and they should be reconciled periodically with the related general ledger control accounts.

Illustrative Accounting Entries

A. The City has an ordinance that requires customer water deposits. Interest on customer deposits is to accrue at the rate of 5 percent per year simple.

B. The customer deposits fee is $50 for both residential and non-residential customers.

C. At the close of the fiscal year:

   - ❖ There were 50 customers with deposits.

   - ❖ No interest had been accrued on any customer deposits.

   - ❖ Subsidiary records for each customer's deposit were maintained, but the deposits themselves were a part of the water operating cash account.

   - ❖ A liability customer deposits payable general ledger account had been established and maintained.

   - ❖ The utility had initiated disconnection proceedings against two customers for nonpayment of water charges. (One delinquent account totaled $30, the other $40.)

RESTRICTED CASH AND CASH EQUIVALENTS/INVESTMENTS - cont.

Illustrative Accounting Entries –cont.

D. The governing body instructed the Clerk to do the following (before closing the books):

- Establish and maintain a restricted cash account for all customer deposits.
- Accrue interest for only the past fiscal year on all customer deposits at the rate of 5 percent simple interest, except for the two customers where disconnection proceedings had been initiated. (The alternative to annual interest accrual on customer deposits is to compute and pay the interest at the time the deposit is refunded.)
- Use the deposits of the two customers (where disconnection proceedings had been initiated) to pay their delinquent bills, and forfeit any excess of deposits to the water operating cash account.

	Debit	Credit
(16)-5210-1021xx - Customer deposits cash	$2,500	
5210-101000 - Water operating cash		$2,500

(To record establishment of the restricted customer deposits cash account and the appropriate decrease to the water operating cash account. (50 depositors x $50 fee = $2,500) Ordinarily, the entry effecting customer restricted cash and customer deposits payable would be recorded as a part of the cash receipt process.)

(Accrual method option)	Debit	Sub	Credit
(17)-5210-242000 - Expenditures	$120		
5210-430510-620 - Interest expense		$120	
5210-206100 - Interest payable			$120

(To record annual accrual of interest on customer deposits and related non-operating interest expense. (48 depositors x $50 x .05 rate = $120) Ordinance stipulates that interest does not accrue on (the two) deposits where the utility has initiated disconnection proceedings. It requires the preparation of a General Journal Voucher.)

RESTRICTED CASH AND CASH EQUIVALENTS/INVESTMENTS- cont.

Illustrative Accounting Entries – cont.

	Debit	Credit	Sub
(18)-5210-214000 - Customer deposits payable	$100		
5210-101000 - Water operating cash	100		
5210-122000 - Water accounts receivable		$ 70	
5210-1021xx - Customer deposits cash		100	
5210-172000 - Revenue		30	
5210-343027 - Miscellaneous water revenue			$ 30

(To record payment of delinquent water accounts through forfeited customer deposits, increasing water operating cash and miscellaneous revenue by the excess of customer deposits over the delinquent accounts owed. Ordinance stipulates that customer deposits are not refunded where more than two notices of delinquency have been made to the customer by the utility. It requires the preparation of a General Journal Voucher.)

(Cash basis method option)	Debit	Sub	Credit
(19)-5210-242000 - Expenditures	$ 5		
5210-430510-620 - Interest expense		$ 5	
5210-214000 - Customer deposits payable	100		
5210-1021xx - Customer deposits cash			$100
5210-101000 - Water operating cash			5

(To record interest paid (for one year) as interest expense on the refund of two customer deposits. Ordinarily, this entry would be recorded as a part of the cash disbursement process. This is an alternative to annual interest accrual.)

TAXES AND ASSESSMENTS RECEIVABLE - (BARS 11XXXX Series)
Taxes Receivable
Concept Discussion

These taxes receivable accounts represent the uncollected portion of property taxes which the government has levied (on behalf of an enterprise) and which are now due.

Property taxes normally are not levied for (self-supporting) enterprise activities, except when subsidies become necessary. This necessity frequently occurs in the financing of hospital and nursing home activities. In such an event, all tax charges should be reported by the recipient enterprise as nonoperating revenue with no offset to deferred revenue (223xxx).

TAXES AND ASSESSMENTS RECEIVABLE – cont.

Assessments Receivable

Concept Discussion

This account represents the uncollected portion of user charge fees placed on the tax roll for collection as assessments and which are now due.

Solid waste enterprise activities (and others) frequently place user charge fees on the tax roll for collection, where they are commonly referred to as assessments. However, placing these user charge fees on the tax roll as assessments does not alter their character. Consequently, all such user fees should be reported by the respective enterprise as operating user fee revenue with **no offset to deferred revenue** (223XXX).

ALLOWANCE FOR UNCOLLECTIBLE TAXES AND/OR ASSESSMENTS - (BARS 11X100)

Concept Discussion

The allowance for uncollectible taxes and/or assessments is a contra-asset valuation account used to estimate the portion of a receivable that is not expected to be collected. (Contra-accounts are a sub classification of accounts and are used to show reductions from related accounts reflecting positive balances). Taxes and assessments that are susceptible to accrual and recognized in the accounts should, ordinarily, be reduced by an allowance for uncollectible items. In practice, this simply means that current tax/ assessment revenue is recorded net of the estimated amount of uncollectible items, and that the current revenue and the estimated allowance provision therefrom are equal to the tax/assessment receivables charged. The need to consider an allowance provision, however, would be greater for those who experience material losses from tax deed taking and/or from taxes paid under protest.

The amount of uncollectible estimated should be based on a percentage of the current year taxes and/or assessments charged and be recorded at that time. The basis used to estimate the uncollectible should be made on a factor or factors derived from historical data. Generally, a receivable is treated as impaired when tax deed is taken on property and/or when taxes are paid under protest. The actual loss therefrom should, accordingly, be taken up in the accounts at that time. This is not to say, however, that receivables do not become impaired when tax deed is not taken on eligible properties. On the contrary, they do. Often times, tax deed is not taken on selected properties, those having special and/or rural improvement assessments against them, because the county must assume the liability for all such future assessments until the properties are sold. Receivables in this situation, where properties are eligible for tax deed proceedings, should also be considered impaired and the estimated losses therefrom taken up in the accounts.

ALLOWANCE FOR UNCOLLECTIBLE TAXES AND/OR ASSESSMENTS – cont.

Concept Discussion – cont.

A more practical and expedient method, but perhaps a questionable one, is use of the direct write-off method. Under this method, losses are recognized in the period in which the accounts are determined to be uncollectible and they are considered a bad debt expense rather than a reduction of revenue. The allowance method, however, is the preferred method. (A detailed discussion on this subject is found under Uncollectible Accounts Receivable that follows.)

Illustrative Accounting Entries

The County of XYZ operates a hospital and solid waste program as enterprise activities. However, the hospital receives a property tax subsidy and the solid waste user charge fees are placed on the tax roll for collection as assessments.

A. The amount of taxes and assessments levied for the current year is $100,000, and uncollectible items estimated at 5 percent.

B. The City collected $50,000 in current taxes/assessments during the current period.

C. The City abated and refunded some current taxes/assessments during the current period, as follows:

   - Enterprise abatements - $1,000
   - Enterprise refunds - $1,500

D. The County took tax deed to property on which delinquent taxes and assessments amounted to $1,000, in which the enterprise activities have a 10 percent interest.

E. This same property was sold at public auction for $900.

	Debit	Credit	Sub
(20)-5110-11XXXX - Taxes/assessments receivable	$100,000		
5110-172000 - Revenue		$95,000	
5110-363100/311000 - Taxes/assessments			$95,000
5110-111100 - Allowance for uncollectible		5,000	

(To record the current taxes/assessments receivable, the current tax/assessment revenue and the amount estimated to be uncollectible. It requires the preparation of a General Journal Voucher.)

ALLOWANCE FOR UNCOLLECTIBLE TAXES AND/OR ASSESSMENTS – cont.

Illustrative Accounting Entries – cont.

	Debit	Credit
(21)-5110-101000 - Cash	$50,000	
5110-11XXXX - Taxes/assessments receivable		$50,000

(To record the collection of taxes/assessments and offsetting reductions to appropriate receivables. Ordinarily, this entry would be recorded as a part of the cash receipt process.)

	Debit	Sub	Credit
(22)-5110-172000 - Revenue	$1,000		
5110-363100/311000 - Taxes/assessments		$1,000	
5110-11XXXX - Taxes/assessments receivable			$1,000

(To record the abatement of current taxes/assessments. Ordinarily, this entry requires the preparation of a General Journal Voucher.)

	Debit	Sub	Credit
(23)-5110-172000 - Revenue	$1,500		
5110-363100/311000 - Taxes/assessments		$1,500	
5110-101000 - Cash			$1,500

(To record -the refund of current taxes/assessments collected. Ordinarily, this entry would be recorded as a part of the cash disbursement process.)

Note: If the taxes/assessments had been abated or refunded in the subsequent period, then the debit entries would be prior period adjustments - provided the abated or refunded amounts were material.

	Debit	Credit
(24)-5110-123000 - Tax deed lands receivable	$100	
5110-11XXXX - Taxes/assessments receivable		$100

(To record the acquiring of tax deed lands and reduction of taxes/assessments receivable. The write-offs should be approved by the respective boards and the affected cities/towns notified. It requires the preparation of a General Journal Voucher.)

ALLOWANCE FOR UNCOLLECTIBLE TAXES AND/OR ASSESSMENTS – cont.

	Debit	Credit
(25)-5110-101000 - Cash	$ 90	
5110-111100 – Allowance for uncollectible	10	
5110-123000 - Tax deed lands receivable		$100

(To record the sale of tax deed lands and adjustments to allowance for uncollectible and tax deed land accounts. The sale of tax deed properties should be conducted by the respective boards and the affected cities and towns notified. Ordinarily, this entry would be recorded as a part of the cash receipt process.)

ACCOUNTS RECEIVABLE - (BARS 122000)

Concept Discussion

The accounts receivable category should represent amounts owed to the enterprise from customers for goods and services provided before the end of the reporting period. (It should not include amounts due from other funds or governmental units.) In practice, however, the accrual of receivables often coincide more with the billing cycle than with the year-end reporting period. Theoretically, unbilled receivables should be reported at year-end especially if they are material.

Policy and/or Procedural Steps

(1) A trial balance of subsidiary ledger accounts receivable should be taken each month, and reconciled with the general ledger receivable control account.

(2) Delinquent sewer accounts collected as tax roll assessments should not be treated as deferred assessments on the general accounting records, but treated as credits to the respective receivable accounts.

Illustrative Accounting Entries

A. The billing cycle of the City of XYZ for water user charge revenues is the 20th of each calendar month.

B. The May 20th though June 20th user charge revenue billings are $5,000.

C. The June user charge revenue collections are $4,000.

ACCOUNTS RECEIVABLE – cont.

Illustrative Accounting Entries – cont.

D. On June 30, ten days of water user charge revenues ($1,500) are unbilled. Because these revenues are considered to be material, the governing body instructs the Clerk to accrue them; and to reverse the accruals in the month following the close of the fiscal year.

	Debit	Credit	Sub
(26)-5210-122000 - Water accounts receivable	$5,000		
5210-172000 - Revenue		$5,000	
5210-343021 - Metered water sales			$5,000

(To record the monthly charges to accounts receivable and offsetting increases to the revenue earned. Ordinarily, this entry would be recorded as a part of the utility billing process.)

	Debit	Credit
(27)-5210-101000 - Water operating cash	$4,000	
5210-122000 - Water accounts receivable		$4,000

(To record the monthly revenues collected and offsetting reductions to accounts receivable. Ordinarily, this entry would be recorded as a part of the cash receipt process.)

	Debit	Credit	Sub
(28)-5210-122000 - Water accounts receivable	$1,500		
5210-172000 - Revenue		$1,500	
5210-343021 - Metered water sales			$1,500

(To record the unbilled charges to accounts receivable and offsetting increases to the revenue earned for the current fiscal year. It requires the preparation of a General Journal Voucher.)

	Debit	Sub	Credit
(29)-5210-172000 - Revenue	$1,500		
5210-343021 - Metered water sales		$1,500	
5210-122000 - Water accounts receivable			$1,500

(This entry is to be made in the month following the close of the previous fiscal year. It reverses the above accruals, so that they will not be duplicated in the succeeding fiscal year. It requires the preparation of a General Journal Voucher.)

UNCOLLECTIBLE ACCOUNTS RECEIVABLE (BARS 122100)

Concept Discussion

Accounts receivable should be reviewed continually to determine the adequacy of their collectability, particularly at year-end. Invariably, some accounts will become uncollectible. If it is probable that an account has been impaired, then the estimated loss therefrom should be expensed as a bad debt.

There are two methods in use for dealing with losses from uncollectible accounts receivable. The direct write-off method and the allowance method. Either method is acceptable, but the allowance method is the preferred method.

Under the direct write-off method, bad debt losses are recognized in the period in which the accounts are determined to be uncollectible. The real virtue of this method is its simplicity and convenience of application. In theory, however, it falls short of GAAP, since accounts receivable are overstated and losses from bad debts are not matched with related revenues.

The allowance method, on the other hand, properly recognizes bad debt losses in the year in which the sale is made. Under this method, an allowance is used to indicate the estimated uncollectible. The account is reflected as a contra to the controlling receivable account, and the indicated subsidiary accounts are left intact. When it is decided that a specific amount is uncollectible, it is charged against the contra allowance credit. (Contra accounts are a sub classification of accounts, and are used to show reductions from related accounts reflecting positive balances.)

Policy and/or Procedural Steps

1. The governing body should adopt a formal policy on what methods and procedures they wish to use in dealing with uncollectible accounts receivable.

2. Each customer account written-off should have the prior approval of the governing body and become a matter of record as well.

3. The customer account record of each receivable written off should be transferred to a separate file and preserved for future reference.

UNCOLLECTIBLE ACCOUNTS RECEIVABLE – cont.

Illustrative Accounting Entries

A. After exhausting all of its remedies, the Water Utility staff of the City of XYZ determined that $1,000 in water accounts is uncollectible.

B. The governing body agrees with the determination and approves the write-off request.

C. The newly adopted policy (June 1) of the governing body requires that:

- The direct write-off method will be used for the remainder of the current fiscal year.
- Effective July 1, and thereafter the allowance method will be used.
- The percentage of receivables deemed uncollectible, under the allowance method, was estimated to be one percent of sales.
- July water billings were $10,000.
- In August, receivables amounting to $100 were determined uncollectible and written-off under the allowance method.

	Debit	Sub	Credit
(30)-5210-242000 - Expenditures	$1,000		
5210-430500-810 - Bad debt expense		$1,000	
5210-122000 - Water accounts receivable			$1,000

(To record the write-off of losses from uncollectible water accounts by the direct write-off method. It requires the preparation of a General Journal Voucher.)

	Debit	Sub	Credit
(31)-5210-242000 - Expenditures	$100		
5210-430500-810 - Bad debt expense		$100	
5210-122100 - Estimated uncollectible A/R			$100

(To record the estimated bad debt losses from uncollectible water accounts receivable for July, by the allowance method. It requires the preparation of a General Journal Voucher.)

UNCOLLECTIBLE ACCOUNTS RECEIVABLE – cont.

Illustrative Accounting Entries – cont.

	Debit	Credit
(32)-5210-122100 - Estimated uncollectible a/r	$100	
5210-122000 - Water accounts receivable		$100

(To record receivables written off under the allowance method. It requires the preparation of a General Journal Voucher.)

PREPAID EXPENSES - (BARS 141000)

Concept Discussion

This account represents expenses entered in the accounts for benefits not yet received. Examples of prepaid expenses are: prepaid rent, prepaid interest and unexpired insurance premiums.

Illustrative Accounting Entries

1. On January 1, the City of XYZ Sewer Utility renewed its motor vehicle liability insurance coverage for one year.

2. The insurance premium costs were $1,000, and they were paid the day of renewal.

3. The expired insurance premiums are to be expensed at the close of each fiscal year.

	Debit	Credit
(33)-5310-141000 - Prepaid expenses	$1,000	
5310-101000 - Sewer operating cash		$1,000

(To record prepaid insurance premiums. Ordinarily, this entry would be recorded as a part of the cash disbursement process.)

NOTE: Entry number (33) could be charged directly to the expense account rather than to prepaid expense. At year-end, a journal voucher could than be prepared reducing the expense account and establish prepaid expenses for prepaid items.

PREPAID EXPENSES - cont.

Illustrative Accounting Entries – cont.

	Debit	Sub	Credit
(34)-5310-242000 - Expenditures	$500		
5310-430610-510 - Insurance		$500	
5310-141000 - Prepaid expenses			$500

(To record expired insurance premiums (as an expense) for the fiscal year. It requires the preparation of a general Journal Voucher.)

CAPITAL ASSETS AND DEPRECIATION - (BARS 180000 Series)

Capital Assets - General

Concept Discussion

Capital assets are long-lived tangible assets obtained or controlled as a result of past transactions, events or circumstances. Capital assets may include buildings, equipment, improvements other than buildings and land. In a commercial enterprise, such as a water or sewer utility, the capital assets are often referred to as property, plant and equipment. The BARS System classifies utility capital assets similarly.

Enterprise capital assets are not recorded in the general fixed asset group of accounts. Instead, they are accounted for as fund assets of the enterprise itself. The treatment differs because enterprise capital assets are utilized in revenue producing activities, and the performance measure of an enterprise is the periodic determination of net income. In the net income determination process, GAAP requires a proper matching of all costs associated with the production of revenues. Depreciation of capital assets used in the production of revenues is a proper element of such costs, therefore, enterprise capital assets are to be capitalized and depreciated in the fund generating the revenues.

Enterprise capital assets are acquired with cash or cash in conjunction with a trade-in, constructed, and acquired through lease agreement, grant, gift or donation. Capital assets acquired for use in enterprise activities should be recorded at historic cost, or if not practically determinable, at estimated historic cost. Donated capital assets should be recorded at their fair market value when received. The cost of a capital asset should include not only its purchase price or construction cost, but also any other reasonable and necessary costs incurred to place the asset in its intended location or use. Such costs could include the following:

- Administration fees/costs
- Legal and title fees
- Appraisal or negotiation fees
- Surveying fees
- Damage payments
- Site preparation costs
- Demolition costs
- Architect & accounting fees
- Insurance premiums during construction
- Interest costs during construction
- Transportation charges

CAPITAL ASSETS AND DEPRECIATION - cont.

Depreciation - General

Concept Discussion

Depreciation is the expiration in the service life of capital assets, except land, attributable to wear and tear, deterioration, action of the physical elements, inadequacy and obsolescence. Depreciation is defined as a rational and systematic method of distributing the cost of a capital asset over its estimated service life.

Depreciation is an important element in the income determination process of an enterprise. The method used to allocate the cost of a capital asset over its estimated service life should be as equitable as possible to the periods which services are obtained from the use of the asset. By far, the most common approach used in practice is the straight-line method. Other methods may also be acceptable. However, our discussion on depreciation methods is limited to the straight-line method.

The straight-line method of depreciation simply requires that the cost of the capital asset (less projected salvage value) be divided by the number of years of estimated service life to arrive at the annual depreciation charge. Estimated service life is the length of time a capital asset can be expected to perform the function for which it was intended.

Policy and/or Procedural Steps

Capital Assets

1. The governing body should establish a formal capital asset policy on what methods and procedures they wish to use in recording and reporting capital assets.

2. Adequate subsidiary records of all capital assets should be maintained and, periodically, they should be reconciled with the related general ledger accounts.

3. A physical inventory should be taken at least once each year and the subsidiary records adjusted to the actual count.

CAPITAL ASSETS AND DEPRECIATION - cont.

Policy and/or Procedural Steps - cont.

Depreciation

Because salvage value borders on the impossible to predict, it will be considered zero for all depreciable assets.

The straight-line method of depreciation, because of its simplicity, will be the method used for all depreciable assets.

Depreciation should be computed (prorated) when the asset is put into service. However, optionally, a full year's depreciation could be reported for assets received in the first six months and none for those received during the balance of the year; or the half year convention could be used where 50 percent of the year's depreciation is taken in the year of addition and in the year of disposition.

Costs Associated With Capital Asset Procurement

Concept Discussion

The cost of a capital asset should include not only its purchase price or construction cost, but also any other reasonable and necessary costs incurred to place the asset in its intended location or use. When an enterprise chooses to construct a capital asset, a primary accounting consideration is determining the capitalized cost associated with the construction. Normally, capitalizable costs include all direct costs. The recognition of indirect costs as part of a constructed asset is a point of debate. Some believe that no indirect costs of an enterprise should be capitalized as part of a construction project. Others believe that incremental overhead costs should be capitalized, while some contend that a portion of all overhead costs should be allocated to the construction project.

Illustrative Accounting Entries

The City of XYZ Water Utility purchased an electric pump (July 1), for use in the Water Pumping Plant. The price of the pump was $15,000, the freight was $1,500, and the installation cost was $3,500. The estimated service life of the asset is 20 years, with zero salvage value. The straight-life method of depreciation is the applicable method to be used.

	Debit	Credit
(35)-5210-189200 - Water pumping plant	$20,000	
5210-101000 - Water operating cash		$20,000

(To record the acquisition of the new electric pump. It is capitalized to include all costs relative to placing the asset in use. Ordinarily, this entry would be recorded as a part of the cash disbursement process.)

CAPITAL ASSETS AND DEPRECIATION - cont.

Costs Associated With Fixed Asset Procurement – cont.

Illustrative Accounting Entries – cont.

	Debit	Sub	Credit
(36)-5210-242000 - Expenses	$1,000		
5210-430530-830 - Depreciation expense		$1,000	
5210-189210 - Allowance for depreciation			$1,000

(To record the annual depreciation charge and offsetting allowance for depreciation for the first year on the new electric pump. It requires the preparation of a General Journal Voucher. Determined as follows):

$$\frac{\$20{,}000 \text{ Historic Cost}}{20 \text{ yr. Service Life}} = \$1{,}000 \text{ annual charge}$$

Trade-In of Equipment

Concept Discussion

The most basic form of machinery and equipment acquisition is a purchase with cash and no trade-in. Many times, however, an enterprise is in a position to trade-in old machinery and equipment as a part of the acquisition of a new asset. In that event, determining the proper amount at which the new asset should be capitalized must be addressed. If an enterprise activity trades-in a productive capital asset (asset used in the production of revenue) for a similar asset, the acquired asset generally would be valued at the net book value of the traded asset, plus any monetary consideration. No gain is recognized on this type of transaction. An enterprise paying monetary consideration should not recognize any gain on a transaction involving assets not held for resale. Conversely, if the net book value of the traded asset exceeds its fair value, the loss would be recognized at the time of the transaction. The underlying principle here is that non-monetary transactions should be valued on the same basis (fair value) as monetary transactions. (APB Opinion No. 29) Fair value can be determined by market quotes or independent appraisal. However, if fair value cannot be determined, then the net book value of the traded asset may be used in determining a basis for the acquired asset and no gain or loss on the transaction recognized.

CAPITAL ASSETS AND DEPRECIATION - cont.

Trade-In of Equipment – cont.

Illustrative Accounting Entries

The City of XYZ Water Utility purchased a new one ton truck (January 1) for General Plant use.

A. The price of the new truck was $25,000.
B. The cash difference paid was $12,000.
C. An old similar truck was traded-in with a book value of $10,000 (i.e., $25,000 historical cost less $15,000 accumulated depreciation).
D. The fair market value of the old truck could not be determined.
E. The estimated service life of the asset is 6 years, with zero salvage value.
F. The straight-line method of depreciation is the applicable method to be used.

	Debt	Credit
(37)-5210-189500 - Water general plant	$22,000	
5210-189510 - Allowance for depreciation	15,000	
5210-101000 - Water operating cash		$12,000
5210-189500 - Water general plant		25,000

(To record acquisition of the new one-ton truck and the appropriate reductions to the allowance for depreciation and capital asset accounts. Two entries, or processes, would ordinarily be required; the general journal voucher process and the cash disbursement process. The value of the new truck is the sum of the cash paid out $12,000, and the book value of the old truck $10,000.)

	Debit	Sub	Credit
(38)-5210-242000 - Expenses	$1,850		
5210-430530-830 - Depreciation		$1,850	
5210-189510 - Allowance for depreciation			$1,850

(To record the annual depreciation expense and allowance for depreciation for half of the fiscal year on the one-ton truck. It requires the preparation of a General Journal Voucher. Determined as follows):

(a) $\frac{\$22{,}000 \text{ Historic Cost}}{6 \text{ yr. Service Life}}$ = $3,700 annual charge (rounded)

(b) $\frac{\$3{,}700 \text{ Annual Charge}}{2 \text{ One-half year}}$ = $1,850 charge for one-half year

CAPITAL ASSETS AND DEPRECIATION - cont.

Trade-In of Equipment – cont.

Valuation Basis Outline - restated

1. Non-monetary transactions should be valued the same as monetary transactions, i.e., fair value. (Fair value can be determined by market quotes or independent appraisal.)

2. If fair value exceeds the net book value of the traded asset, no gain on the transaction is recognized. An enterprise paying monetary consideration should not recognize any gain on a transaction involving assets not held for resale.

The value of the new asset would be the net book value of the traded asset, plus any monetary consideration given up.

3. If the net book value exceeds fair value of the traded asset, the loss would be recognized at the time of the transaction.

The value of the new asset would be the fair value of the traded asset, plus any monetary consideration given up.

4. If fair value is not determinable, no gain or loss is recognized on the transaction.

The value of the new asset would be the net book value of the traded asset, plus any monetary consideration given up.

CAPITAL ASSETS AND DEPRECIATION - cont.

Sale of Equipment

Often times, a government may find it more economical to sell directly, or auction-off, an old piece of equipment - rather than trading it in on a new piece of equipment. If a gain or loss results from the sale of an asset, such gain or loss should be recognized in current year operations.

Illustrative Accounting Entries

The City of XYZ Water Utility sold one of its old heavy duty trucks, which had been used for General Plant activity.

A. The historical cost was $15,000.
B. The accumulated depreciation was $11,000.
C. The sales price was $2,000, and was received at the time of sale.

	Debit	Sub	Credit
(39)-5210-101000 - Water oper. cash	$ 2,000		
5210-189510 - Allowance for depreciation	11,000		
5210-242000 - Expense control	2,000		
5210-430500-800 - Loss on sale		$ 2,000	
5210-189500 - General plant			$15,000

(To record disposal of the old truck, with appropriate reductions to the allowance for depreciation and fixed asset accounts and recognizing the loss on the sale. Ordinarily, this entry would be recorded as a part of the cash receipt process and a general journal voucher.)

Scrapping of Equipment

Frequently, equipment wears out or becomes obsolete and must be discarded and eventually scrapped. If a gain or loss results from the disposal of an asset, such gain or loss should be recognized in current year operations.

CAPITAL ASSETS AND DEPRECIATION - cont.

Scrapping of Equipment – cont.

Illustrative Accounting Entries

The City of XYZ Water Utility scrapped one of its old pickup trucks, which had been used for general plant activity.

A. The historical cost was $10,000.
B. The accumulated depreciation was $9,000.
C. No salvage value had been considered.

	Debit	Credit
(40)-5210-189510 - Allowance for depreciation	$9,000	
5210-430500-800 - Loss	1,000	
5210-189500 - General plant		$10,000

(To record scrapping of the old pickup truck, with appropriate reductions to the allowance for depreciation and fixed asset accounts and recognizing the loss therefrom. It requires the preparation of a General Journal Voucher.)

Contributed Capital

Concept Discussion

Enterprise capital assets are often financed by grants from Federal or State sources. A grant from another government is generally defined as a contribution or gift of cash or other assets to be used or expended for a specified purpose or facility. When a grant is provided to finance a capital expense, the grant is recorded as a revenue and is reported as a capital contribution after income (loss) before transfers on the income statement. Depreciation is computed and recorded on contributed capital assets as well as other capital assets, but the depreciation expense is recorded against the contributed capital account rather than retained earnings. Contributed capital accounts in existence prior to the implementation of GASB Statement #33 (BARS code 260000) can be continued until the assets the purchased are fully depreciated or they may be closed to retained earnings.

CAPITAL ASSETS AND DEPRECIATION - cont.

Contributed Capital – cont.

Illustrative Accounting Entries

The City of XYZ applied for and was awarded a grant amounting to $40,000, for a water tower. The City contracted with and paid the Acme Water Company $40,000, to construct the water tower. The estimated service life of the tower is 40 years, with zero salvage value. The tower was placed in service on July 1. The straight-line method of depreciation is the applicable method to be used.

	Debit	Credit
(41)-5210-102110 - Construction cash	$40,000	
5210-330000 – Intergovernmental revenue		$40,000

(To record receipt of the tower construction grant. Ordinarily, this entry would be recorded as a part of the cash receipt process.)

	Debit	Credit
(42)-5210-189400 – Transmission and Distribution	$40,000	
5210-102110 - Construction cash		$40,000

(To record payment for construction of the tower. Ordinarily, this entry would be recorded as a part of the cash disbursement process.)

	Debit	Sub	Credit
(43)-5210-242000 - Expenses	$1,000		
5210-430530-830 - Depreciation expense		$1,000	
5210-189410 - Allowance for depreciation			$1,000

(To record the annual depreciation expense and allowance for depreciation on the tower. This option (830) closes depreciation expense to Retained earnings. It requires the preparation of a General Journal Voucher. Determined as follows:)

$$\frac{\$\,40{,}000 \quad \text{Historic Cost}}{40\text{ yr.} \quad \text{Service Life}} = \$\,1{,}000 \text{ annual charge}$$

	Debit	Sub	Credit
(44)-5210-242000 - Expenses	$1,000		
5210-430530-840 - Depreciation expense		$1,000	
5210-189410 - Allowance for depreciation			$1,000

(To record the annual depreciation expense and allowance for depreciation on the tower. This option (840) closes depreciation expense to contributed capital if such an account still remains for older capital assets acquired with capital contributions. It requires the preparation of a General Journal Voucher.)

CAPITALIZATION OF INTEREST COSTS

Concept Discussion

When an enterprise chooses to construct a fixed asset, a primary accounting consideration is determining the capitalized cost associated with the construction. Traditionally, capitalized costs have not included interest costs. Now, however, the capitalization of interest is required for qualifying assets if its effect, compared with the effect of expensing interest, is material. If the net effect is not material, then interest capitalization is not required.

The objectives of capitalizing interest are to obtain a measure of acquisition cost that more closely reflects the enterprise's total investment in the asset, and to charge a cost that relates to the acquisition of a resource that will benefit future periods against the revenues of the periods benefited. The amount of interest to be capitalized is that portion of the interest cost incurred during the assets' acquisition periods that theoretically could have been avoided if the expenditures for the assets had not been made.

Assets qualifying for interest capitalization are assets that are constructed for the enterprises own use, whether by its own employees or outside contractors.

Non-qualifying assets include:
1. Existing assets currently in use for operations.
2. Assets acquired with grants that are restricted by the grantor to acquisition of the specific asset; similarly, assets acquired from interest earned on investment of such grants.

In situations involving qualifying assets financed with the proceeds of restricted tax-exempt borrowings, the amount of interest to be capitalized is the interest cost of those borrowings less any interest earned on temporary investment of those borrowings from the date of borrowing until the qualifying assets acquired are ready for their intended use.

In other situations: (a) The amount of interest capitalized in an accounting period should be determined by applying an interest rate (the capitalization rate) to the average amount of accumulated expenditures for the asset during the period. The capitalization rate used in an accounting period should be based on the rates applicable to borrowings outstanding during the period. (b) If a specific borrowing is for acquiring the asset, its interest rate may be applied to that portion of the average accumulated expenditures that does not exceed that amount of the borrowing. (c) If the average accumulated expenditures for the asset exceed the amount of a specific new borrowing associated with the asset, the capitalization rate to be applied to such excess shall be the weighted average of the rates applicable to other borrowings of the enterprise. (d) If an enterprise fund has outstanding debt but chooses to use existing resources to fund new construction rather than pay off that debt, its considered to be effectively “recycling”. The borrowing and interest must be capitalized. In such a case, the rate used to calculate the amount of capitalized interest would be the weighted average interest rate on outstanding borrowings of the fund.

CAPITALIZATION OF INTEREST COSTS – cont.

Concept Discussion – cont.

The total amount of interest cost capitalized in an accounting period should not exceed the total amount of interest cost incurred by the enterprise in that period.

Some of the more common financing sources used to construct fixed assets are:

1. Revenue bond proceeds
2. FMHA loans
3. DNRC loans
4. Local bank loans
5. DNRC grants
6. CDBG grants
7. EPA grants
8. Inter-cap loans

The bond and/or loan agreements will, ordinarily, indicate whether the borrowings are tax-exempt or not.

Guidance on the capitalization of interest is contained in two authoritative pronouncements, SFAS No. 34 and SFAS No. 62.

Illustrative Accounting Entries

The City of XYZ water utility plans to construct a new water plant at the cost of $2,600,000.

A. It will be financed from the following sources:

   1. The sale of $1,000,000 in tax-exempt revenue bonds, with a seven percent interest rate for 20 years (the bonds were sold on January 1, and the proceeds received the same day).
   2. A grant for $100,000 (received January 1).
   3. Cash reserve in the amount of $1,500,000.

B. Work on the project will take two and one-half years after start of construction, January 1, to complete.

C. The local bank has agreed to pay eight percent on the bond and grant proceeds invested.

D. The interest rate on the enterprise's other current borrowings is six percent.

ENTERPRISE FUNDS – cont.

CAPITALIZATION OF INTEREST COSTS – cont.

Illustrative Accounting Entries – cont.

	Debit	Sub	Credit	Sub
(45)-5210-172000 - Revenue	$40,000			
5210-371XXX - Interest earned		$40,000		
5210-242000 - Expenses			$35,000	
5210-430XXX-620 - Interest expense				$35,000
5210-188000 - Construction in progress			5,000	
(46)-5210-172000 - Revenue	$24,000			
5210-371XXX - Interest earned		$24,000		
5210-188000 - Construction in progress	44,250			
5210-24200 - Expenses			$68,250	
5210-430XXX-620 - Interest expense				$68,250

	Debit	Credit	Sub
(47)-5210-188000 - Construction in progress	$65,530		
5210-242000 - Expenses		$65,530	
5210-430XXX-620 - Interest expense			$65,530

(To record the effect of capitalizing interest costs for each of the three periods in which the construction of the Water Plant took place. (See worksheets on the following pages.) However, the amount of interest cost capitalized in an accounting period should not exceed the total amount of interest cost incurred by the enterprise in that period.)

ENTERPRISE FUNDS – cont.

CAPITALIZATION OF INTEREST COSTS – cont.

Average Accumulated Expenditure Worksheet (Miller Format)

Date		Actual Amt. Of Expense		Period from Expense To end of Year		Average Accum. Expense
	Year #1					
1/1						
2/1		25,000	X	5/12	=	10,417
3/1						
4/1		50,000	X	3/12	=	12,500
5/1						
6/1		25,000	X	1/12	=	2,083
	Totals	100,000				25,000
	Year #2					
7/1						
8/1						
9/1		300,000	X	10/12	=	250,000
10/1						
11/1						
12/1		250,000	X	7/12	=	145,833
2/1						
3/1		250,000	X	4/12	=	83,333
4/1						
5/1						
6/1		100,000	X	1/12	=	8,333
	Totals	900,000				487,499
	Year #3					
7/1		500,000	X	12/12	=	500,000
8/1						
9/1		500,000	X	10/12	=	416,667
10/1						
11/1						
12/1						
1/1		300,000	X	6/12	=	150,000
2/1						
3/1						
4/1		200,000	X	3/12	=	50,000
5/1						
6/1		100,000	X	1/12	=	8,333
	Totals	1,600,000				1,125,000
	Grand Totals	2,600,000				

Note: FASB provides little guidance for determining average accumulated expenses other than to say that reasonable approximations may be used in the determination of these amounts.

ACCOUNTING POLICIES cont.

ENTERPRISE FUNDS – cont.

CAPITALIZATION OF INTEREST COSTS – cont.

Capitalization of Interest Worksheet - (FASB Format)

	19 X 1	19 X 2	19 X 3
1. Average qualifying assets	$ 25,000	$ 487,500	$ 1,125,000
2. Average funding received			
a. Borrowing	1,000,000	1,000,000	1,000,000
b. Grant	100,000	100,000	100,000
3. Average temporary investments			
a. Borrowing	1,000,000	300,000	-0-
b. Grant	100,000	100,000	-0-
4. Interest earned			
a. Borrowing	40,000	24,000	-0-
b. Grant	4,000	8,000	-0-
5. Average qualifying assets in excess of borrowing, grant and interest earned on grant.	-0-	-0-	13,000
6. Interest cost capitalized – other Borrowing (cash reserves)	-0-	-0-	780
7. Interest cost – tax exempt borrowing	35,000	68,250	64,750
8. Interest capitalized	$ (5,000)	$ 44,250	$ 65,540

Notes to Interest Worksheet

Line 1. Represents the average accumulated expenses for the qualifying assets.

Line 2. Represent the accumulated amounts of tax-exempt borrowing and grants received.

Line 3. Represents amounts of tax-exempt borrowing and grants invested during the period.

Line 4. Represents the accumulated amounts of interest earned on tax-exempt borrowings and grants for the period (Line 3 X .08).

Line 5. Represents Line 1, minus the accumulated amounts to date of Line 2a, 2b, and the sum of Line 4b, to date. Cannot be less than zero. Applicable only when Line 1 exceeds the accumulations of Line 2a, 2b, and the sums of Line 4b, to date.

Line 6. Represents interest costs capitalized based on the rates of the enterprise's other outstanding debt (Line 5 X .06).

Line 7. Represents the period interest costs on tax-exempt bonds (Line 2a – less principal payments – X .07).

Line 8. Represents the amount of interest costs to be capitalized (Line 4a, minus Lines 6 and 7. Not to exceed the total amount of interest cost incurred by the enterprise in the period).

ACCOUNTS PAYABLE - (BARS 202100)

Concept Discussion
Accounts payable is commonly associated with liabilities incurred on open account owing to private persons, firms or corporations for goods and services received by a governmental unit (but not including amounts due to other funds of the same governmental unit).

Policy and/or Procedural Steps
The subsidiary ledgers or files payable accounts should be reconciled each month with the general ledger payable control account.

Illustrative Accounting Entries
The City of XYZ accrues all material unrecorded costs at year-end and reverses these accruals in the month following the close of the fiscal year.

A. The monthly payroll period ends on the 20th of each calendar month. The unrecorded employer costs represent 25 percent of the employee payroll; and the unrecorded employee payroll costs at year-end were $10,000, allocated as follows:

Administration	$ 1,000
Facilities	2,500
Source of Supply and Pumping	2,000
Purification and Treatment	2,500
Transmission and Distribution	2,000

B. Additional unrecorded costs included the following claims for:

Audit services (administration)	$10,000
Consumable items (administration)	15,000

		Debit	Sub	Credit
(48)-	5210-242000 - Expenses	$12,500		
	5210-430510-110 - Personal services		$1,000	
	5210-430520-110 - Personal services		2,500	
	5210-430530-110 - Personal services		2,000	
	5210-430540-110 - Personal services		2,500	
	5210-430550-110 - Personal services		2,000	
	5210-430510-140 - Employer costs		250	
	5210-430520-140 - Employer costs		625	
	5210-430530-140 - Employer costs		500	
	5210-430540-140 - Employer costs		625	
	5210-430550-140 - Employer costs		500	
	5210-202100 - Accounts payable			$12,500

(To record the unrecorded payroll expenses at year-end and establish the appropriate liability for them. It requires the preparation of a General Journal Voucher).

ACCOUNTS PAYABLE – cont.

Illustrative Accounting Entries – cont.

	Debit	Credit	Sub
(49)-5210-2021000 – Accounts payable	$12,500		
5210-242000 – Expenses		$12,500	
5210-430510-110 - Personal services			$1,000
5210-430520-110 - Personal services			2,500
5210-430530-110 - Personal services			2,000
5210-430540-110 - Personal services			2,500
5210-430550-110 - Personal services			2,000
5210-430510-140 - Employer costs			250
5210-430520-140 - Employer costs			625
5210-430530-140 - Employer costs			500
5210-430540-140 - Employer costs			625
5210-430550-140 - Employer costs			500

(This entry is to be made in the month following the close of the previous fiscal year. It reverses the above accruals, so that they will not be duplicated in the succeeding fiscal year. It requires the preparation of a General Journal Voucher.)

	Debit	Sub	Credit
(50)-5210-242000 – Expenses	$25,000		
5210-430510-230 - R & M supplies		$15,000	
5210-430510-350 - Professional services		10,000	
5210-202100 - Accounts payable			$25,000

(To record unrecorded expenses at year-end and establish the appropriate liability for them. It requires the preparation of a General Journal Voucher.)

	Debit	Credit	Sub
(51)-5210-202100 - Accounts payable	$25,000		
5210-242000 - Expenses		$25,000	
5210-430510-230 - R & M supplies			$15,000
5210-430510-350 - Professional services			10,000

(This entry is to be made in the month following the close of the previous fiscal year. It reverses the above accruals, so that they will not be duplicated in the succeeding fiscal year. It requires the preparation of General Journal Voucher.)

IMPACT FEES- BARS 214100

Concept Discussion

Developers often are assessed impact fees to help defray a portion of the costs that result from increased development (e.g., construction of new parks and schools). Most often, impact fees should be used for capital acquisition or related debt service.

Policy and/or Procedural Steps

- Impact fees should be reported as a current liability until they become nonrefundable.
- Once they become nonrefundable, they become revenue to the unit of local government.
- It is also acceptable to classify impact fees as "non-operating revenues". However, GAAFR cautions that there may be legal complications connected with revenue bond coverage, if this approach is used.

Illustrative Accounting Entries

	Debit	Credit
(52) 5210-102000 - Cash-restricted other	$5,000	
5210-214100 – Impact fees payable		$5,000

(To record impact fees paid by developers. This entry would ordinarily be recorded as a part of the cash receipt process.)

	Debit	Credit
(53) 5210-214100 – Impact fees payable	$5,000	
5210-343025 - Water Impact Fees/Permits		$5,000

(To record impact fees as revenue once they become nonrefundable. It requires the preparation of a General Journal Voucher.)

CONTRACTS PAYABLE - (BARS 204100 and 235000)

Concept Discussion

Contracts Payable (BARS Account 204100) is a short-term liability account which represents any contract amounts due to private persons or organizations during the current fiscal year. Contracts Payable (BARS Account 235000) is a long-term liability account which represents any noncurrent contract amounts due to private persons and organizations at year-end.

Policy and/or Procedural Steps

1. All contractual liabilities incurred should be recorded on the general accounting records.

2. All contractual liabilities should be segregated on the general accounting records as either short-term or long-term liabilities.

3. The subsidiary ledgers or file contract accounts should be reconciled each month with the general ledger contract control account(s).

Illustrative Accounting Entries

A. The City of XYZ Water Utility purchased a parcel of land, under contract, for its water well potential.

B. The five-year contract was executed by the parties on March 31.

C. The purchase price of the land was $60,000, with a $10,000 down payment, to be paid the date of contract execution. And, $10,000 due and payable on each succeeding June 30 until the contract liability is retired.

D. Simple interest at six percent per annum is due and payable with each principal payment.

E. The interest and principal payment due on June 30, was made on that date.

CONTRACTS PAYABLE - (BARS 204100 and 235000)

Illustrative Accounting Entries – cont.

	Debit	Credit
(54)-5210-189100 - Water source of supply	$10,000	
5210-101000 - Water operating cash		$10,000

(To record down payment on the land. Ordinarily, this entry would be recorded as part of the cash disbursement process.)

	Debit	Credit
(55)-5210-189100 - Water source of supply	$50,000	
5210-204100 - Short-term contracts payable		$10,000
5210-235000 - Long-term contracts payable		40,000

(To record acquisition of land and the related short-term and long-term liabilities for it. It requires the preparation of a General Journal Voucher.)

	Debit	Sub	Credit
(56)-5210-242000 - Expenses	$ 750		
5210-490500-620 - Interest expense		$ 750	
5210-206100 - Interest payable			$ 750

(To record contract interest expense and the accrued interest payable at year-end. It requires the preparation of a General Journal Voucher. Determined as follows:)

(a) .06 (rate) x $50,000 (balance) = $3,000 - annual interest
(b) $3,000 (annual interest) x 3/12 = $750 years interest

	Debit	Credit
(57)-5210-206100 - Interest payable	$ 750	
5210-204100 - Short-term contracts payable	10,000	
5210-101000 - Water operating cash		$10,750

(To record payment of contract interest and principal due on June 30. Ordinarily, this entry would be recorded as a part of the cash disbursement process.)

REVENUE BONDS PAYABLE - (BARS 205100 and 231300)

Concept Discussion

Revenue Bonds Payable (BARS Account 205100) are bonds which will reach their maturity date during the current fiscal year. Revenue Bonds Payable (BARS Account 231300) are the face value of bonds issued and unpaid and not due within one year.

Revenue bonds are debt instruments for which the enterprise has pledged certain revenues from operations. Because revenue bonds are not full faith and credit bonds, they are not shown as a liability in the general long-term debt account group. Revenue bonds are either serial or amortization type bonds. Serial bonds are bonds which are paid in annual installments. Amortization bonds are a form of bonds on which a part of the principal is required to be paid each time interest becomes due and payable.

Revenue bonds are sold at not less than par value and often with accrued interest to date. In such an event, the proceeds from accrued interest are placed in the bond sinking and interest cash account of the respective issue and off-set as a credit to interest expense.

In governmental funds, bond issuance costs are recognized in the current period. However, significant costs of bond issue fees, insurance and underwriting for proprietary funds should be recorded as deferred charges and amortized over the life of the issue. There are three methods by which bond issue costs may be amortized; the straight line method, the bonds outstanding method and the interest method.

Authoritative guidance for amortizing the deferred charge is contained in APB No. 12 and APB No. 21. These pronouncements provide that the interest method, defined in APB No. 12, should be used to amortize bond issue costs. However, the other methods of amortization may be used if the results obtained are not materially different from those which would result from the interest method.

REVENUE BONDS PAYABLE – cont.

Concept Discussion – cont.

The straight-line method of amortization simply requires that the amount of bond issue costs be divided by the number of years of the bond issue to arrive at the annual amortization charge. The bonds outstanding method of amortization is determined by dividing the face value of the bonds outstanding, which decreases each year, by the sum of the bonds for each period. The result is then multiplied by the issue costs to arrive at the amortization charge. Under the interest method, the difference between the periodic interest (effective interest) cost so calculated and the nominal interest (stated interest) on the outstanding amount of the debt is the amount of the periodic amortization.

The straight-line method of amortization, while simpler to compute, is not generally considered to be theoretically sound. The bonds outstanding method, on the other hand, is less complicated to compute than the interest method yet it approximates the results of the more complex interest method. And is, consequently, the method used later to illustrate the amortization of bond issuance costs.

Policy and/or Procedural Steps

1. All revenue bonds issued should be recorded in the general accounting records.

2. A bond register and/or bond amortization schedule should be maintained and kept current for each revenue bond issue.

3. The bond register and/or bond amortization schedule should be reconcilable to the revenue bonds payable general ledger account(s).

4. All revenue bonds payable should be segregated on the general accounting records as either short-term obligations or long-term obligations.

REVENUE BONDS PAYABLE – cont.

Illustrative Accounting Entries

A. On January 1, the City of XYZ Water Utility issued and sold $500,000 of water revenue serial bonds. The issue term was 20 years.

B. On February 1, the City received a check for $503,750, which included $3,750 of accrued interest.

C. The stated interest rate (nominal interest) was nine percent.

D. Interest on the revenue bonds is due and payable on June 30, and December 31, each year.

E. The principal is to be repaid in 20 equal installments and is due and payable on June 30, each year ($500,000 / 20 = $25,000).

F. The fees and underwriting costs on the issue were $25,000.

	Debit	Credit	Sub
(58)-5210-102110 - Construction cash	$500,000		
5210-102210 - Bond sinking cash	3,750		
5210-231300 - Bonds payable		$500,000	
5210-242000 - Expenses		3,750	
5210-490200-620 - Bond interest			$3,750

(To record the sale of revenue bonds and establish the appropriate liability for them. Ordinarily, this entry would be recorded as a part of the cash receipt process.) This entry is correct as long as the related interest payment is made in the same period, or if the accrued interest payable is recorded at year-end.

	Debit	Credit
(59)-5210-231000 - Bonds pay. long-term	$25,000	
5210-205100 - Bonds pay. current		$25,000

(This entry moves the principal amount of bonds due in the current fiscal year from bonds payable (long-term) to bonds payable (short-term). It requires the preparation of a General Journal Voucher.)

	Debit	Credit
(60)-5210-205100 - Bonds pay. current	$25,000	
5210-102210 - Bond sinking cash		$25,000

(To record liquidation of bonds payable and the payment for them. Ordinarily, this entry would be recorded as a part of the cash disbursement process.)

ENTERPRISE FUNDS – cont.

REVENUE BONDS PAYABLE – cont.

Illustrative Accounting Entries – cont.

	Debit	Sub	Credit
(61)-5210-242000 - Expenses	$22,500		
5210-490200-620 - Bond interest expenditures		$22,500	
5210-205200 - Accrued interest payable			$22,500

(To record bond interest expense due and amount payable during the current fiscal year. It requires the preparation of General Journal Voucher.)

	Debit	Credit
(62)-5210-205200 - Accrued interest payable	$22,500	
5210-102210 - Bond sinking cash		$22,500

(To record the payment of bond interest expense and liquidation of the current liability. Ordinarily, this entry would be recorded as a part of the cash disbursement process.)

	Debit	Credit
(63)-5210-170000 - Defer. issuance	$25,000	
5210-10XXXX - Cash		$25,000

(To record revenue bond issuance costs as deferred charges for amortization over the life of the issue. Ordinarily, this entry would be recorded as a part of the cash disbursement process.)

	Debit	Sub	Credit
(64)-5210-242000 - Expenses	$2,381		
5210-490200-350 - Professional services		$2,381	
5210-176000 - Deferred issuance costs			$2,381

(To amortize revenue bond issuance costs for the first full year. It requires the preparation of a General Journal Voucher. See following worksheet.)

REVENUE BONDS PAYABLE – cont.

Amortization of Bond Issuance costs worksheet

Bonds Outstanding Method

	Step #1		Step #2				
Year	Sum of Bonds Outstanding Each Period		Computations				Annual Amortization Charge
1	$500,000	/	$5,250,000	X	$25,000	=	$2,381
2	475,000	/	$5,250,000	X	$25,000	=	2,262
3	450,000	/	$5,250,000	X	$25,000	=	2,143
4	425,000	/	$5,250,000	X	$25,000	=	2,024
5	400,000	/	$5,250,000	X	$25,000	=	1,905
6	375,000	/	$5,250,000	X	$25,000	=	1,786
7	350,000	/	$5,250,000	X	$25,000	=	1,667
8	325,000	/	$5,250,000	X	$25,000	=	1,548
9	300,000	/	$5,250,000	X	$25,000	=	1,429
10	275,000	/	$5,250,000	X	$25,000	=	1,310
11	250,000	/	$5,250,000	X	$25,000	=	1,190
12	225,000	/	$5,250,000	X	$25,000	=	1,071
13	200,000	/	$5,250,000	X	$25,000	=	952
14	175,000	/	$5,250,000	X	$25,000	=	833
15	150,000	/	$5,250,000	X	$25,000	=	714
16	125,000	/	$5,250,000	X	$25,000	=	595
17	100,000	/	$5,250,000	X	$25,000	=	476
18	75,000	/	$5,250,000	X	$25,000	=	357
19	50,000	/	$5,250,000	X	$25,000	=	238
20	25,000	/	$5,250,000	X	$25,000	=	119
	$5,250,000						$25,000

/ = division symbol

LANDFILL CLOSURE AND POSTCLOSURE CARE COSTS - (BARS 236000)

INTRODUCTION

GASB Statement No.18 establishes standards of accounting and reporting for municipal solid waste landfill (MSWLF) closure and post-closure care costs that are required to be incurred by federal, state, or local laws or regulations.

The general principles underlying Statement No. 18 are as follows:

- Closure and post-closure costs must be recognized while the landfill is operational.

- The true cost of current disposal must be identified, and the estimated cost of closure and post-closure care must be recognized as an expenditure and liability in each year that the landfill accepts solid waste.

- Accounting for closure and post-closure liabilities must begin on the date that landfill first accepts solid waste, and these costs must be fully recognized by the time the landfill stops accepting waste.

Definition of Estimated Total Current Cost of MSWLF Closure and Post closure Care

The starting point in satisfying the standards established by GASB No.18 is to identify "the estimated total current cost of MSWLF closure and post closure care". Current cost refers to the cost of buying in the current year, capital assets and services related to closure and post closure care, even though those costs will actually be incurred in future periods. Specifically, the estimated total current cost of MSWLF closure and post closure care should include the current cost of (1) capital assets (2) final cover, and (3) monitoring and maintenance activities.

Annual Re-Evaluation

At the end of each year, a governmental entity should evaluate its estimate of the total current cost related to closure and post closure care of a MSWLF. Changes in expected cost may arise from a number of factors, including inflation or deflation, technological advancements, and modifications to legal requirements at the local, state, or national level.

LANDFILL CLOSURE AND POSTCLOSURE CARE COSTS – cont.

Proprietary Fund Accounting and Reporting

When MSWLF activities are accounted for in a proprietary fund, a portion of the estimated total current cost of closure and postclosure care should be recognized each year as an expense. The cost basis for determining the amount of expense to be recognized is based on the definition of *estimated total current cost.* It is likely that cost estimates will change from year to year, and for this reason, the computation of the annual expense must take into consideration the capacity used and the amount of expense recognized in previous years.

The analysis that should be used each year to determine the amount to be recognized is based on the following formula:

$$\frac{\text{Estimated total current cost} \times \text{Cumulative capacity used}}{\text{Total estimated capacity}} - \text{Amount previously recognized}$$

Equipment and facilities included in the estimated total current cost of closure and post closure care should not be reported as capital assets. Equipment, facilities, services, and final cover included in the estimated total current cost should be reported as a reduction of the accrued liability for MSWLF closure and post closure care when they are acquired.

Capital assets that will be used exclusively for a MSWLF and that are excluded from the calculation of the estimated total current cost of closure and post closure care should be fully depreciated by the date that the MSWLF stops accepting solid waste. If capitalized, facilities and equipment installed or constructed for a single cell should be depreciated over the estimated useful life of that cell.

Illustrative Accounting Entries

For example:

- if the estimated total current cost is $1,000,000,
- the cumulative capacity used is 100,000 cubic yards,
- the total estimated capacity is 500,000 cubic yards,
- the amount of expense recognized in all previous years is $125,000

the expense to be recorded in the current year is computed as follows:

LANDFILL CLOSURE AND POSTCLOSURE CARE COSTS – cont.

Illustrative Accounting Entries – cont.

$ 1,000,000 x 100,000 cubic yards - $125,0000 = $75,000 (current expense
500,000 cubic yards

(65)		Debit	Credit	Sub
5410-242000 - Expenses	$ 75,000			
5410-430890580 – Closure/Post closure Costs		$75,000		
5410-236000 – Closure/Post closure Liability			$75,000	

(To record expenses and liability for current year. It requires the preparation of a General Journal.)

Governmental Fund and Account Group Accounting and Reporting

When MSWLF activities are accounted for in a governmental fund, the basic measurement approach used by a proprietary fund should also be used by the governmental fund. A portion of the estimated total current cost of closure and post closure care should be recognized each year using the estimated life of the landfill and the usage of the land fill for a particular period. However, due to the difference in the measurement focus and basis of accounting of a governmental fund as compared to a proprietary fund, the annual cost recognition related to estimated closure and post closure care costs generally will not affect a governmental entity's activity statement.

The basic facts used to illustrate the accounting for MSWLF activities in a proprietary fund can be used to illustrate the activity in a governmental fund. As computed earlier, the amount of closure and post closure costs recognized was $75,000. This amount must be analyzed to determine whether ii is to be paid with current expendable resources of the governmental entity. Current expendable resources refer to payments that must be made within a very short time after the date of the balance sheet. The amount of time would probably be no more than 60 days, but current governmental generally accepted accounting principles do not provide a precise definition.

LANDFILL CLOSURE AND POSTCLOSURE CARE COSTS – cont.

Governmental Fund and Account Group Accounting and Reporting – cont.
In almost all instances, it is unlikely that any of the estimated closure and post closure costs will use current expendable resources because they are based on "disbursements near or after the date that the MSSWLF stops accepting solid waste". Assuming that none of the $75,000 will consume current expendable resources, the governmental entity will report the total amount of the current cost in its General Long-Term Account Group.

Illustrative Accounting Entries

(66)	Debit	Credit
9500-174300 Amount to be Provided	$75,000	
9500-236000-Landfill Closure/Post closure Costs		$75,000

(To record current year cost in the General Long-term Debt Account Group. It requires the preparation of a General Journal voucher.)

Because, it is unlikely that little, if any, of the annual costs related to landfill closure and post closure care will be reported on the governmental entity's operating statement, GASB 18 requires that the computed annual amount be disclosed either in a note to the financial statements or as a parenthetical comment directly on the entity's operating statement. Continuing with the previous illustration, the following disclosure would be made on the face of the operating statement.

Expenditures:

Landfill closure and post closure care ($75,000[total amount determined for the year under GASB-18) less $75,000 change in General Long-Term Debt Account Group liability) $ -0-

LANDFILL CLOSURE AND POSTCLOSURE CARE COSTS – cont.

Accounting for Assets Placed in Trust—All Fund types and Entities

Under requirements of the EPA rule, some owners or operators of landfills will have to provide financial assurance concerning the future landfill closure and post closure care costs. The purpose of the EPA requirement is to make sure that landfill owners or operators will have the capability to provide resources to assure that the financial burden of a filled landfill will not become the responsibility of taxpayers. The EPA rule can be achieved by putting assets in various forms of trusts.

When a governmental entity makes payments to the trust, those payments should not be reported as expenditures/expenses, but rather should be reported on the balance sheet as assets with an appropriate title such as "Amounts Held by Trustee." The assets should be reported in the fund that accounts for the landfill activities. Earnings on amounts held by the trustee (or otherwise set aside) should be reported as investment income and not as a reduction to the estimated total current cost of closure and post closure care. The BARS account number to accommodate these assets is 105000 **Amounts Held by Trustee.**

The notes to the financial statements should disclose:

a. The nature and source of landfill closure and post closure care requirements (federal, state or local laws or regulations)
b. That recognition of a liability for closure and post closure care costs is based on landfill capacity used to date.
c. The reported liability for closure and post closure care at the balance sheet date (if not apparent from the financial statements) and the estimated total current cost of closure and post closure care remaining to be recognized.
d. The percentage of landfill capacity used to date and estimated remaining landfill life in years.
e. How closure and post closure care financial assurance requirements, if any, are being met. Also, any assets restricted for payment of closure and post closure care costs (if not apparent from the financial statements).
f. The nature of the estimates and the potential for changes due to inflation or deflation, technology, or applicable laws or regulations.

COMPENSATED ABSENCES - (BARS 239000)

Concept Discussion

This liability account represents enterprise employee's sick leave, vacation leave and related employer's contributions accrued at fiscal year-end. (The liabilities for all other employee's compensated absences are recorded in the Long-Term Debt Group of Accounts.)

There are four conditions that should be met before a compensated absences liability is accrued by an enterprise. The criteria is as follows:

1. The employer's obligation relating to employee's rights to receive compensation for future absences is attributable to employee's services already rendered,
2. The obligation relates to rights that vest or accumulate;
3. The payment of compensation is probably; and
4. The amount can be reasonably estimated.

The liability for compensated absences is calculated by multiplying the number of eligible days/hours times the applicable daily/hourly salary rate for each employee. Then adding to the related employer's contribution for each employee. The compensated absences year-end liability can be determined with relative ease by use of the worksheet that follows. The worksheet will become the basis for adjusting the liability and serve as documentation for it.

Policy and/or Procedural Steps

The compensated absences account is adjusted only at year-end. The amount of the adjustment will be the difference (plus or minus) between the current year's accrual and the balance of the prior year's liability.

Illustrative Accounting Entries

A. The City of XYZ Water Utility current year-end accrual is $15,000.
B. The City of XYZ Water Utility prior year-end liability was $13,500.

	Debit	Sub	Credit
(67)-5210-242000 - Expenses	$1,500		
5210-430510-130 - Other personal service expense		$300	
5210-430520-130 - Other personal service expense		300	
5210-430530-130 - Other personal service expense		300	
5210-430540-130 - Other personal service expense		300	
5210-430550-130 - Other personal service expense		300	
5210-239000 - Compensated absences payable			$1,500

(To record the year-end accrual of compensated absences. It requires the preparation of a General Journal Voucher.)

ACCOUNTING POLICIES cont.

LONG-TERM LIABILITIES

COMPENSATED ABSENCES WORKSHEET

	1	2	3	4	5	6	7	8	9	10
EMPLOYEE	Hourly Rate	Vacation	Total Vac	Sick Leave	25% of S/L	Total S/L	Comp	Total	Employer	Total
Total		$				$	$	$	$	$

Employer Contributions (Line 9)	
FICA	$
PERS	
Workers Comp	
Unemployment	
Unemployment P/R Tax	
Total (Line 9 above)	$

ENTERPRISE FUNDS - cont.

EQUITY - (BARS 250000, 260000 & 270000 Series)

Concept Discussion

The equity of an enterprise represents the difference between assets and liabilities of the fund. Equity has three primary elements; reserved retained earnings (250000), contributed capital (260000), and unreserved retained earnings (270000).

Reserved retained earnings represent amounts that are legally segregated for specific purposes. Common examples include accounts associated with debt service sinking funds.

Contributed capital is created when a grant is received that is restricted to capital acquisition or construction, when a general fixed asset is transferred to the enterprise, and when fixed assets are contributed by developers or customers. Contributed capital is no longer required to be recorded with the implementation of GASB Statement #33. Existing contributed capital account balances may be closed to retained earnings or may remain until the assets to which the apply have been fully depreciated and the depreciation used to reduce the contributed capital. Contributed capital is shown on the income statement as capital contributions following income (loss) before operating transfers.

Unreserved retained earnings are the accumulated earnings of the enterprise which are not reserved for any specific purpose.

Illustrative Accounting Entries

A. The City of XYZ Water Utility maintains the four cash accounts normally associated with a revenue bond indenture. At year-end, it was determined that the amounts reserved for debt service were not equal to the amounts of the respective debt service cash accounts. Determined as follows:

Account Title	Cash Account	Reserve Account	Difference
Bond sinking and interest	$ 20,000	$ 15,000	$ + 5,000
Reserve	15,000	16,000	- 1,000
Surplus	10,000	6,000	+ 4,000
Replacement and depreciation	5,000	8,000	- 3,000
Totals	$ 50,000	$ 45,000	$ + 5,000

B. The Water Utility received a CDBG capital grant in the amount of $40,000.

C. At fiscal year-end, the Clerk was instructed to close the water revenue control account ($50,000) and the water expenditure control account ($35,000) to unreserved retained earnings.

EQUITY - cont.

Illustrative Accounting Entries – cont.

	Debit	Credit
(68)-5210-272000 - Unreserved retained earnings	$9,000	
5210-250300 - Bond interest and sinking		$5,000
5210-250500 - Surplus		4,000
(69)-5210-250400 - Reserve	$1,000	
5210-250600 - Replacement and depreciation	3,000	
5210-272000 - Unreserved retained earnings		$4,000

(This increases or decreases the specific amounts to be reserved for revenue bond debt service, with corresponding offsets to unreserved retained earnings. It requires the preparation of a General Journal Voucher.)

	Debit	Credit
(70)-5210-102110 - Water construction cash	$40,000	
5210-331010 – CDBG		$40,000

(To record receipt of the CDBG capital grant).

	Debit	Credit
(71)-5210-172000 - Revenue	$50,000	
5210-272000 - Unreserved retained earn.		$50,000

(To record the year-end closing of revenue. It requires the preparation of a General Journal Voucher.)

	Debit	Credit
(72)-5210-272000 - Unreserved retained earnings	$35,000	
5210-242000 - Expenses		$35,000

(To record the year-end closing of expenditures. It requires the preparation of a General Journal Voucher.)

REVENUES AND EXPENSES - (BARS 343000 and 430000 Series)

Concept Discussion

Enterprise revenues and expenses are recognized, as stated earlier, utilizing the accrual basis of accounting. Moreover, there is also a need to classify revenues and expenses as operating and non-operating.

Operating revenues are those revenues that are directly related to the enterprise's primary activities and consist primarily of user charges. Operating expenses are expenses relating directly to the enterprise's primary activities. The basic theory behind revenue and expense recognition is the matching process. Under this concept, costs and revenues associated with the same transaction are recognized simultaneously.

On the other hand, non-operating revenues are revenues incidental to or byproducts of, the enterprise's primary activities, i.e., rentals, interest on investments, etc. Non-operating expenses are expenses not directly related to the enterprise's primary activities, i.e., interest paid, etc.

SPECIAL INTERIM TREATMENT OF CERTAIN TRANSACTIONS

Concept Discussion

The proceeds from the sale of bonds and loans, etc., may be treated as revenue on an interim basis during the fiscal year. And, similarly, the payments made for capital outlay and the principal portion of debt service, etc., may be treated as an expense on an interim basis during the fiscal year. This departure provides a level of simplicity and a visibility of transactions on interim reports that otherwise would not occur.

Because managerial styles and perceived information needs vary widely, appropriate internal interim reporting is largely a matter of professional judgment and is not set forth in detail in GASB.

Policy and/or Procedural Steps

At year-end, the respective accounts must be adjusted so that all nominal accounts and all permanent accounts are reflected properly in the general accounting records.

SPECIAL INTERIM TREATMENT OF CERTAIN TRANSACTIONS - cont.

Illustrated Accounting Entries

A. The City of XYZ Water Utility has decided to employ the special interim treatment of certain transactions for the current fiscal year.

- On August 1, the City water utility sold $500,000 of water revenue bonds (treated as revenue).
- On September 30, the City Water Utility was awarded and received a $50,000 CDBG capital grant for a water tower (treated as revenue).
- On October 1, the City Water Utility purchased a new truck for $15,000 (no trade-in) (treated as expense).
- On December 31, the City Water Utility retired $25,000 (principal portion) of outstanding revenue bonds (treated as expense).

B. At year-end, the Clerk was instructed to adjust the accounts so that all nominal accounts and all permanent accounts are reflected properly in the general accounting records.

	Debit	Credit	Sub
(73)-5210-102110 - Construction cash	$500,000		
5210-172000 - Revenue		$500,000	
5210-380XXX - Sale of bonds			$500,000

(To record (on an interim basis) bond proceeds as revenue. Ordinarily, this entry would be recorded as a part of the cash receipt process.)

	Debit	Sub	Credit
(74)-5210-172000 - Revenue	$500,000		
5210-380XXX - Sale of bonds		$500,000	
5210-231300 - Bonds payable			$500,000

(To reverse entry #73, and recognize the revenue bonds as a liability. It requires the preparation of a General Journal Voucher.)

SPECIAL INTERIM TREATMENT OF CERTAIN TRANSACTIONS - cont.

Illustrated Accounting Entries – cont.

	Debit	Sub	Credit
(75)-5210-242000 - Expenses	$15,000		
5210-430550-900 - Capital outlay		$15,000	
5210-101000 - Water operating cash			$15,000

(To record (on an interim basis) the purchase of a new truck as an expense. Ordinarily, this entry would be recorded as a part of the cash disbursement process.)

	Debit	Credit	Sub
(76)-5210-189400 - Transmission & distribution	$15,000		
5210-242000 - Expenses		$15,000	
5210-430550-900 - Capital outlay			$15,000

(To reverse entry #75, and recognize the purchase of the new truck as a capital expense. It requires the preparation of a General Journal Voucher.)

	Debit	Sub	Credit
(77)-5210-242000 - Expenses	$25,000		
5210-430XXX-610 - Bond principal		$25,000	
5210-102210 - Bond sinking			$25,000

(To record (on an interim basis) the payment of revenue bond principal. Ordinarily, this entry would be recorded as a part of the cash disbursement process.)

	Debit	Credit	Sub
(78)-5210-205100 - Bonds payable	$25,000		
5210-242000 - Expenses		$25,000	
5210-430XXX-510 - Bond principal			$25,000

(To reverse entry #77, and recognize the revenue bond principal payment as liquidation of a liability. It requires the preparation of a General Journal Voucher. Note: Debit account 205300 (long-term bonds payable), if account 205100 (short-term bonds payable) was not established.)

ADMINISTRATIVE CHARGES

Water and/or sewer enterprise activities are often billed by the general fund for various overhead costs, i.e., rent, heat, light, etc., and often for various clerical, legal and management type services as well. In these events, all such charges should be based on acceptable rationale, be reasonable and properly documented. Any resulting transactions should be treated as a quasi-external transaction: a charge for services by the general fund and as an operating expense by the respective water and/or sewer enterprise.

Illustrative Accounting Entries

The City of XYZ general fund billed the Water Utility of the City for $2,400, as administrative charges for the quarter ending June 30. The charges were approved and paid in the same fiscal year, delineated as follows:

Utilities	$ 300
Professional services	1,200
Rent	900
Total	$ 2,400

Water Fund

	Debit	Sub	Credit
(79)-5210-242000 - Expenses	$2,400		
5210-430510-340 - Utilities		$ 300	
5210-430510-350 - Professional services		1,200	
5210-430510-530 - Rent		900	
5210-101000 - Cash			$2,400

(To record administrative charges as expenses. It requires the preparation of a General Journal Voucher.)

General Fund

	Debit	Credit	Sub
(80)1000-101000 - Cash	$2,400		
1000-172000 - Revenues		$2,400	
1000-340000 - Charges for services			$2,400

(To record administrative charges as revenues. It requires the preparation of a General Journal Voucher.)

INTERNAL SERVICE FUNDS

INTRODUCTION

Nature and Purpose

Internal service funds are used to account for the financing of goods or services provided by one department or agency to other departments or agencies of the governmental unit, or to other governmental units, on a cost reimbursement basis.

Generally accepted accounting principles do not require the use of internal service funds. Governmental units choose to use internal service funds to achieve a level of operating efficiency that may not be available if the same activities are performed by multiple units within the governmental organization. Their use is precipitated by many factors including the desire to:

a. Account for the total cost of each activity,
b. Provide greater ease in costing and pricing services,
c. Accumulate resources for replacing fixed assets,
d. Combine certain governmental fund type overhead costs, so they can be redistributed to the benefiting programs,
e. Isolate interfund services so that governmental fund types do not display revenues and expenditures related to interfund transactions twice within the same fund type.

Typical examples of internal service funds are those used to account for motor pools, central duplicating and printing services, central data processing services, central purchasing, central stores, communications and self insurance activities. Generally, a separate internal service fund should be established for each service activity.

Costing and Pricing Services

The relationship of costing and pricing is an important one, since the objective of internal service funds is to recover the total cost of services through user charges. Costs would, ordinarily, include both direct and indirect costs, and the pricing of services should include the replacement of fixed assets as well.

Capital Assets

1. The governing body should establish a formal capital asset policy on what methods and procedures they wish to use in recording and reporting capital assets.

2. Adequate subsidiary records of all capital assets should be maintained, and periodically they should be reconciled with the related general ledger accounts.

3. A physical inventory should be taken at least once a year and the subsidiary records adjusted to the actual count.

INTERNAL SERVICE FUNDS – cont.

INTRODUCTION – cont.

Depreciation

1. Because salvage value borders on the impossible to predict, it will be considered zero for all depreciable assets.

2. The straight-line method of depreciation, because of its simplicity, will be the method used for all depreciable assets.

3. Depreciation should be computed (prorated) when the asset is put into service. However, optionally, a full year's depreciation could be reported for assets received in the first six months and none for those received during the balance of the year; or the half year convention could be used where 50 percent of the year's depreciation is taken in the year of addition and in the year of disposition.

Activities Selected for Discussion and Illustration

The offerings that follow are limited to central data processing and self-insurance activities identified as the more relative internal service user areas. **Policies and procedures in other user areas (i.e. central stores, central garage, motor pool, equipment rental, etc.) would be similar to those discussed below.**

CENTRAL DATA PROCESSING (BARS 6030)

Concept Discussion

Internal service funds are commonly used to account for central data processing services. Users are charged for the full cost of the services, including fixed asset replacement. Service charges vary depending on the type of service provided. A governmental unit might charge for each printed page and for data storage. Specialized programming might be charged at an hourly rate. Or, the charge could be based on the actual time spent on the computer processing unit. And, terminals could be charged at a fixed hourly rate or an annual rate per unit.

Policy and/or Procedural Steps

1. The central data processing unit should bill-out and record all accumulated user charges the last working day of each calendar month.

2. All user departments should authorize and record payment (as a quasi-external transaction) the month in which the services were actually provided.

Illustrative Accounting Entries

A. The County of XYZ decided to centralize all of its data processing activities, effective July 1, through the use of an internal service fund.
B. The historical cost of the (undepreciated) data processing equipment (as shown in the GFAAG) is $100,000.
C. The average age of the equipment is 2 years, with an average remaining service life of 8 years. Salvage value is zero. The straight-line method of depreciation is the applicable method to be used.
D. A startup contribution of $25,000 was provided by the general fund of the governmental unit.

	Debit	Credit
(81)9000-280000 - Investment capital assets	$100,000	
9000-186000 - Equipment		$100,000

(To record the transfer of general capital assets. It requires the preparation of a General Journal Voucher.)

	Debit	Credit	
(82)6030-186000 - Equipment	$100,000		
6030-186100 - Accumulated depreciation		$ 20,000	
6030- 397000 - Contribution from local government			$ 80,000

(To record contribution of capital assets. It requires the preparation of a General Journal Voucher.)

(a) $\frac{\$100{,}000 \text{ Equipment Cost}}{10 \text{ Years Estimated Life}} = \$10{,}000$ Depreciation per year

(b) $10,000 Depreciation. x 2 years = $20,000 Accumulated depreciation.

(c) $100,000 Equipment cost minus $20,000 Dep. = $80,000 Cont. cap.

	Debit	Credit
(83)6030-101000 - Operating cash	$25,000	
6030-397000 - Contribution from local government		$25,000

(To record contribution of cash transferred to the central data processing fund from the general fund. It requires the preparation of a General Journal Voucher.)

	Debit	Credit
(84)1000-500300 – Internal service cent. data processing	$25,000	
1000-101000 - Cash		$25,000

(To record contribution of cash transferred from the general fund to the central data processing. It requires the preparation of a General Journal Voucher.)

SELF-INSURANCE - (BARS 6050)

Concept Discussion and Policy and Procedural Steps

Self-insurance is the term often used to describe a government's retention of risk or loss arising out of the ownership of property or from some other cause, rather than transferring that risk to an independent third party through the purchase of an insurance policy. It is sometimes accompanied by setting aside assets to fund any related losses. Because no insurance is involved, the term "self-insurance" is somewhat of a misnomer.

Two essential elements of any self-insurance decision are:

1. An understanding of the frequency and severity of the risks involved; and

2. The risk-bearing capabilities of the governmental unit in excess of the amount of loss potential.

The types of self-insurance activities vary from government to government. Almost any type of potential liability could be self-insured. However, the most common types found to be self-insured are for employee's medical and dental benefits and public liability.

Ideally, a government's self-insurance program should be operated similar to an insurance company. In which case, the government would set up reserves as a contingency in case of financial losses. The amount of reserves required would be determined by an actuary. In actual practice, however, actuaries are seldom used. Most governments estimate losses and costs based upon their claims experience to determine the amount of reserves.

Self-insurance activities should be fully funded. This means, generally, that a self-insured program should have assets sufficient to meet any of its potential liabilities. However, in fact, most of them do not. A common alternative used is a coinsurance plan. In such case, the government self-insures a portion of its potential liability and an insurance company coinsures the remainder to protect against losses in excess of the government's financial capability.

With a coinsurance plan, a government might use an aggregate deductible, commonly called an aggregate stop loss. This puts a maximum amount on annual losses under the deductible. For example, if the aggregate deductible was set at $500,000, this amount would be the maximum cost to the government in a given policy year. By contrast, standard deductibles usually are established as an amount per occurrence. That is, if the government has a $50,000 deductible each time a claim is honored, the government would have to pay the first $50,000 in liabilities and the insurance coverage would assume the balance of the liabilities.

INTERNAL SERVICE FUNDS – cont.

SELF-INSURANCE - cont.

Concept Discussion and Policy and Procedural Steps – cont.

Another alternative, loosely defined as non-insurance, is also available. In this case, the government assumes 100 percent of the risk and does not maintain any reserves, resulting in all claims being paid from current resources. Carrying no insurance (going bare) is a passive response to a self-insured activity. In a non-insurance situation, losses are frequently accounted for on a pay-as-you-go basis. Under these circumstances, a catastrophic loss could result in the depletion of a government's assets.

The self-insurance fund may use any basis it considers appropriate to charge other funds of the governmental unit, as long as the total charge by the self insurance fund to the other funds is based on an actuarial method or historical cost information and adjusted over a reasonable period of time so that self-insurance fund revenues and expenses are approximately equal. In addition, such total charge may also include a reasonable provision for expected future catastrophic losses.

Charges made in accordance with the foregoing should be recognized as revenue by the self-insurance fund and as expenditures by the insured funds. Deficits, if any, in the self-insurance fund do not need to be charged back to the other funds in any one year, as long as adjustments are made over a reasonable period of time; however, a deficit fund balance of the self-insurance fund should be disclosed in the notes to financial statements. Retained earnings in the self-insurance fund should be reported as equity designated for future catastrophic losses in the notes to the financial statements. This is the sole instance where the use of a designation is appropriate in a proprietary fund.

If the charge by the self-insurance fund to the other funds is greater than historic costs and catastrophic loss provisions, the excess should be reported in both the self-insurance fund and the other funds as an operating transfer. If the charge by the self-insurance fund to the other funds fail to recover the full cost of claims over a reasonable period of time, any deficit fund balance in the self-insurance fund should be charged back to the other funds and reported as an expenditure of those funds.

The proceeds collected from any tax levy imposed for employer's benefit costs should first be accounted for in a special revenue fund. And, transferred to the self-insurance fund on an as needed basis. Transfers should be treated as expenditures by the insured funds and revenue by the self-insurance fund.

When a government uses a self-insurance fund to account for its risk financing activities, the recognition of a loss contingency arising from claims and judgments is governed by FASB Statement 5. This Statement (Accounting for Contingencies) serves as the guideline for recognizing a loss liability and related cost. It identifies different probabilities for the occurrence of a loss contingency. The probabilities range from probable to reasonably possible to remote.

INTERNAL SERVICE FUNDS – cont.

SELF-INSURANCE - cont.

Concept Discussion and Policy and Procedural Steps – cont.

When a loss contingency exists, and it is determined that the probability of the insurance liability occurring or failing to occur is slight, the loss contingency is considered remote. When probability is more than remote but less then probable, it is classified as reasonably possible. Finally, if it is likely that a loss will occur, it is classified as probable. The classification of risks is important, because accounting and reporting requirements relate directly to this classification.

A loss contingency must be accrued when the following conditions exist:

1. Information available prior to issuance of the financial statements indicates that it is probable that an asset had been impaired, or a liability had been incurred, at the date of the financial statements. (It is implicit in this condition that it must be probable that one or more future events will occur confirming the fact of the loss.)

2. The amount of loss can be reasonably estimated.

If these two conditions are met, the loss contingency must be recognized in the self-insurance fund as an expense and a liability (FASB-5).

All claims outstanding (those not settled) should be reviewed to determine which classifications the loss contingency applies. In addition, IBNR (incurred but not reported) claim losses should be made based on an estimate of what the costs will be when the claims are reported and settled. NCGA-4 indicates that the liabilities may be estimated through a case-by-case review of all claims and potential claims, the application of historical experience to the outstanding claims or a combination of these methods. Where historical experience is used, the outstanding claims should be stratified by amount and type of claim, and the strata should be sufficiently refined to assure that the estimation is reasonable.

Even if a separate self-insurance fund is established to account for claims and judgments of other governmental funds, the loss contingencies are still backed by the full faith and credit of the governmental unit. For this reason, although the liability is recognized in the self-insurance fund, the loss contingency should be disclosed as a contingent liability in the general long-term debt account group.

SELF-INSURANCE - cont.

Concept Discussion and Policy and Procedural Steps – cont.

There is an inconsistency between NCGA-4, and FASB-5, in regard to the treatment of loss contingency resource transfers. Under NCGA-4, the resources transferred to the self-insurance fund by the insured funds is recorded as an operating transfer and not as an expenditure. The amount of the transfer that can be recorded as an operating transfer can be no greater than the actuarially determined value (present value) of the loss contingencies. Any excess must be treated as a residual equity transfer by the insured funds and the self-insurance fund. FASB-5, on the other hand, recognizes the gross value (not present value) of all loss contingency resource transfers.

Actuarial value is defined as the discounted value of an amount or series of amounts payable or receivable at various times, determined as of a given date by the application of a particular set of actuarial assumptions. Needless to say, few if any loss contingencies in Montana are determined by an actuary. Consequently, the transfer of resources by insured funds for loss contingencies will, undoubtedly, have to be treated as operating transfers.

Often times, a governmental unit may opt to hire-out the administration and processing of self-insurance benefit claims. In that event, a formal contract should be executed by the parties, and made explicitly clear as to the respective responsibilities. Accounting for self-insurance transactions, under those circumstances, would be similar to those where benefit claims are handled in-house.

Illustrative Accounting Entries

1. The County of XYZ decided (effective June 1) to use an internal service fund for all of its medical and dental self-insurance activity.

2. Employee premiums for the month of June were $15,000 and employer costs were $20,000.

3. The employee premiums and employer costs are to be transferred the last working day of the calendar month.

4. Employee benefit payments for the month of June were $15,000.

5. At the end of the fiscal year, the loss contingencies were determined to be $20,000.

SELF-INSURANCE - cont.

Illustrative Accounting Entries – cont.

	Debit	Credit	Sub
(85)-6050-101000 - Cash	$35,000		
6050-172000 - Revenue		$35,000	
6050-340000 Charge for services			$35,000

(To record as revenue employee medical/dental premiums and related employer contribution resources transferred from insured funds to the self-insurance fund. It requires the preparation of a General Journal Voucher.)

	Debit	Sub	Credit
(86)-1000-242000 – Expenditures	$15,000		
410000-510 – General Government		$ 5,000	
420000-510 - Public safety		10,000	
2110-242000 - Expenditures	10,000		
430000-510 - Public works		10,000	
5210-242000 – Expenses	10,000		
430500-510 - Public works		10,000	
1000-101000 - Cash			$15,000
2110-101000 - Cash			10,000
5210-101000 - Cash			10,000

(To record medical/dental premiums and related employer contribution resources transferred to the self-insurance fund by insured funds. Non-payroll fund example without group insurance fund utilized. It requires the preparation of a General Journal Voucher.)

	Debit	Sub	Credit
(87)-2371-242000 - Expenditures	$25,000		
410000-510 – General Government		$ 5,000	
420000-510 - Public safety		10,000	
430000-510 - Public works		10,000	
5210-242000 - Expenses	10,000		
430500-510 - Public works		10,000	
2371-101000 - Cash			$25,000
5210-101000 - Cash			10,000

(To record medical/dental premiums and related employer contribution resources transferred to the self-insurance fund by the insured funds. Non-payroll fund example - with group insurance fund utilized. Accounting treatment may vary depending on the automated system in use. It requires the preparation of a General Journal Voucher.)

SELF-INSURANCE - cont.

Illustrative Accounting Entries – cont.

	Debit	Credit	Sub
(88)-6050-101000 - Cash	$35,000		
6050-172000 - Revenue		$35,000	
6050-340000 - Charge for services			$35,000

(To record employee premiums and employer contribution resources. It requires the preparation of a General Journal Voucher.)

	Debit	Sub	Credit
(89)-6050-242000 - Expenses	$15,000		
6050-500600-510 - Other		$15,000	
6050-101000 - Cash			$15,000

(To record benefit payments made on behalf of employees. Ordinarily, this entry would be recorded as a part of the cash disbursement process.)

	Debit	Sub	Credit
(90)-6050-242000 - Expenses	$20,000		
6050-500600-510 - Other		$20,000	
6050-206100 - Loss contingencies			$20,000

(To record loss contingency liabilities for claims and judgments at year-end. It requires the preparation of a general journal voucher.)

	Debit	Credit	Sub
(91)-6050-101000 - Cash	$20,000		
6050-172000 Revenue		$20,000	
6050-383000 – Transfers in			$20,000

(To record transfer of loss contingency resources from insured funds to the self-insurance fund as operating transfers-in at year-end. It requires the preparation of a General Journal Voucher.)

SELF-INSURANCE - cont.

Illustrative Accounting Entries – cont.

	Debit	Sub	Credit
(92)-1000-242000 - Expenditures	$10,000		
1000-521000-800 – Transfer out		$10,000	
2110-242000 - Expenditures	5,000		
2110-521000-800 – Transfer out		5,000	
5210-242000 - Expenses	5,000		
5210-521000-800 – Transfer out		5,000	
1000-101000 - Cash			$10,000
1000-101000 - Cash			5,000
5210-101000 - Cash			5,000

(To record loss contingency resources transferred to the self-insurance fund by the insured funds - without group insurance fund. It requires the preparation of a General Journal Voucher.)

	Debit	Sub	Credit
(93)-2371-242000 - Expenditures	$15,000		
521000-800 – Transfer out		$15,000	
5210-242000 - Expenses	5,000		
521000-800 – Transfer out		5,000	
2371-101000 - Cash			$15,000
5210-101000 - Cash			5,000

(To record loss contingency resources transferred to the self-insurance fund by the insured funds - with group insurance fund. It requires the preparation of a General Journal Voucher.)

FIDUCIARY FUND TYPES

INTRODUCTION

Nature and Purpose

Fiduciary fund types are used to account for assets when a governmental unit is functioning either as a trustee or an agent for others. Because the governmental unit is functioning in a fiduciary capacity, the authority to employ, dispose of, or otherwise use the assets is determined by the applicable laws and agreements that created the trustee or agency relationship. NCGA-1 classifies fiduciary fund types in the following manner:

- Pension trust funds
- Investment trust funds
- Private purpose trust funds
- Agency funds

Ordinarily, a separate fund should be used for each individual trustee or agency relationship.

PENSION TRUST FUNDS

Nature and Purpose

This fund type sub classification is generally applicable to government employers who maintain employee pension trust funds. This fund type should be used for police reserve funds of third class cities and towns (if law enforcement employees contribute to the system) and by cities and towns for fire department relief association and disability funds (if the Clerk/Treasurer is the custodian of the fund).

Both police and firefighter pension systems would be categorized as defined benefit plans, which mean that pension benefits are based on age, years of service and/or compensation. Conversely, defined contribution plans base pension benefits solely on amounts contributed to the participants account.

The mere fact that a government offers pension benefits to its employees does not necessarily mean that the government should report a pension trust fund. The critical factor is whether a government is holding resources in trust for that purpose.

FIDUCIARY FUND TYPES

INVESTMENT TRUST FUNDS

Nature and Purpose

Investment trust funds are maintained for the purpose of satisfying the reporting requirements imposed by Governmental Accounting Standards Board (GASB) Statement No. 31. They are utilized to report the net assets and the changes in net assets related to the government's custody of the cash and cash equivalents and investments of other governments as part of a pooled investment or investments held by specific agency funds. The external portion of the pool would be reported in this fund. Typically, in Montana, such an arrangement would exist between the county and the school districts, or any other special purpose districts located in the county.

The use of this fund is generally used only in reporting. Cash and cash equivalents or investments are removed from the participating agency funds and placed in the investment trust fund for reporting purposes. Entries are generally not made in the general ledger to facilitate this reporting unless the annual report is generated by the data system used to maintain the accounting system.

PRIVATE PURPOSE TRUST FUNDS

Nature and Purpose

This fund type sub classification should be used when both the principal and revenues earned on that principal may be expended for purposes designated by the trust agreement in which the expenditure of such funds benefit individuals, private organizations or other governments. If the trust benefits the government, the resources are accounted for in a special revenue fund. Private purpose trust funds are accounted for in the same manner as governmental funds. The basis of accounting is the modified accrual basis, and the measurement focus is essentially the flow of current financial resources. Generally, there is no need to have formal budgetary integration for a private purpose trust fund. However, sound management control and oversight would suggest that a budget be adopted for control purposes.

FIDUCIARY FUND TYPES

AGENCY TYPE FUNDS

Nature and Purpose

This fund type sub classification should be used to account for assets held for other funds, governments or individuals. Agency funds are custodial in nature (assets equal liabilities), and do not involve measurement of operations. Therefore, agency funds generally serve as clearing accounts.

The most common uses of agency funds include taxes collected by one government on behalf of other governments, payroll or claims clearing and taxes paid under protest.

Taxes Paid Under Protest

Concept Discussion

When taxes are paid under protest, the money received is to be placed in a special fund designated as the protested tax fund. The money must be retained in such fund until final determination of any action or suit to recover the same, unless released at the request of the taxing jurisdiction pursuant to Section -15-1-402(7). If no action is commenced within the specified time, or if an action is determined in favor of the county, the amount protested is to be apportioned and distributed with interest thereon. If an action is determined adversely to a county, the person holding the judgment is entitled to receive such protested taxes together with interest thereon.

The rate of interest to be paid on protested taxes is the greater of: (a) the rate of interest generated from the (state) pooled investment fund, or (b) 6 percent per year. The accrual of interest on all protested taxes should be done at each fiscal year-end.

To satisfy the payment of such interest, the protested tax amounts must, accordingly, be invested. The resulting accumulated resources and offsetting liabilities owed should be accounted for in a separate agency fund, apart from the protested tax fund.

With reference to subsection 7, of 15-1-402, the governing board of a taxing jurisdiction effected by the payment of taxes under protest in the second and subsequent years, that a tax protest remains unresolved, may demand that the treasurer of the county or municipality pay the requesting taxing jurisdiction all or a portion of the protest payments to which it is entitled, except the amount paid by the taxpayer in the first year of the protest. The decision in a previous year of a taxing jurisdiction to leave protested taxes in the protest fund does not preclude it from demanding in a subsequent year any or all of the payments to which it is entitled, except the first-year protest amount. To date, only school districts have opted to exercise their rights under this provision.

FIDUCIARY FUND TYPES

AGENCY TYPE FUNDS – cont.

Taxes Paid Under Protest – cont.

Concept Discussion – cont.

If the protest action is decided adversely to a taxing jurisdiction and the amount retained in the protest fund is insufficient to refund the tax payments and costs to which the taxpayer is entitled and for which local government units are responsible, the treasurer shall bill and the taxing jurisdiction shall refund to the treasurer that portion of the taxpayer refund, including tax payments and costs, for which the taxing jurisdiction is proratably responsible. In satisfying these requirements, the taxing jurisdiction is allowed not more than 1 year from the beginning of the fiscal year following a final resolution of the protest. The taxpayer is entitled to interest on the unpaid balance at the greater of the rates referred to from the date of payment under protest until the date of final resolution of the protest and at the combined rate of the federal reserve discount rate quoted from the federal reserve bank in New York, New York, on the date of final resolution, plus four percentage points, from the date of final resolution of the protest until refund is made.

A taxing jurisdiction may satisfy these requirements by use of funds from one or more of the following sources:

(a) Imposition of a property tax to be collected by a special tax protest refund levy;
(b) The general fund, except that amount generated by the all purpose mill levy, or any other funds legally available to the governing body; and
(c) Proceeds from the sale of bonds issued by a county, city, or school district for the purpose of deriving revenue for the repayment of tax protests lost by the taxing jurisdiction. The governing body of a county, city, or school district is hereby authorized to issue such bonds pursuant to procedures established by law. The bonds may be issued without being submitted to an election. Property taxes may be levied to amortize the bonds.

The distribution or release of protested taxes to a taxing jurisdiction, in advance of any action or suit to recover same, would require the county to maintain a detailed accounting of all such advances within the protested tax fund.

The recipient taxing jurisdiction should consider recognizing any advance as tax revenue to the fund utilizing such resource; since the advance would meet the revenue recognition criteria of available and measurable.

FIDUCIARY FUND TYPES

AGENCY TYPE FUNDS – cont.

Taxes Paid Under Protest – cont.

Concept Discussion – cont.

If it is probable that such advance or portion thereof may be refundable, the appropriate liability should be recorded in the fund utilizing the resources. Provided that expendable available financial resources will be used to meet the claim. If, however, expendable available resources will not be used to meet the claim, the liability should then be classified as part of the GLTDAG. (NCGA-4 and FASB-5)

When a loss contingency arising from a claim is either not probable or not subject to reasonable estimation, the contingency must be disclosed in the financial statements when it is reasonably possible that the loss will eventually be incurred. The financial statement disclosure should describe the nature of the loss contingency and an estimate of the possible loss or range of loss. If an estimate cannot be made, the disclosure should state no estimate can be made. (NCGA-4 and FASB-5)

Illustrative Accounting Entries

A. Taxpayer Jones (residing in the County of XYZ) paid the entire second half of his current real property taxes under protest. The taxes were paid on May 31, in the amount of $1,500. (No special assessments were involved.)

B. At year-end, the Bookkeeper was instructed to compute and record the accrued interest (at 6%) on the above protested amount.

C. The County of XYZ released taxes paid under protest to School District A ($5,000) and School District B ($5,000).

	Debit	Credit
(94)-7130-101000 - Cash	$1,500	
7130-203200 - Protested taxes payable		$1,500

(To record payment of taxes paid under protest. Ordinarily, this entry would be recorded as a part of the cash receipt process.)

	Debit	Credit
(95)-XXXX-116000 - Protested taxes receivable	$1,500	
XXXX-113XXX - Taxes receivable		$1,500

(To reclassify receivables as protested taxes. It requires the preparation of a General Journal Voucher.)

FIDUCIARY FUND TYPES

AGENCY TYPE FUNDS – cont.

Taxes Paid Under Protest – cont.

Illustrative Accounting Entries – cont.

	Debit	Credit
(96)-7131-101000 - Cash	$8	
7131-206320 - Interest payable		$8

(To record accrued interest payable on protested taxes at year-end. $1,500 x .06 x 1/12 = $8.00 rounded. It requires the preparation of a General Journal Voucher.)

	Debit	Credit
(97)-7130-233000 - P/T advances - School A	$5,000	
7130-233000 - P/T advances - School B	5,000	
7130-101000 - Cash		$10,000

(To record release of protested taxes in advance of any action or suit to recover same. It requires the preparation of a General Journal Voucher.)

GENERAL FIXED ASSETS ACCOUNT GROUP

INTRODUCTION

With the implementation of Governmental Accounting Standards Board (GASB) Statement No. 34, the reporting of the General Fixed Assets Account Group (GFAAG) is no longer required to be reported as a part of the basic financial statements. However, to accomplish the preparation of the government wide statements required by the GASB #34, the information previously recorded and reported in this account group still needs to be accumulated. To facilitate the accumulation of the necessary data, the BARS chart of accounts still provides for the recording of this information and has expanded the chart to facilitate the recording of depreciation for general capital assets which was not previously required.

We have included a discussion of each account group below to provide an understanding of what information is required to be accumulated for the purposes intended by GASB #34. Also included is an example of a schedule of the GFAAG would look like to facilitate the gathering of information for GASB #34.

GENERAL FIXED ASSETS ACCOUNT GROUP

Nature and Purpose

Governmental funds use the flow of current financial resources measurement focus. Except for certain limited cases (inventories) and in keeping with the aims of that measurement focus, only financial assets (assets that will be converted into cash in the course of normal operations) are reported in those funds. Therefore, fixed assets, because they are not financial in nature, are excluded. Yet, accountability requires that adequate control be maintained over fixed assets. Accordingly, prior to GASB #34, generally accepted accounting principles required that those fixed assets of a government not reported in a proprietary fund or a trust fund be reported in a general fixed assets account group (GFAAG). The GFAAG serves as a list of the government's fixed assets and is designed to ensure accountability. To facilitate the gathering of information pertaining to the depreciation of the general capital assets, we have included depreciation expenditure (expense) accounts for each functional level of expenditure (expense) and accumulated depreciation accounts for each category of asset.

GENERAL FIXED ASSETS ACCOUNT GROUP

GENERAL FIXED ASSETS ACCOUNT GROUP – cont.

Nature and Purpose – cont.

The General Fixed Assets Account Group (GFAAG) is no longer required to be included in the basic financial statements of the government entity, however, the information contained in the account group is vital to the preparation of the government wide statements required by GASB #34. The assets reported in the GFAAG are presented in the classes of land, buildings, improvements other than buildings, equipment and infrastructure (roads, bridges, curbs, gutters, etc). The assets reported in the GFAAG are recorded at original cost net of accumulated depreciation. The total amount of these assets is offset by accumulated depreciation accounts and an investment in general fixed assets account, which represents equity.

COUNTY/CITY/TOWN OF ______________________________
GENERAL FIXED ASSETS ACCOUNT GROUP
FYE JUNE 30, 20__

ACCOUNT NUMBER	ACCOUNT DESCRIPTION	BALANCE JULY 1, 20__	DEBITS	CREDIT	BALANCE JUNE 30, 20__
181000	LAND				
182000	BUILDINGS				
182100	ALLOWANCE FOR DEPRECIATION				
184000	IMPROVEMENTS OTHER THAN BUILDINGS				
184100	ALLOWANCE FOR DEPRECIATION				
186000	MACHINERY & EQUIPMENT				
186100	ALLOWANCE FOR DEPRECIATION				
187000	INFRASTRUCTURE				
187100	ALLOWANCE FOR DEPRECIATION				
	DEPRECIATION EXPENSE:				
410000830	GENERAL GOVERNMENT				
420000830	PUBLIC SAFETY				
430000830	PUBLIC WORKS				
440000830	PUBLIC HEALTH				
450000830	SOCIAL/ECONOMIC SERVICES				
460000830	CULTURE AND RECREATION				
470000830	HOUSING/COMMUNITY DEVELOPMENT				
	TOTAL				
280000	INVESTMENT IN GENERAL FIXED ASSETS				
	TOTAL				

GENERAL LONG TERM DEBT ACCOUNT GROUP

With the implementation of the Governmental Accounting Standards Board (GASB) Statement No. 34, the reporting of the General Long-term Debt Account Group (GLTDAG) is no longer required to be reported as a part of the basic financial statements. However, to accomplish the preparation of the government wide statements required by the GASB No. 34, the information previously recorded and reported in this account group still needs to be accumulated.

Nature and Purpose

The general long-term debt account group (GLTDAG) is used to account for unmatured long-term indebtedness (including special improvement debt) that has not been identified as a specific fund liability of a proprietary or trust fund.

Although the title of the account group refers to general long-term debt, the term is broader and encompasses various types of noncurrent liabilities. Some of which are:

- Loans/notes
- Contracts
- Bonds
- Compensated Absences
- Capital Leases

The GLTDAG is not a fund. It does not present results of operations or reflect the financial position of general long-term liabilities. Instead, those liabilities are simply offset by other debits to balance the account group presentation. The GLTDAG is no longer required to be reported as part of the basic financial statements, however, we have continued to provided the accounts to maintain the account group for the purposes of gathering information for the government wide statements required by GASB No. 34.

Accounting Issues

There are several accounting issues or problem areas commonly associated with GLTDAG. Those which are most problematic and recurring are identified, discussed and illustrated on the following pages.

GENERAL LONG TERM DEBT ACCOUNT GROUP – cont.

AMOUNTS AVAILABLE AND AMOUNTS TO BE PROVIDED – (173000 and 174000)

Concept Discussion

The GLTDAG contains an amounts available account (BARS 173000) which represents current financial resources available to retire liabilities presented in the GLTDAG (typically, amounts reported as debt service fund balance). The amounts to be provided (BARS 174000) account represents the difference between the liabilities reported in the GLTDAG and the amounts available. These accounts are necessary only for the purpose of recording the liabilities and are of no consequence in the financial reporting at the government-wide level.

Illustrative Accounting Entries

A. The City of XYZ has one general obligation bond issue outstanding and one debt service fund.

- On June 30, the fund (equity) balance of this debt service fund was $10,000.
- On June 30, the amount available for the retirement of this debt reflected in the GLTDAG was $8,000.
- During the current fiscal year, the amount of principal paid on outstanding general obligation bonds was $50,000.

B. The City of XYZ has one improvement district bond issue outstanding and one debt service fund.

- On June 30, the fund (equity) balance of this debt service fund was $2,000.
- On June 30, the amount available for the retirement of this debt reflected in the GLTDAG was $3,000.
- During the current fiscal year, the amount of principal paid on outstanding improvement district bonds was $10,000.

GENERAL LONG TERM DEBT ACCOUNT GROUP – cont.

AMOUNTS AVAILABLE AND AMOUNTS TO BE PROVIDED – cont.

Illustrative Accounting Entries – cont.

	Debit	Credit
(98)-9500-173100 - Amounts available - GO debt	$2,000	
9500-174100 - Amounts provided - GO debt		$2,000

(To record increase in financial resources available to retire GO debt. It requires the preparation of a General Journal Voucher.)

	Debit	Credit
(99)-9500-231100 - Bonds payable - GO debt	$50,000	
9500-174100 - Amounts provided - GO debt		$50,000

(To record retirement of GO bonds and offset to amounts provided. It requires the preparation of a General Journal Voucher.)

	Debit	Credit
(100)-9500-174200 - Amounts provided - SID debt	$1,000	
9500-173200 - Amounts available - SID debt		$1,000

(To record decrease in financial resources available to retire SID debt. It requires the preparation of a General Journal Voucher.)

	Debit	Credit
(101)-9500-231400 - Bonds payable SID debt	$10,000	
9500 - 174200 - Amounts provided - SID debt		$10,000

(To record retirement of SID bonds and offset to amounts provided. It requires the preparation of a General Journal Voucher.)

CONTRACTS PAYABLE - (BARS Account 235000)

Concept Discussion

Contracts payable is a long-term liability account which represents any noncurrent contract amounts due to private persons and organizations at year-end.

Policy and/or Procedural Steps

All noncurrent contract liabilities should be reflected in GLTDAG; and related subsidiary or file accounts reconciled each month to the control account.

GENERAL LONG TERM DEBT ACCOUNT GROUP – cont.

CONTRACTS PAYABLE - (BARS Account 235000) –cont.

Illustrative Accounting Entries

C. The City of XYZ purchased a new motor vehicle (without trade) on July 1, for the police department.

- The purchase and contract price was $20,000, with no down payment.
- The contract is to be repaid in one installment (balloon payment) two years hence.
- Interest on the contract will accrue at the rate of 6 percent simple, and be paid on each June 30, thereafter.

	Debit	Credit
(102)-9500-174300 - Amounts to be provided	$20,000	
9500-235100 - Contracts payable		$20,000

(To record the contract liability. It requires the preparation of a General Journal Voucher.)

COMPENSATED ABSENCES - (BARS Account 239000)

Concept Discussion

This liability account represents sick leave, vacation leave and other related employer's contributions, accrued at yearend, for all employees except those of proprietary funds.

GENERAL LONG TERM DEBT ACCOUNT GROUP – cont.

COMPENSATED ABSENCES - (BARS Account 239000) – cont.

Concept Discussion – cont.

There are four conditions that should be met before a compensated absences liability is accrued. The criteria are as follows:

1. The employer's obligation relating to employee's rights to receive compensation for future absences is attributable to employee's services already rendered;

2. The obligation relates to rights that vest or accumulate;

3. The payment of compensation is probably; and

4. The amount can be reasonably estimated.

The liability for compensated absences is calculated by multiplying the number of eligible days/hours times the applicable daily/hourly salary rate for each employee. Then, adding to this the related employer's contribution for each employee. The compensated absences year-end liability can be determined with relative ease by use of the worksheet that follows. The worksheet will become the basis for adjusting the liability and serve as documentation for it.

Policy and/or Procedural Steps

The compensated absences account is adjusted only at year-end. The amount of the adjustment will be the difference (plus or minus) between the current year's accrual and the balance of the prior year's liability.

GENERAL LONG TERM DEBT ACCOUNT GROUP – cont.

COMPENSATED ABSENCES - (BARS Account 239000) – cont.

Illustrative Accounting Entries

D. The current year-end accrual for compensated absences for the City of XYZ is $20,000, and the prior year-end liability was $15,000.

	Debit	Credit
(103)-9500-174XXX - Amounts to be provided	$5,000	
9500-239000 - Compensated absences payable		$5,000

(To record the year-end accrual of compensated absences. It requires the preparation of a General Journal Voucher.)

GENERAL LONG-TERM DEBT ACCOUNT GROUP

COMPENSATED ABSENCES WORKSHEET

		1	2	3	4	5	6	7	8	9	10
	EMPLOYEE	Hourly Rate	Vacation Hours	Total vac Dollars	Sick Leave Hours	25% of S/L Hours	Total S/L Hours	Comp time	Total Gross	Employer Contrib.	Total
H-7											
	Total		$				$	$	$	$	$
					Employer						
					FICA					$	
					PERS						
					Workers						
					Unemploy						
					Unemploy						
					Total (Line	$					

REFUNDING AND ADVANCE REFUNDING BONDS

Concept Discussion

Refunding bonds are bonds issued to refinance an outstanding bond issue that is callable before maturity. Advance refunding bonds are bonds issued to refinance an outstanding bond issue before the date the outstanding bonds become callable. Refunding and advance refunding are mechanisms by which old debt is (eventually) paid off with the proceeds of substitute debt in order to obtain lower interest rates and interest costs.

Bond Issuance Authorization

The refunding and advance refunding of bonds for Montana county governments is authorized and governed by Title 7, Chapter 7, Part 23, for general obligation bonds, Title 7, Chapter 7, Part 25, for revenue bonds, and Title 7, Chapter 12, Part 21, for improvement district bonds. For Montana municipal governments, the refunding and advance refunding of bonds is authorized and governed by Title 7, Chapter 7, Part 43, for general obligation bonds, Title 7, Chapters 7 and 13, Parts 43, 45 and 46 for revenue bonds, and Title 7, Chapter 12, Part 41, for improvement district bonds.

County and municipal governments may issue refunding and advance refunding bonds without the benefit of an election.

In the case of general obligation bonds, the bonds may not be issued unless they bear interest at a rate of at least 1/2 of 1% less than the outstanding bonds to be refunded. However, the bonds may bear interest in excess of the rate on the bonds if the issuance results in a reduction of the total debt service costs to the issuing government.

In the case of revenue bonds, the bonds may not be issued unless their average annual interest rate, computed to their stated maturity date, excluding premium, is at least 3/8 of 1% less than the average annual interest rate on the bonds refunded. However, bonds may bear interest at a rate lower or higher than the bonds refunded if:

(a) They are issued to refund matured principal or interest for the payment of which revenues on hand are not sufficient.

(b) The bonds are combined with an issue of new bonds for reconstruction, improvement, betterment, extension, and the lien of such new bonds upon the revenues of the undertaking are subordinate to the lien of the outstanding bonds refunded, or

(c) The issuance of the refunding bonds, including their total costs result in a reduction of total debt service cost to the issuing government.

REFUNDING AND ADVANCE REFUNDING BONDS – cont.

Bond Issuance Authorization – cont.

In the case of improvement district bonds, the bonds may not be issued:

(a) The rate of interest is at least ½ of 1% a year less than the rate of interest on the bonds to be refunded.

(b) There is, or will be on the next payment date, default in the payment of bond principal or interest, or

(d) 50% or more of the installments of assessments levied in the improvement district and payable in a single fiscal year have been delinquent for at least one year.

Defeasance

Refunding and advance refunding of bonds are usually conducted to result in either legal defeasance or in-substance defeasance of the old debt. The term defeased means terminated or rendered null and void. Debt that has been defeased is considered to be extinguished and is thus removed from the accounts.

Legal Defeasance (conventional refunding)

In law, a debt is considered defeased by being legally defeased when the debtor fulfills the defeasance provisions of the debt indenture. In conventional refunding, debt is normally defeased by being paid off, with such debt removed from the accounts.

In-substance Defeasance (advance refunding)

An in-substance defeasance occurs when debt is considered defeased for accounting and reporting purposes, even though a legal defeasance has not occurred. When old debt is defeased, it is no longer reported as a liability, only the new debt is reported as such. The old debt is considered in-substance defeased for reporting purposes if:

> The debtor irrevocably places cash or other assets with an escrow agent in trust to be used solely to satisfy scheduled payments of both interest and principal of the old (defeased) debt.

To qualify for in-substance defeasance, the trust assets must be:

- Denominated in the currency in which the debt is payable and

- Monetary assets are essentially risk free as to the account, timing and collection of interest and principal.

REFUNDING AND ADVANCE REFUNDING BONDS – cont.

Governmental Fund Types

When debt reported in the GLTDAG is defeased through conventional refunding or advance refunding, the proceeds from the issue of the new debt should be recorded as other financing sources in the fund that received the proceeds. The newly issued debt should also be recorded as a liability in the GLTDAG. When payments to the paying agent or escrow agent to defease the old debt are made, the payments should be recorded as a liability in the GLTDAG. When payments to the paying agent or escrow agent to defease the old debt are made, the payments should be recorded as other financing uses. If however, other resources are used to make payments to the paying agent or escrow agent, they should be reported as debt service expenditures. The defeased debt should then be removed from the GLTDAG. Accounting gains or losses on the retirement of long-term debt are not reported in governmental fund types.

Enterprise Funds

If the old debt is retired when the new debt is issued and no reporting problems exist, the old bonds are written-off and the new bonds reported as long-term debt. If the old bonds are not retired immediately but are considered in substance defeased, they are removed from the accounts when payment is made to the escrow agent. The defeasance of debt due to refunding and advance refunding for enterprise activities usually result in an accounting gain or loss. The gain or loss should be reported as an extraordinary item on the operating statement. The extraordinary gain or loss on refunding is calculated as the difference between the carrying value of the debt and the price paid to retire the debt. An accounting gain and an economic gain (discussed later) are not synonymous.

Required Note Disclosures

Regardless of where the debt is reported, all governments that defease debt through refunding or advance refunding are required to provide a general description of the transaction in the notes to the financial statements in the year of such refunding. At a minimum, the disclosures should include:

1. The difference between (a) the cash flows required to service the old debt and (b) the cash flows required to service the new debt.

   Difference in Cash Flow Requirements Explained. The cash flow requirements of the old debt are simply the sum of all future interest and principal payments that would have to be paid by the entity if the debt remained outstanding until its maturity date. The cash flow requirements of the new debt are the sum of all future interest and principal payments that will have to be paid to service the debt in the future, and other payments that are made from the entity's current resources rather than from proceeds from the issuance of the new debt. Any proceeds from the issuance of the new debt that represent accrued interest (when the bonds are sold between interest payment dates) should not be included as cash flow requirements related to the new debt. When new debt is issued in an amount that exceeds the amount needed to defease the old debt, only the portion of the new debt needed to defease the old debt should be included as cash flow requirements related to the new debt.

REFUNDING AND ADVANCE REFUNDING BONDS – cont.

Required Note Disclosures – cont.

2. The economic gain or loss resulting from the transaction:

   Economic Gain or Loss Explained. The economic gain or loss is computed by determining the difference between the present value of cash flow requirements of the old debt and the present value of cash flow requirements of the new debt. The interest or discount rate used to determine the present value of the cash flows is a rate that generally must be computed through trial and error (either manually or by using a computer software package). The objective is to identify an interest rate that, when applied to the cash flow requirements for the new debt, produces an amount equal to the sum of the (1) proceeds of the new debt (net or premium or discount) and (2) accrued interest, less the (a) underwriting spread and (b) nonrecoverable issuance costs.

Computing the Required Note Disclosures

To clarify the computation of the differences in cash flow requirements and the economic gain or loss arising from the refundings, GASB-7 has formulated a series of suggested steps that may be followed to compute the required disclosures. The following demonstrates how these suggested steps can be applied to specific circumstances.

Step 1: Compute the amount of resources that will be required to (1) make a payment to the escrow agent in order to defease the debt and (2) pay issuance costs. The payment to the escrow agent must be large enough to make all interest payments and the principal payment based on either the call date or maturity date of the old debt. Either the call date or the maturity date is used, depending on which one is specified as the retirement date in the escrow fund agreement. The amount of the required payment to the escrow agent is also dependent upon the rate of return that can be earned in the escrow fund. The escrow rate of return is determined by the market investment conditions and the allowable yield on the escrow investment as determined by Treasury Department regulations. The amount of the issuance costs must be added to the amount that is paid to the escrow agent in order to determine the total amount of resources required to defease the debt.

Step 2: Compute the effective interest rate target amount. The effective interest rate target amount is computed by subtracting the amount of non-recoverable issuance costs from the amount of the resources required to defease the old debt and to pay issuance costs (computed in Step 1). By reducing the amount required to defease the old debt (and to pay issuance costs) by the non-recoverable issuance costs, the effective interest rate (to be computed in Step 3) will be decreased. If all issuance costs are recoverable and the new debt is sold at par, the coupon rate on the new debt will be the same as the effective interest rate.

REFUNDING AND ADVANCE REFUNDING BONDS – cont.

Computing the Required Note Disclosures – cont.

Step 3: Compute the effective interest rate.
The effective interest rate is the interest rate used to discount the debt service requirements on the new debt so that it is exactly equal to the effective interest rate target amount (computed in Step 2). The computation of the effective interest rate is relatively easy if you have access to a microcomputer and a software program. If you do not have access to a microcomputer, the computation of the effective interest rate is tedious because it must be determined through trial and error and by using interpolation.

Step 4: Compute (1) the difference between the cash flow required to service the new debt and (2) the economic gain or loss resulting from the refunding.

The difference between the cash flow requirements can be computed as shown in the following:

Total interest payments on old debt (using the maturity date of the old debt)	$ X	
Principal payment to retire old debt	X	
Total cash flow requirements to service old debt		$ X
Total interest payments on new debt	$ X	
Principal payment to retire new debt	X	
Other resources used to defease old debt	X	
Less: Accrued interest on new debt at date of issuance	-X	
Total cash flow requirements to service new debt		-X
Difference in cash flow requirements		$ X

The economic gain or loss on the refunding can be computed as follows:

Present value of cash flow requirements to service old debt		$ X
Present value of cash flow requirements to service new debt	$ X	
Other resources used to defease old debt	X	
Less: Accrued interest in new debt at date of issuance	-X	- X
Economic gain (loss) on refunding		$ X

The computations necessary to determine the difference in cash flows and economic gain or loss require a working knowledge of present value math. Ordinarily however, these intricate computations will be generated and furnished by the firm retained to do the refunding.

REFUNDING AND ADVANCE REFUNDING BONDS – cont.

Authoritative Pronouncements

The refinancing of general obligation and revenue bonded debt through issuance of refunding and advance refunding bonds present a number of unique accounting situations. The authoritative pronouncements that follow, however, provide accounting and reporting guidance on the early extinguishment of debt.

NCGA Interpretation No. 9 - Applicable Standards

GASB Statement No. 7 - Debt Extinguishments

GASB Statement No. 23 - Accounting and Financial Reporting for Refundings of Debt Reported by Proprietary Activities

SFAS No. 76 - Extinguishment of Debt

APB No. 26 - Early Extinguishment of Debt

SFAS No. 4 - Reporting Gains and Losses From Extinguishment of Debt

SFAS No. 64 - Extinguishment of Debt to Satisfy Sinking Fund Requirements

APB No. 30 - Reporting the Results of Operations

Clarification of Refunding Terms

Montana law makes a clear distinction between refunding bonds issued to refinance (general obligation or revenue) outstanding bonds that are callable before maturity, and those for refunding bonds issued to refinance (general obligation or revenue) outstanding bonds before they become callable. Under Montana law, the term refunding is used specifically for such bonds that are callable before maturity. And, the term advance refunding is used specifically for such bonds not subject to immediate redemption. Accounting literature, on the other hand, uses the term advance refunding synonymously. In the case of improvement district bonds, however, Montana law makes no distinction.

Accounting Exercise

The set of facts that follow will be used as the basis to demonstrate the various accounting entries required for both refunding (callable) and advance refunding (uncallable) bonds, and there applicability to governmental funds (general obligation and improvement district bonds) and proprietary funds (revenue bonds) alike.

REFUNDING AND ADVANCE REFUNDING BONDS – cont.

Accounting Exercise – cont.

Keep in mind, however, that the proceeds from a refunding issue would be sent to a "paying agent" to legally defease the old debt. But, the proceeds of an advance refunding issue would be sent to an "escrow agent" in an in-substance defeasance of the old debt. In either case, from an accounting standpoint, the debt is defeased once the proceeds are sent to the "paying agent" or the escrow agent and the old debt is then removed from the accounts.

Illustrative Accounting Entries

A. On March 31, 1999, the County and City of ABC refunded and defeased outstanding bonds of $34,980,000 (interest rate of 10.125%), with new debt of $42,855,000 (weighted interest rate of 7.299%), dated March 1, 1999.

B. The issuance costs of $1,577,646 (set forth below) were paid from bond proceeds.

Insurance (allowable and recoverable)	$ 564,003
Underwriters spread (not allowable)	707,108
Financing Costs (not allowable)	306,535
Total	$1,577,646

C. The bond proceeds (from the new debt) are net of issuance costs. ($42,855,000 minus $1,577,646 = $41,277,354)

D. Debt Service and/or sinking and interest monies of the old debt amounting to $1,761,024 are to be used in the defeasance. ($34,980,000 minus $1,761,024 = $33,218,976)

E. The amount needed to defease the old debt is $43,038,378. ($41,277,354 plus $1,761,024 = $43,038,378)

F. Accrued interest on the new debt from March 1, to March 31, is $258,351.

REFUNDING AND ADVANCE REFUNDING BONDS – cont.

Illustrative Accounting Entries – cont.

Governmental Funds - Refunding or Advance Refunding
(General Obligation or Improvement District Bonds)

Debt Service Fund

	Debit	Credit	Sub
(104)-3000-101000 - Cash	$41,277,354		
3000-172000 - Revenues		$41,277,354	
3000-380000 - Other financing sources			$41,277,354

(To record bond proceeds from new debt - net of issuance costs.)

	Debit	Credit	Sub
(105)-3000-101000 - Cash	$258,351		
3000-242000 - Expenditures		$258,351	
3000-490200-620 - Bond interest			$250,351

(To record accrued interest on new debt.)

NOTE
Normally entry 103 will only be required in a refunding bond situation; i.e., where the old bonds are callable. And is correct as long as the related interest payment is made in the same period, or if the accrued interest payable is recorded at year-end.

	Debit	Sub	Credit
(106)-3000-242000-Expenditures	$43,038,378		
3000-520000 - Other financing uses		$41,277,354	
3000-490000-600 - Escrow/Paying agent		1,761,024	
3000-101000 - Cash			$43,038,378

(To record defeasance of the bonds.)

REFUNDING AND ADVANCE REFUNDING BONDS – cont.

Illustrative Accounting Entries – cont.

GLTDAG

	Debit	Credit
(107)-9500-173100 - Amounts available	$33,218,976	
9500-174100 - Amounts to be provided		$33,218,976

(To record resources available in debt service fund to retire old bonds.)

	Debit	Credit
(108)-9500-174100 - Amounts to be provided	$42,855,000	
9500-23100 - Bonds payable		$42,855,000

(To record issuance of new bonds.)

	Debit	Credit
(109)-9500-23100 - Bonds payable	$34,980,000	
9500-174100 - Amounts to be provided		$34,980,000

(To record retirement of old bonds.)

Proprietary Funds - Refunding or advance refunding
(Revenue Bonds)

Enterprise Fund

	Debit	Credit
(110)-5210-101000 - Cash	$41,277,354	
5210-170600 - Deferred costs	1,577,646	
5210-231300 - Bonds payable		$42,855,000

(To record issuance of new bonds.)

	Debit	Sub	Credit
(111)-5210-231300 - Bonds payable	$34,980,000		
5210-242000 – Expenses	8,058,378		
5210-430500-800 - Loss		$8,058,378	
5210-101000 - Cash			$43,038,378

(To record in-substance defeasance of old debt.)

CASH AND INVESTMENTS

CASH/CASH EQUIVALENTS - (BARS 10XXXX)

Concept Discussion and Policy and/or Procedural Steps

The composition of cash may include amounts in demand deposits, time deposits and other short-term investments and long-term investments. It is unnecessary to use separate account codes for cash/cash equivalents and investments. BARS account numbers 101000 (unrestricted cash/cash equivalents) and BARS account number 102XXX (restricted cash/cash equivalents) may both include demand deposits, time deposits and other short-term investments. BARS account numbers 101100 (unrestricted investments) and 102300 (restricted investments) would include long-term U. S. Government Securities, bonds, U.S. Treasury Notes/Bills, etc. However, an investment register should be maintained to record all transactions relative to each interest bearing cash/cash equivalent or investment.

The investment register should include the following:

1. Date of purchase or deposit;
2. Number of treasurer's check issued
3. Description of investment;
4. Identification number on securities;
5. Maturity date;
6. Face value;
7. Premium paid on purchase;
8. Discount at which purchased; in payment of investment;
9. Net cost - book value;
10. Interest received on investment;
11. Treasurer's receipt number covering deposit of interest
12. Date of sale or redemption of investment.

Certain investments purchased often include the purchase of accrued interest to date. In that event, such interest purchased should be treated as part of the cost of the investment and not recorded as revenue when returned.

Demand Deposits

Demand deposits are defined as deposits payable upon demand. (32-1-109(9). Demand deposits may be placed only in banks. (7-6-205(2).

CASH AND INVESTMENTS – cont.

CASH/CASH EQUIVALENTS – cont.

Concept Discussion and Policy and/or Procedural Steps – cont.

Investments

A local governing body may invest public money not necessary for immediate use by the county, city, or town as provided for in Section 7-6-202, MCA as follows:

Investment of public money in direct obligations of United States.

(1) A local governing body may invest public money not necessary for immediate use by the county, city, or town in the following eligible securities:
  - (a) United States government treasury bills, notes, and bonds and in United States treasury obligations, such as state and local government series (SLGS), separate trading of registered interest and principal of securities (STRIPS), or similar United States treasury obligations;
  - (b) United States treasury receipts in a form evidencing the holder's ownership of future interest or principal payments on specific United States treasury obligations that, in the absence of payment default by the United States, are held in a special custody account by an independent trust company in a certificate or book-entry form with the federal reserve bank of New York; or
  - (c) obligations of the following agencies of the United States, subject to the limitations in subsection (2):
    - (i) federal home loan bank;
    - (ii) federal national mortgage association;
    - (iii) federal home mortgage corporation; and
    - (iv) federal farm credit bank.

(2) An investment in an agency of the United States is authorized under this section if the investment is a general obligation of the agency and has a fixed or zero-coupon rate and does not have prepayments that are based on underlying assets or collateral, including but not limited to residential or commercial mortgages, farm loans, multifamily housing loans, or student loans.

(3) The local governing body may invest in a United States government security money market fund if:
  - (a) the fund is sold and managed by a management-type investment company or investment trust registered under the Investment Company Act of 1940 (15 U.S.C. 80a-1 through 80a-64), as may be amended;
  - (b) the fund consists only of eligible securities as described in this section;
  - (c) the use of repurchase agreements is limited to agreements that are fully collateralized by the eligible securities, as described in this section, and the investment company or investment trust takes delivery of the collateral for any repurchase agreement, either directly or through an authorized custodian;
  - (d) the fund is listed in a national financial publication under the category of "money market mutual funds", showing the fund's average maturity, yield, and asset size; and

CASH AND INVESTMENTS

CASH/CASH EQUIVALENTS – cont.

Concept Discussion and Policy and/or Procedural Steps – cont.

Investments – cont.

(e) the fund's average maturity does not exceed 397 days.

(4) Except as provided in subsection (5), an investment authorized in this part may not have a maturity date exceeding 5 years, except when the investment is used in an escrow account to refund an outstanding bond issue in advance.

(5) An investment of the assets of a local government group self-insurance program established pursuant to 2-9-211 or 39-71-2103 in an investment authorized in this part may not have a maturity date exceeding 10 years, and the average maturity of all those authorized investments of a local government group self-insurance program may not exceed 6 years.

(6) This section may not be construed to prevent the investment of public funds under the state unified investment program established in Title 17, chapter 6, part 2.

Time Deposits

Time deposits are defined as deposits payable in seven days. (32-1-109(20)). The local governing body may solicit bids for time deposits from any bank, savings and loan association, or credit union in the state. The local governing body may not deposit public money in such institutions unless a local financial institution agrees to pay the same rate of interest bid by a financial institution not located in the county, city, or town. The governing body may solicit bids by notice sent by mail to the investment institutions who have requested that their names be listed for bid notice with the department of administration (7-6-206(2)). The bank, building and loan association, savings and loan association, or credit union in which the money is deposited shall pay on the money from private sources on the same terms. Refusal of any bank, building and loan association, savings and loan association, or credit union to pay said interest rate shall constitute a waiver of that institution's right to participate in the deposit of public funds. (7-6-203(1)(2))

Repurchase Agreements

The local governing body shall call for bids as provided in 7-6-206 to contract for a repurchase agreement from all financial institutions chartered to do business in the State of Montana, which are authorized to accept demand deposits and to buy and sell securities. The call for bids shall specify the minimum acceptable rate of interest, effective date of the repurchase agreement and the period of duration and range of funds to be invested.

CASH AND INVESTMENTS

CASH/CASH EQUIVALENTS – cont.

Concept Discussion and Policy and/or Procedural Steps – cont.

Investments – cont.

Repurchase Agreements – cont.

A repurchase agreement is a contract that specifies the minimum and maximum of public money that the local governing body will invest in securities that the financial institution will sell to the local governing body, and that the financial institution will repurchase on mutually agreeable terms.

The local governing body may maintain, in the same financial institution contracting for the repurchase agreement, a demand account into which each business day shall be deposited a sum equal to the day's disbursements, and that deposit will be the proceeds of the redemption by the financial institution of securities previously purchased by the local governing body under the provisions of the repurchase agreement, so that the balance of the demand account at the close of each day's business will be zero. (7-6-213)

State Investment Pool

The State Board of Investments has promulgated rules and procedures for investing in the State Short-Term Investment Pool (STIP) (17-6-204(1)).

Pledged Securities

It is the duty of the treasurer to obtain sufficient security from financial institutions to ensure the safety of all deposits. Pledged securities are required for at least 50 percent of those deposits not guaranteed or insured according to law, if the institution in which the deposit is made has a net worth to total assets ratio of 6 percent or more. If this ratio is less than 6 percent, pledged securities are required to be 100 percent of those deposits. (7-6-207 and 17-6-102)

CASH AND INVESTMENTS

CASH/CASH EQUIVALENTS – cont.

Interest Income Distribution

Section 7-6-204, requires that all interest paid and collected on deposits and investments should be credited to the general fund of the county, city or town, unless otherwise provided by law or terms of a gift, grant or donation. Additionally, interest on surplus investments **may** be distributed to each fund in proportion to each fund's participation in the investment. (2003 Legislative Amendment.)

Laws that specifically provide otherwise include:

	County	City/Town
General Obligation Sinking Fund	7-7-123	7-7-123
Registered Warrants	7-6-2701	7-6-4603
County General Obligation Bond Fund	7-7-2112	7-7-4102
Capital Improvement Program Fund	7-6-2702	7-6-4135
Fair Capital Improvement Fund	7-21-3413	N/A
R.S.I.D./S.I.D. Funds	7-12-2173	7-12-4105
R.S.I.D./S.I.D. Sinking/Maint. Funds	7-12-2175	7-12-4207
Hard Rock Trust Fund	7-6-2225(5)	N/A
Hard Rock Reserve Fund	7-6-2226(3)	N/A
Library Capital Improvement Fund	22-1-307	22-1-307
911 Interest Fund	10-4-303	10-4-303
S.I.D. Revolving Fund	N/A	7-12-4226
Revenue Bond Sinking Fund	N/A	7-13-4326

There are also entities other than counties, cities and towns that have specific interest income distribution laws, including school districts (20-9-212(10)(13), fire districts (7-6-204(2), irrigation districts (85-7-2133(2)), etc.

With the amendment to Section 7-6-204, MCA, interest income distribution to proprietary fund types is no longer an issue. Proprietary fund type activities, such as enterprise and internal service funds, normally take on the same characteristics as those of commercial business enterprises. Consequently, they are obligated to be self sufficient. To do so, proprietary fund types must have the managerial flexibility to maximize the utilization of resources generated from users and from the investment of their idle funds.

CASH AND INVESTMENTS

CASH/CASH EQUIVALENTS – cont.

PETTY CASH - (BARS 103000)

Concept Discussion and Procedural Steps

Petty cash is a sum of money set aside on an imprest basis to make change or to pay small obligations for which the issuance of a formal voucher or warrant would be too expensive and time consuming. Petty cash accounts are sometimes referred to as petty cash funds. However, they are not funds in the sense of governmental accounting individual funds.

Petty cash accounts should be reported as assets of the fund of ownership and be maintained on the imprest basis. An imprest petty cash account is an account into which a fixed amount of money is placed for minor disbursements or disbursements for a specific purpose. When disbursements are made, a voucher is completed to record their date, amount, nature and purpose. From time to time, a report with substantiating vouchers is prepared. And, the account is replenished for the exact amount of the disbursements and the appropriate accounts charged. The total of cash plus substantiating vouchers always should equal the total fixed amount of money set aside in the petty cash imprest account(s).

Illustrative Accounting Entries

(A) The council of the City of XYZ authorized (on April 1,) the establishment of a $500 petty cash account for general fund use. The account is to be operated on the impressed basis.

(B) On May 1, the custodian of the petty cash account submitted substantiating vouchers for reimbursement as follows:

Administration (420110-210)	$ 25
Road and Streets (430200-220)	50
Parking Lots (430340-230)	75
Total	$150

	Debit	Credit
(112)-1000-103000 - Petty cash	$500	
1000-101000 - Petty cash		$500

(To record establishment of the petty cash account. It requires the preparation of a General Journal Voucher.)

CASH AND INVESTMENTS

PETTY CASH – cont.

Illustrative Accounting Entries – cont.

	Debit	Sub	Credit
(113)-1000-242000 - Expenditures	$150		
1000-420110-210 - Office supplies		$25	
1000-430200-220 - Operating supplies		50	
1000-430340-230 - Repair and Maintenance supplies		75	
1000-101000 - Cash			$150

(To record petty cash expenditures and replenishment of the petty cash account. Ordinarily, this entry would be recorded as a part of the cash disbursement process.)

CASH WITH FISCAL AGENT - (BARS 104000)

Concept Discussion and Procedural Steps

Cash with fiscal agent, a depository used for (only) unregistered bearer bonds, consists of cash deposited by the government for the future payment of unregistered bonded debt principal and interest. A fiscal agent is a fiduciary agent who performs the function of paying debt principal and interest, on behalf of the government, when due.

All municipal bonds issued prior to the early 1980s, are bearer bonds (no longer issued) - are not registered, but are presumed to belong to whomever has possession of them. Each bearer bond has dated interest coupons attached, which the bearer clips and deposits with the fiscal agent. Upon maturity, bonds are processed similarly. Traditionally, the fiscal agent forwarded the paid coupons and bonds to the treasurer of the issuing government. In recent times, however, fiscal agents have not always returned the paid coupons and bonds to the issuing government, but instead provide a statement of coupon and bond payments.

All municipal bonds issued since the early 1980s, on the other hand, are registered bonds - that is, the bonds are registered in the name of the investor-creditor. A local government can perform all bond-related registration and debt service payment functions internally. That is, they register and reregister their bonds, prepare individual interest and principal payment checks, and prepare required annual reports of their debt service activities and payments. However, most local governments retain a registration agent and/or paying agent to perform such bond related functions. A local government that retains a bond registrar and paying agent, usually a large bank, sends its debt service checks to the agent. The agent prepares and processes the individual investor-creditor checks, registers and reregisters bonds as ownership changes, prepares and files the necessary reports and sends the local government reports summarizing its activities on their behalf.

CASH AND INVESTMENTS

CASH WITH FISCAL AGENT - (BARS 104000)

Illustrative Accounting Entries

The County of XYZ has one 20-year bond issue outstanding. The principal and interest is due on January 1, each year. For the current year, the principal is $25,000 and the interest is $12,500. The following entries give effect to required accounting treatment when a fiscal agent is retained (for unregistered bonds) and when a registrar and paying agent is retained (for registered bonds).

	Debit	Credit
(114)-3XXX-104000 - Cash with fiscal agent	$37,500	
(3XXX-101000 - Cash		$37,500

(To record deposit made with the fiscal agent for unregistered general obligation bonds. It requires the preparation of a General Journal Voucher.)

	Debit	Sub	Credit
(115)-9500-205100 - Bonds payable	$25,000		
3XXX-242000 - Expenditures	12,500		
3XXX-490500-620 - Interest		$12,500	
3XXX-104000 - Cash with fiscal agent			$37,500

(To record payment of bond P&I made to the registrar/paying agent for registered general obligation bonds. Ordinarily, this entry would be recorded as a part of the cash disbursement process.)

REAL PROPERTY TAX DEED AND TAX SALE PROCEDURES

INTRODUCTION

The assessment of taxes on real property imposes a lien upon such property. Failure of the owner of the property to pay such taxes may make the property subject to the foreclosure procedures provided for in Title 15, Chapters 17 and 18, and Title 7, Chapter 8 of the Montana Code. However, the laws relating to real property foreclosures are unfortunately complicated, somewhat ambiguous and often times difficult to comprehend.

PERTINENT LAWS AND PROCEDURES

(A) **Notices of Pending Tax Sales**

The county treasurer is required to publish a Notice of Pending Tax Sale after May 31, each year on all property having delinquent real property taxes. Among the publication requirements is the provision that the notice must be published once a week for three consecutive weeks, and that the notice must be first published on or before the last Monday in June. (Section 15-17-122)

(B) **Affidavit**

Section 15-17-123, requires that immediately following publication of the notice (Section 15-17-122), the treasurer shall file a copy of the notice with the clerk and recorder. The copy must be accompanied by an affidavit signed by the treasurer.

(C) **Tax Sale Certificates**

Tax sale certificates (tax liens) should be offered for sale to the public as required by Sections 15-17-211 and 15-17-212. Under Section 15-17-214, the county is considered the purchaser of all unsold liens. This section further requires that the treasurer identify and list all property liens that were actually sold at the tax sale, and record that the county is the purchaser of all property liens unsold. Section 15-17-214(3), provides that the record of the property in which the county is listed as purchaser and lien holder may be made by a separate tax sale certificate of each property or by reference to the property as recorded in the list required under Section 15-16-301.

(D) **Assignment of Rights**

Under Section 15-17-323(1), any tax sale certificate or other official record in which the county is listed as the purchaser of unsold liens must be assigned by the treasurer to any person who pays the amount of the delinquent taxes, including penalty, interest and costs accruing from the date of delinquency.

PERTINENT LAWS AND PROCEDURES – cont.

E) Municipality As Purchaser

Whenever property has been struck off to the county at a tax sale under 15-17-214, is subject to the lien of delinquent special assessments, and has not been assigned under 15-17-214 or 15-17-323, at the request of the municipality the county treasurer shall assign all of the rights of the county acquired therein at the sale to the municipality upon payment of any delinquent taxes (excluding assessments) and costs, without penalty or interest. The duplicate certificate of sale must be delivered to the treasurer of the municipality and filed by him in his office. No charge may be made for the duplicate certificate when the municipality is the purchaser, and in such case the county treasurer shall make an entry "sold to the municipality" on the assessment book opposite the tax, and he must be credited with the delinquent amount thereof in the settlement. Property sold to the municipality must be held in trust by the municipality for the improvement fund into which the delinquent special assessments are payable.

F. Assignment Of Municipality's Interest

(1) At any time after a parcel of land has been acquired by a municipality, as provided in 15-17-317, and has not been redeemed, the treasurer of the municipality shall assign all the rights of the municipality in the property to any person who pays:

  (a) The purchase price paid by the municipality;
  (b) The delinquent assessments;
  (c) Interest on the purchase price and delinquent assessments at the rate of 5/6 of 1 percent a month; and
  d) Penalties and costs as provided by law.

(2) The treasurer of the municipality shall execute to such person a certificate of sale for the parcel, which may be in substantially the form provided in 15-17-212 for the assignment of the interests of the county. If the certificate of sale becomes lost or accidentally destroyed by the assignee, the treasurer of the municipality shall issue a duplicate certificate to the assignee after the assignee delivers to the treasurer evidence satisfactory to him, including an affidavit of the assignee, that the certificate has been lost or destroyed.

PERTINENT LAWS AND PROCEDURES – cont.

F. **Assignment Of Municipality's Interest – cont.**

(3) An assignment by a municipality under this section discharges the trust created under 15-17-317. The municipality may also discharge the trust created under 15-17-317 by paying into the improvement fund the amount of the delinquent assessments and interest accrued thereon.

(G) **Redemption of Tax Liens**

The redemption of tax liens should be done in general conformity with Sections 15-18-111 and 15-18-112.

Once redemption of the property tax lien has been made, the treasurer is required to give such notice to the purchaser of the tax lien. If the money is not claimed by the purchaser within one year, the purchaser relinquishes all claim to the money, and the money is credited to the general fund of the county (Section 15-18-114).

(H) **Expiration of Redemption Period - Notification Thereof**

Not more than 60 days prior to and not more than 60 days following the expiration of the redemption period provided in 15-18-111, a notice must be given as follows:

(a) for each property for which there has been issued to the county a tax sale certificate or for which the county is otherwise listed as the purchaser or assignee, the county clerk shall notify all persons considered interested parties in the property and the current occupant of the property, if any, that a tax deed may be issued to the county unless the property tax lien is redeemed prior to the expiration date of the redemption period; or

(b) for each property for which there has been issued a tax sale certificate to a purchaser other than the county or for which an assignment has been made, the purchaser or assignee, as appropriate, shall notify all persons considered interested parties in the property, if any, that a tax deed will be issued to the purchaser or assignee unless the property tax lien is redeemed prior to the expiration date of the redemption period. (Section 15-18-212)

PERTINENT LAWS AND PROCEDURES – cont.

(I) Public Auction Sale of County Tax Deeded Property

Whenever property is acquired by tax deed, it is the duty of the commissioners, within six months after acquiring title, to make and enter an order for sale of the property at public auction. (Section 7-8-2301(1))

A sale may not be made for a price less than the sales price of the property, as determined and fixed by the commissioners prior to making the order of sale. (Section 7-8-2301(2))

If no bids or offers are received at the public auction sale, the commissioners shall order another auction sale within six months and may re-determine the sales price. (Section 7-8-2301(4))

In the period of time between the auction conducted under subsection (1), in which there were no qualifying bids for the property, and an auction held pursuant to this subsection, the board may sell the land by negotiated sale at a price that is not less than the sales price that was fixed for the original auction under subsection (1). (Section 7-8-2301(4))

Notwithstanding the amount of the sales price fixed by the board prior to the auction, if the successful sale bidder is the delinquent taxpayer or his successor in interest, his agent, or a member of his immediate family, the purchase price may not be less than the amount necessary to pay, in full, all county costs of conducting the sale, delinquent taxes, assessments, and all interest and penalties. Section 7-8-2301(6))

If no bids or offers are received at the public auction sale, the board may dispose of the land as provided in Section 7-8-2218.

If the property to be sold is reasonably of a value less than $2,500, sale thereof may be made at either public or private sale, at the discretion of the commissioners. Section 7-8-2217)

PERTINENT LAWS AND PROCEDURES – cont.

(J) **Terms of Sale for Tax-Deeded Property**

A sale of property may be made for cash or on terms. If the sale is made on terms, at least 20 percent of the purchase price must be paid in cash at the date of sale and the remainder may be paid in installments extending over a period not to exceed five years. All deferred payments bear interest at a rate established by the board of county commissioners. The rate may not exceed more than 4 percentage points a year above the prime rate of major New York banks, as published in the Wall Street Journal within 7 days prior to the date of sale. If a sale is made on terms, the chairman shall execute a contract containing the terms that are provided by a contract approved by the Department of Revenue (Section 7-8-2304).

The proceeds received from the sale of all tax title property are to be apportioned and distributed in the following manner:

(1) (a) Upon a sale of the property, the proceeds of each sale must be credited to the county general fund for reimbursement of expenditures made in connection with the procurement of the tax deed and holding of the sale.

(b) Upon a sale of the property, if there is any money remaining after the payment of the amount specified in (1)(a) and the remainder is:

(i) in excess of the aggregate amount of all taxes and assessments accrued against the property and all funds and purposes, without penalty and interest, then as much of the remaining proceeds must be credited to each fund or purpose as each fund or purpose would have received had the taxes been paid before becoming delinquent, and all excess must be credited to the general fund of the county; or

(ii) less in amount than the aggregate amount of all taxes and assessments accrued against the property for all funds and purposes, without penalty or interest, the proceeds must be prorated between the funds and purposes in the proportion that the amount of taxes and assessments accrued against the property for each fund or purpose bears to the aggregate amount of taxes and assessments accrued against the property for all funds and purposes (Section 7-8-2306).

REAL PROPERTY TAX DEED AND TAX SALE PROCEDURES

PERTINENT LAWS AND PROCEDURES – cont.

CONCEPT DISCUSSION

When a county acquires real property by tax deed, the funds and/or purposes which shared in the related receivables written-off continue to maintain a legal interest in the property in that same proportion. Each fund should account for their individual interest within their respective fund. As a result, the taxes/assessments receivable must be reclassified as tax deed lands receivable.

ILLUSTRATIVE ACCOUNTING ENTRIES

On July 1, the County of XYZ acquired title to four properties by tax deed. The delinquent taxes/assessments on the properties were as follows: property (A) $1,000, property (B) $2,000, property (C) $3,000 and property (D) $4,000.

All Funds

	Debit	Credit
(116)-XXXX-123XXX - Tax deed lands receivable	$10,000	
XXXX-11XXXX - Taxes/assessments receivable		$10,000

(To record the acquisition of tax deed lands and the related reduction to taxes/ assessments receivable. In practice, however, entries would be required for each fund interest. It requires the preparation of a General Journal Voucher).

OPTIONAL TREATMENT

Rather than maintain receivables in each fund as illustrated above, an agency fund could be created to record the acquisition of tax deed lands until their sale.

ALL FUNDS

	Debit	Credit
(117) xxxx-223xxx - Deferred Revenue	$10,000	
Xxxx-11xxxx Taxes/Assessment Receivables		$10,000

(To reduce taxes receivables and related deferred in each applicable fund.)

(118)7180-11xxxx Taxes/Assessment Receivables	10,000	
-212500 Due to Other Funds		10,000

(To record total taxes/assessment receivable of lands acquired by tax deed receivables by type and by year must be recorded. Agency funds will offset to "Due To" accounts rather than deferred revenue.)

MUNICIPALITY AS PURCHASER OF REAL PROPERTY TAX SALE CERTIFICATE

INTRODUCTION

Whenever property has been struck off to the county at a tax sale, is subject to the lien of delinquent special assessments, and has not been assigned, the county treasurer, at the request of the municipality, shall assign all the rights acquired to the municipality upon payment of any delinquent taxes (excluding assessments) and costs, without penalty or interest. (Section 15-17-317)

At any time after a municipality has taken an assignment of a tax sale certificate, and the property has not been redeemed, the treasurer of the municipality shall assign all the rights of the municipality in the property to any person who pays:

(a) The purchase price paid by the municipality
(b) The delinquent special assessments
(c) Interest on the purchase price and delinquent assessments at the rate of 5/6 of 1 percent a month, and
(d) Penalties and costs provided by law

An assignment by a municipality discharges the trust created under Section 15-17-317. The municipality may also discharge the trust by paying the amount of the delinquent special assessments and interest accrued thereon. (Section 15-17-318)

A municipality may sell or lease property it acquires by tax deed in the same manner as a county may sell or lease tax deed property. All money received by the municipality from the sale or lease of such property, after payment of the cost of sale, not to exceed $25, must be paid into the improvement fund to the extent of the delinquent assessments, interest and penalties. The surplus, if any, must be paid into a revolving fund that secures payment of such special assessments or, if none, to the general fund of the municipality. (Section 15-17-319)

For property that the municipality acquires by tax deed, subsequent installments of the special assessments or assessments, if any, and other special assessments not then delinquent must be levied, and the taxes for the following years must be assessed in the same manner as if the property had not been so acquired. If the special assessments or taxes are not paid when due, the property must again be sold in the manner provided by law and the levies of special assessments, assessment of taxes, and the sale of the Property for delinquent assessments and taxes must continue until the time when the property has been redeemed from such sale. (Section 15-17-320)

MUNICIPALITY AS PURCHASER OF REAL PROPERTY TAX SALE CERTIFICATE

ACCOUNTING ISSUES

Whenever a municipality opts to become the purchaser of a tax sale certificate, on assignment from the county, a number of accounting scenarios are likely to ensue. For example, the property could be redeemed by the owner, or the city could assign the certificate and the property could be redeemed by the owner, or the city could take tax deed to the property and later sell it at public auction. The accounting illustrations that follow speak to these possibilities.

A. **Tax Sale Certificate Struck Off To County**

A parcel of real property located within the city was struck off to the county at the last tax sale. The amounts delinquent and owing were $1,600, broken down as follows:

Taxes	$ 1,000
Assessments (SID No. 1)	500
Penalty and interest	100
Total	$ 1,600

1. This tax sale certificate was struck off to the county in June 1999.

2. All prior taxes and special assessments had been paid current.

3. The special assessments cover a 10 year, $2,500 (SID No.1) bond issue that, with interest, amounts to $5,000 over its life.

4. The deferred assessments receivable and the deferred revenue amounts were recorded at that time.

5. Since then, $2,000 of these special assessments have been paid current and $500 are presently delinquent.

MUNICIPALITY AS PURCHASER OF REAL PROPERTY TAX SALE CERTIFICATE

B. Tax Sale Certificate Assigned to City

At the request of the city, the county assigned all of its rights to the city (on June 30, 2002) in exchange for payment of the taxes, but excluding assessments and penalty and interest. Payment was made from the city's revolving fund.

City of "X" Transactions

Revolving Fund

	Debit	Credit
(119)-34XX-120XXX - Tax lien held	$1,000	
34XX-101000 - Cash		$1,000

(To record tax sale certificate purchased from the county. Ordinarily, this entry would be recorded as a part of the cash disbursement process).

SID Improvement Fund No. 1

	Debit	Credit
(120)-3XXX-12XXXX - Assignment receivable	$500	
(3XXX-118000 - Assessments receivable		$500

(To reclassify receivable without adjustment to the deferred revenue offset. It requires the preparation of a General Journal Voucher).

County of "Y" Transactions

	Debit	Credit
(121)-XXXX-101000 - Cash (various)	$1,000	
XXXX-212XXX - Due to city	500	
XXXX-11XXXX - Taxes rec. (various)		$1,000
XXXX-118000 - Assessments receivable		500

(To record effect of tax sale certificate assignment. In practice, however, two separate entries would be recorded. One recorded as a part of the cash receipt process, the other by General Journal Voucher).

MUNICIPALITY AS PURCHASER OF REAL PROPERTY TAX SALE CERTIFICATE

C. **Tax Sale Certificate Redeemed**
One year from the date of purchase (June 30, 2003), the property on which the city held the tax sale certificate was redeemed at the office of county treasurer. The owner of the property was required to pay the taxes, assessments, penalty and interest and 10 percent interest thereon for one year. The money was placed in the redemption fund by the treasurer. ($1,600 x 1.10 = $1,760) (15-17-318 and 15-18-112)

City of "Y" Transactions

Redemption Fund

	Debit	Credit
(122)-7150-101000 - Cash	$1,760	
7150-212000 - Due to city		$1,650
7150-211000 - Due to other funds		110

(To record redemption of property. Ordinarily, this entry would be recorded as a part of the cash receipt process).

	Debit	Credit
(123)-7150-212000 - Due to city	$1,650	
7150-211000 - Due to other funds	110	
7150-101000 - Cash		$1,760

(To record redemption fund settlement. Ordinarily this entity would be recorded as a part of the cash disbursement process).

Agency Fund

	Debit	Credit
(124)-78XX-101000 - Cash	$1,650	
78XXX-212000 - Due to city		$1,650

(To record receipt of proceeds from redemption fund. Ordinarily, this entry would be recorded as a part of the cash receipt process).

	Debit	Credit
(125)-78XX-212000 - Due to city	$1,650	
78XX-101000 - Cash		$1,650

(To record payment of redemption fund proceeds to city. Ordinarily, this entry would be recorded as a part of the cash disbursement process.)

Other Various Funds

	Debit	Credit	Sub
(126)-XXXX-101000 - Cash (various)	$110		
XXXX-172000 - Revenue		$110	
XXXX-312000 - Penalty and interest			$110

(To record receipt of proceeds from redemption fund. Ordinarily, this entry would be recorded as a part of the cash receipts process.) This entry reflects revenue to county funds only. Agency funds distribution would be offset by "Due To".

MUNICIPALITY AS PURCHASER OF REAL PROPERTY TAX SALE CERTIFICATE

Other Various Funds – cont.

City of "X" Transactions

Revolving Fund

	Debit	Credit	Sub
(127)-34XXX-101000 - Cash	$1,100		
34XX-1021XX - Tax lien held		$1,000	
34XX-172000 - Revenue		100	
34XX-37XXXX - Interest			$100

(To record receipt of proceeds redeeming the tax lien held. Ordinarily, this entry would be recorded as a part of the cash receipt process).

SID Improvement Fund No. 1

	Debit	Credit	Sub
(128) - 3XXX-101000 - Cash	$550		
3XXX-12XXXX - Assignment receivable		$500	
3XXX-223300 - Deferred revenue	$500		
72000 - Revenue Control		$550	
363020 - Assessment receivable			$550

(To record receipt of redemption proceeds regarding assignment receivable.)

D. **Assignment Of Tax Sale Certificate By City**

(This scenario presumes that the tax sale certificate assigned to the city has yet to be redeemed by the property owner.) On the following December 31, 2002, at the request of John Doe, the city assigned all of its rights in the tax sale certificate to Mr. Doe. In exchange, Mr. Doe was required to pay the taxes ($1,000), the special assessments ($500), 10 percent interest thereon for 6 months ($75), and penalty and interest ($100) to the city, a total of $1,675. (Refer to scenario A and scenario B for point of beginning).

City of "X" Transactions

Revolving Fund

	Debit	Credit	Sub
(129)-34XX-101000 - Cash	$1,675		
34XX-120XXX - Tax lien held		$1,000	
34XX-211000 - Due to SID No. 1		575	
34XX-212000 - Due to county		100	
34XX-172000 - Revenue		50	
34XX-371000 - Interest			$50

(To record assignment of tax sale certificate by city. Ordinarily, this entry would be recorded as a part of the cash receipt process).

MUNICIPALITY AS PURCHASER OF REAL PROPERTY TAX SALE CERTIFICATE

City of "X" Transactions – cont.

Revolving Fund – cont.

	Debit	Credit
(130)-34XX-211000 - Due to SID No. 1	$525	
34XX-212000 - Due to county	100	
34XX-101000 - Cash		$625

(To record payment to SID No. 1 and the county. Ordinarily, this entry would be recorded as a part of the cash disbursement process).

SID Improvement Fund No. 1

	Debit	Credit	Sub
(131)-3XXX-101000 - Cash	$525		
3XXX-12XXXX - Assignment receivable		$525	
3XXX-172000 - Revenue		25	
3XXX-363XXX - Assessment Revenue			$25

(To record proceeds received from revolving fund. Ordinarily, this entry would be recorded as a part of the cash receipts process.)

County of 'Y" Transactions

	Debit	Credit	Sub
(132)-XXXX-101000 - Cash (various)	$100		
XXXX-172000 - Revenue		$100	
XXXX-312000 - Penalty and interest			$100

(To record receipt of penalty and interest from the City of "X". Ordinarily, this entry would be recorded as a part of the cash receipt process). This entity reflects revenue to county funds only. Agency fund distribution would be offset by "Due To".

E. Redemption Of Tax Sale Certificate Assigned By City

One year from the date John Doe purchased the tax sale certificate, (December 31, 2003), assigned to him by the city, (Scenario D) the owner redeemed the property. The owner was required to pay the city treasurer $1,675 (taxes $1,000, assessments $500, interest paid the city $75, penalty and interest $100), plus 10 percent interest thereon for one year, or $1,843.

The city held the tax sale certificate for six months and received their interest for this period directly from John Doe. John Doe held the certificate for twelve months and is, consequently, entitled to 10 percent interest for one year on his original investment of $1,675. Since there is no specific statutory direction in this regard, the methods used here would seem equitable in the circumstances. (Sections 15-18-112 and 15-16-102)

MUNICIPALITY AS PURCHASER OF REAL PROPERTY TAX SALE CERTIFICATE

E. Redemption Of Tax Sale Certificate Assigned By City – cont.

City of "X" Transactions

Redemption Fund

	Debit	Credit
(133)-7150-101000 - Cash	$1,843	
7150-212500 - Due to others		$1,843

(To record tax sale certificate redemption. Ordinarily, this entry would be recorded as a part of the cash receipt process).

	Debit	Credit
(134)-7150-212500 - Due to others	$1,843	
7150-101000 - Cash		$1,843

(To record redemption settlement. Ordinarily, this entry would be recorded as a part of the cash disbursement process).

F. Tax Deed Acquisition By City

1. This scenario provides that the tax sale certificate assignment to the city was not redeemed by the property owner. Refer back to scenario A and scenario B for point of beginning.)
2. The city took tax deed (June 30, 19-4) to the property on which they held the tax sale certificate dated June, 19-1).
3. Tax sale certificates issued for the years 19-2, 19-3, and 19-4, were all struck off to the county and were not assigned to anyone.
4. The unpaid taxes and assessments for these years, as of June, 19-4, were as follows:

	19-2	19-3	19-4	Total
Taxes	$ 1,000	$ 1,100	$ 1,200	$ 3,300
Assessments (SID No. 1)	500	500	500	1,500
Totals	$ 1,500	$ 1,600	$ 1,700	$ 4,800

5. The portion of special assessments authorized but not yet charged is $1,000.

6. The property was later appraised for $2,000.

MUNICIPALITY AS PURCHASER OF REAL PROPERTY TAX SALE CERTIFICATE

F. **Tax Deed Acquisition By City – cont.**
City of "X" Transactions

Revolving Fund

	Debit	Credit
(135)-34XX-123XXX - Tax deed lands rec.	$1,000	
34XX-1021XX - Tax lien held		$1,000

(To record effect of tax deed acquisition. It requires the preparation of a General Journal Voucher).

SID Improvement Fund No. 1

	Debit	Credit
(136)-3XXX-233300 - Deferred revenue	$3,000	
3XXX-119000 - Deferred assess. rec.		$1,000
3XXX-118XXX - Del. assess. rec.		1,500
3XXX-12XXXX - Assignment rec.		500

(To record effect of tax deed acquisition. It requires the preparation of a General Journal Voucher).

County of "Y" Transactions

	Debit	Credit
(137)-XXXX-223XXX - Deferred revenue	$3,300	
XXXX-223300 - Deferred revenue	1,500	
XXXX-113000 - Property taxes rec.		$3,300
XXXX-118000 - Assessments receivable		1,500

(To record effect of tax deed acquisition. It requires the preparation of a General Journal Voucher).

G. **Sale Of Tax Deed Property By City**

1. The city sold the property at public auction for $1,200.

City of "X" Transactions
Revolving Fund

	Debit	Credit
(138)-34XX-101000 - Cash	$1,000	
34XXX-123XXX-Tax deed lands rec.		$1,000

(To record effect of tax deed property sale. Ordinarily, this entry would be recorded as a part of the cash receipt process).

SID Improvement Fund No. 1

	Debit	Credit	Sub
(139)-3XXX-101000 - Cash	$200		
3XXX-172000 - Revenue		$200	
3XXX-313000 - Tax title prop. sale			$200

(To record effect of tax deed property sale. Ordinarily, this entry would be recorded as a part of the cash receipts process).

APPLICABLE ATTORNEY GENERAL'S OPINIONS

A. Volume No. 40, Opinion No. 15

HELD: The period of redemption for land sold for delinquent taxes is provided for by section 15-18-101, MCA. Payment of <u>all</u> taxes and assessments is required for redemption to occur. The time period cannot be tolled by payment of part of the delinquent taxes.

B. Volume No. 41, Opinion No. 77

HELD:
1. A city must pay all delinquent taxes, including special assessments, to a county to effect an assignment of the rights of the county in property struck off following a tax sale.
2. A county is not required to take a tax deed to subdivision property struck off following a tax sale.
3. Following issuance of a tax deed to a county, the county is not responsible for payment of accelerated delinquent special assessments due prior to issuance of the deed.

C. Volume No. 42, Opinion No. 82

HELD:
1. When a city has established a revolving fund to secure payments on SID bonds, and when an SID fund does not have sufficient amounts to make payments on its bonds, the city must continue to make loans from the revolving fund to the SID fund, and must continue to levy the property, tax in accordance with section 7-12-4222, MCA, until the obligations on all bonds and warrants in the SID are discharged.
2. A city whose taxes are collected by the county has statutory authority to accelerate future installments of special assessments when an installment becomes delinquent.
3. Prior to 1987 a city could not obtain a valid tax deed on property it received through a tax sale until the outstanding and delinquent assessments on the property were paid and discharged.

D. Volume No. 43, Opinion No. 38

HELD:
1. When a county becomes a purchaser of a tax sale certificate pursuant to section 15-17-214, MCA, the county is not required to pay special assessments levied against the property after the tax sale.
2. When a county assigns its interest as purchaser of a tax sale certificate, it must collect from the assignee all delinquent taxes and assessments due on the property that is the subject of that interest, unless the assignee is a municipality. If the assignee is a municipality, the county must collect only delinquent taxes (excluding assessments) and costs.

D. Volume No. 43, Opinion No. 38 – cont.

3. If a municipality takes an assignment of interest in a tax sale certificate from a county pursuant to section 15-17-317, MCA, the municipality must reassign that interest only if a subsequent purchaser pays both the municipality's purchase price and any delinquent assessments against the property, plus interest, penalties and costs.

4. If either a county or a municipality takes a tax deed to property pursuant to section 15-18-211, MCA, the granting of the tax deed extinguishes the lien created by any special assessment against the property which becomes payable prior to the issuance of the deed, but leaves unaffected any lien created by a special assessment which first becomes payable after issuance of the deed.

E. Volume No. 45, Opinion No. 2

HELD: MCA -7-8-2306, which governs the distribution of proceeds from a sale of county tax deed land, requires that city assessments be included and prorated as part of the allocation of monies received from that sale, regardless of when those assessments became payable.

GRANTS, ENTITLEMENTS AND SHARED REVENUES

CONCEPT DISCUSSIONS

Introduction

Resources received by governmental units from other governments are frequently accompanied by legal or contractual requirements that govern their use and often include special accounting and reporting requirements. When accounting and reporting requirements for such resources are not consistent with generally accepted accounting principles (GAAP), the recipient government should provide for the accomplishment of both (a) accounting and reporting in conformity with GAAP, and (b) accounting and reporting in accordance with the legal or contractual requirements. A properly designed accounting system will enable simultaneous accomplishment of both of these objectives. If the accounting system will not accommodate both objectives, it may be necessary to maintain supplemental accounting records.

GASB Section G60 establishes standards of accounting and financial reporting for grants and other financial assistance. Other financial assistance includes entitlements, shared revenues, pass-through grants, food stamps, and on-behalf payments for fringe benefits and salaries.

- **Grant** – A contribution or gift of cash or other assets from another government to be used or expended for a specific purpose, activity, or facility.

- **Operating grant** – A grant that is intended to finance operations or that may be used for either operations or capital outlays at the discretion of the grantee.

- **Capital grant** – a grant that is restricted by the grantor for the acquisition and/or construction of fixed (capital assets).

- **Pass-through grant** – a grant and other financial assistance received by a governmental entity to transfer or spend on behalf of a secondary recipient.

- **Entitlement** – The amount of payment by which a state or local government is entitled as determined by the federal government pursuant to an allocation formula contained in applicable statutes.

- **On-behalf payments for fringe benefits and salaries –** direct payments made by one entity (the paying entity or paying government) to a third-party recipient for the employees of another, legally separate entity (the employer entity or employer government).

GRANTS, ENTITLEMENTS AND SHARED REVENUES

CONCEPT DISCUSSIONS – cont.

Basis of Accounting

The fund type in which grant, entitlement, or shared revenue transactions are recorded determines the basis of accounting. Basis of Accounting requires that transactions accounted for in governmental funds (general, special revenue, capital projects, debt service and permanent funds) should be recorded on the modified accrual basis. Transactions accounted for in proprietary funds (enterprise and internal service funds) or in fiduciary funds that have the same measurement objective (private purpose trust and pension trust funds) should be recorded on the accrual basis.

Some such resources, usually entitlements or shared revenues, are restricted more in form than substance. Only a failure on the part of the recipient to comply with prescribed regulations will cause a forfeiture of the resources. Such resources should be recorded at the time of receipt of earlier if the susceptible to accrual criteria are met.

Grants, entitlements, or shared revenues received for proprietary fund operating purposes, or that may be used for either operations or capital expenditures at the discretion of the recipient government, should be recognized as “non-operating” revenues in the accounting period in which they are earned and become measurable (accrual basis). Resources restricted for the acquisition or construction of capital assets should be recorded as revenue but reported as contributed capital on the operating statement.

In some instances, it may be necessary or desirable to record grant, entitlement, or shared revenue transactions in an agency fund in order to provide an audit trail and/or to facilitate the preparation of special purpose financial statements. The transactions are recorded as they occur in the agency fund using "memoranda" revenue and expenditure accounts coded in accordance with specialized needs. The same transactions are subsequently recorded as revenues or contributed capital and expenditures or expenses, as appropriate, in conformity with GAAP in the fund(s) financed. The agency fund memoranda accounts are not reported as operating accounts. This “dual” recording approach is suggested only when a beneficial purpose is served. When an agency fund is used for this purpose, fund assets and liabilities should be combined with those of the fund(s) financed for financial statement presentation.

GRANTS, ENTITLEMENTS AND SHARED REVENUES

CONCEPT DISCUSSIONS – cont.

Fund Identification and Use

All transactions should be accounted for within one of the seven fund types: general, special revenue, capital projects, debt service, enterprise, internal service, and trust and agency funds. To identify the proper fund, the purpose and requirements of each grant, entitlement, or shared revenue should be carefully analyzed. It is not always necessary to establish a separate fund. Rather, existing funds should be used to account for grants, entitlements, or shared revenues whenever possible.

Some grants, entitlements, and shared revenues may be used in more than one fund at the discretion of the recipient. Pending determination of the funds(s) to be financed, such resources should be accounted for in an agency fund. When the decision is made about the fund(s) to be financed, the asset(s) and revenues should be recognized in the fund(s) financed and removed from the agency fund. Assets being held in agency funds pending a determination of the fund(s) to be financed should be disclosed in the notes to the financial statements.

Revenue Recognition

In governmental funds, grant revenues should be recognized in the accounting year they become susceptible to accrual. The modified accrual basis of accounting requires that revenue be measurable and available. Most grant payments are based on the grantee's performance, or expenditure of the funds. Hence, upon performance the grantee is considered to have earned the revenue. Therefore, revenue should be recognized simultaneously as the expenditure is made. In the case where moneys have been received prior to their expenditure, the payments should be recognized as a deferred revenue. At the time of expenditure, deferred revenue is debited and revenue is credited. Care should be taken to make sure uncollected grant payments are truly available. If reimbursement for an expenditure has not been received within a reasonable time after the fiscal year end, availability could be questioned. On this point, the accounting literature is limited. It provides that payment needs to be received soon enough after the fiscal year end to be used to pay liabilities of the current year. Current practice varies from 30, 60 to 90 days to one year. The availability of grant revenues should be determined in a manner consistent with the grantee's overall policy.

In proprietary funds, grants should be recognized as non-operating revenue in the fiscal year they are earned. Grants restricted for capital acquisition should be reported as capital contributions on the operating statement.

In fiduciary funds, revenues recorded in trust funds should be recognized as revenue on a basis consistent with the fund's measurement objective (governmental or proprietary). Revenue is not recognized in agency funds. Such resources initially recorded in agency funds are subsequently recognized as asset(s) and revenues in the fund(s) financed according to the applicable revenue recognition criteria.

GRANTS, ENTITLEMENTS AND SHARED REVENUES

CONCEPT DISCUSSIONS – cont.

Pass-Through Grants/Resources

Pass-through resources are grants or even loans received by a government to transfer to another entity. The receipt or disbursement of such resources does not affect the operations of the host government except for any accounting and reporting requirements imposed by the terms of the grant.

Pass-through resources have the following characteristics:

- The resources must be grants or loans not entitlements or shared revenues. Shared revenues and entitlements are programs whose distribution is based on a formula or some other predetermined basis.
- The resources must be disbursed to another agency (usually governmental or nonprofit) that provides direct services or contracts with a provider of direct services.
- The services that are ultimately provided may not be a mandated statutory function of the municipality that receives the grant.
- The host government may not use a significant amount of its local (non-grant) resources to provide the same kind of services provided through the use of the grant moneys.

The use of an agency fund for pass-through grants is now limited to only those pass-through grants for which a government functions essentially as a cash conduit under GASB Statement No. 24, *Accounting and Financial Reporting for Certain Grants and Other Financial Assistance*

GRANTS, ENTITLEMENTS AND SHARED REVENUES

CONCEPT DISCUSSIONS – cont.

Pass-Through Grants/Resources – cont.

Governmental entities often receive grants and other financial assistance to transfer to or spend on behalf of a **secondary recipient.** These amounts are referred to as pass-through grants. All cash pass-through grants received by a governmental entity (referred to as a **recipient government**) should be reported in its financial statements. As a general rule, cash pass-through grants should be recognized as revenue and expenditures or expenses in a governmental, proprietary, or trust fund. In those infrequent cases in which a recipient government serves only as a cash conduit, the grant should be reported in an agency fund. A recipient government serves only as a cash conduit if it merely transmits grantor-supplied moneys without having administrative or direct financial involvement in the program. A recipient government has administrative involvement if, for example, it:

(a) monitors secondary recipients for compliance with program-specific requirements,
(b) determines eligible secondary recipients or projects, even if using grantor-established criteria, or
(c) has the ability to exercise discretion in how the funds are allocated.

For example, a county government establishes a program to provide hot lunches to home-bound citizens. It is not a mandated program and will be financed with federal moneys received through a state agency. The state agency allows the county a small percentage of program funds to be used for the county's administrative effort. For its part, the county contracts with a nonprofit meal service to provide the meals. The county provides no other similar service. In view of the above, the moneys received and disbursed to the nonprofit contractor should be accounted for as pass-through resources. The moneys received and spent administering the program should be accounted for as revenues and expenditures of the county.

The key objective of accounting for pass-through grants is to avoid reporting the receipts and disbursements as revenue and expenditure, respectively. The theory is straightforward; resources that a government does not use itself should not be reported as revenues and expenditures of that government. However, there are problems with its practical application because it is not always easy to distinguish between buying services from another entity and passing resources to that entity. Furthermore, management responsibilities of a pass-through program do affect the government's operations t the extent that accounting and administrative services are performed. The cost of management services, and any attendant revenues, should be presented as revenues and expenditures of the host government, while the pass-through resources themselves are not.

GRANTS, ENTITLEMENTS AND SHARED REVENUES

CONCEPT DISCUSSIONS – cont.

Pass-Through Grants/Resources – cont.

The second objective of accounting for pass-through resources is to assure that the accounting records develop adequate information to manage the programs. The most common method of accounting for pass-through grants is to record them in an agency fund. This assures they will not be recorded as revenue or expenditure. Because agency fund accounting typically produces little accounting detail, however, supplemental records may be necessary. Many governments find it necessary to incorporate formal budgetary accounting procedures to adequately manage the programs. If there is an administrative element to the program, its costs and revenues are frequently recorded in a special revenue fund.

A second method of accounting for pass-through resources is to handle them as a pure balance sheet transaction. The moneys are channeled through an account entitled Due to Other Governments. This method will produce even less detail than the agency fund method.

An alternative to both these methods is to process the moneys on a day-to-day basis, as if they were a revenue and expenditure of the government, in a special revenue fund. This assures that the detail accounting and budgetary controls needed to manage the program will exist. For GAAP reporting purposes, an adjusting entry is made to remove the pass-through resources from the revenue and expenditure accounts in the host's special revenue fund. The remaining amounts will typically be the administrative costs of the program. The pass-through amounts can be moved to an agency fund or even presented as corresponding Other Financing Sources and Uses in the host's special revenue fund.

Revolving Loan Programs

Some grant-financed loan programs are of the revolving type. Under such arrangements, the grantor requires that collections on loans be used by the recipient government to finance further loans in the same program.

One common approach to accounting for such revolving loan programs is to report revenues and expenditures in a special revenue fund. The initial receipt of funds from the grantor, as well as repayments of loan principal by recipients, is reported as revenue. Similarly, the disbursement of loan proceeds to participants in the program is reported as expenditure. This approach produces a continuing cycle of revenue and expenditure as the loan revolves. For financial reporting purposes, a receivable is reported on the balance sheet at year-end with a corresponding amount of deferred revenue.

GRANTS, ENTITLEMENTS AND SHARED REVENUES

CONCEPT DISCUSSIONS – cont.

Revolving Loan Programs – cont.

Governments often favor this approach because it allows them to report cash flows related to loans in the operating statement of the same fund (special revenue) typically used to report the government's other grant activity. Unfortunately, this treatment poses some theoretical problems. It is questionable, for instance, whether it is appropriate to report a loan to a third party as an expenditure (reduction of financial resources) when its collectability is not seriously impaired. Likewise, reporting the repayment of principal as revenue appears problematic.

An alternative approach would be to report the initial receipt of funds from the grantor as revenue of the special revenue fund, but to report the disbursement of loan proceeds and the repayment of loan principal as balance sheet transactions, i.e., the exchange of one type of financial asset (cash) for another (receivable). Although this method would avoid the theoretical problem just discussed, it would have the disadvantage of eliminating from the financial statements information on cash flows related to loan principal. Accordingly, governments may wish to consider other alternatives.

Because revolving loan programs are designed to maintain a base of capital to be loaned again and again, governments may wish to consider using a fund with a capital maintenance focus to account for this activity. Accordingly, governments may wish to consider using either an enterprise fund or a nonexpendable trust fund to account for their revolving loan programs. Because they are balance sheet transactions, the disbursement of loan proceeds and the collection of principal repayments would not be reflected in the operating statements of these funds, just as was the case for special revenue funds. However, unlike special revenue funds, enterprise and nonexpendable trust funds will be required to present a statement of cash flows. Therefore, if these funds are used, information on cash flows related to the disbursement of loan proceeds and the collection of principal repayments would be reported in the financial statements.

The use of an agency fund for revolving loan programs would not appear appropriate, because of the level of management involvement in the loan process (loan approval). Ideally, agency funds are purely custodial in nature.

GRANTS, ENTITLEMENTS AND SHARED REVENUES

CONCEPT DISCUSSIONS – cont.

Other Loan Programs

In some loan programs, the collectability of loans may be quite low, or loans may routinely be forgiven if certain criteria are met (residing in rehabilitated housing for a certain number of years). In such cases, although the legal form of the transaction may be a loan, in substance the transaction appears to be more like a grant. The proper accounting for these loan programs would differ from that discussed earlier for revolving loans.

It would appear appropriate to record receipts from the grantor as revenue and loans as expenditures in the fund normally used to account for grants (special revenue fund). At the same time, a receivable would be recognized and offset by an allowance for doubtful accounts and deferred revenue. When revenue from loan collections does become both measurable and available, deferred revenue would be reduced and revenue would be recognized. Similarly, when specific accounts are determined to be ultimately uncollectible, the receivable and the allowance for doubtful accounts would be reduced accordingly.

ON BEHALF PAYMENTS FOR FRINGE BENEFITS AND SALARIES

On behalf payments include pension plan contributions, employee health and life insurance premiums, and salary supplements or stipends. For example, a state government may make contributions directly to a pension plan for elementary and secondary school teachers employed in public school districts within the state. In Montana, the State makes payments directly to the Public Employees Retirement System (PERS), Municipal Police Officers' Retirement System (MPORS) and to Firefighters' Unified Retirement System (FURS) on-behalf of employers participating in the retirement plans. Also, the State makes payments directly to County Attorneys for fifty percent of their salaries.

GRANTS, ENTITLEMENTS AND SHARED REVENUES

CONCEPT DISCUSSIONS – cont.

ON BEHALF PAYMENTS FOR FRINGE BENEFITS AND SALARIES – cont.

Recognition and Measurement

An employer government should recognize revenue and expenditures or expenses for on behalf payments for fringe benefits and salaries. The employer government should recognize revenue equal to the amounts that third-party recipients of the payments received and that are receivable at year-end for the current fiscal year.

- If the employer government is not legally responsible for the payment, it should recognize expenditures or expenses equal to the amount recognized as revenue.
- If the employer government is legally responsible for the payment, it should follow accounting standards for that type of transaction to recognize expenditures or expenses and related liabilities or assets. For example, expenditures or expenses for on behalf payments for contributions to a pension plan should be recognized and measured using pension plan accounting standards for state and local governmental employers.

Employer governments should obtain information about the amount of on behalf payments for fringe benefits and salaries from the paying entity or the third-party recipient; inter-entity cooperation is encouraged. If information cannot be obtained from those sources, employer governments should make their best estimates of the amounts.

An employer government is not required to allocate on behalf payments to individual funds. However, the employer government may choose to allocate a portion of the revenue and expenditures or expenses to one or more funds based on the related salaries charged in those funds. If an employer government reports using more than one fund and a single fund is used to report on behalf payments that fund usually should be the general fund.

GRANTS, ENTITLEMENTS AND SHARED REVENUES

CONCEPT DISCUSSIONS – cont.

ON BEHALF PAYMENTS FOR FRINGE BENEFITS AND SALARIES – cont.

Disclosure

Employer governments should disclose in the notes to financial statements the amounts recognized for on behalf payments for fringe benefits and salaries. Further, for on behalf payments that are contributions to a pension plan for which the employer government is not legally responsible, the employer government should disclose the name of the plan that covers its employees and the name of the entity that makes the contributions.

ILLUSTRATIVE ACCOUNTING ENTRIES

(1) During the fiscal year, the State paid $1,000, for there .01% PERS contribution on behalf of the County, directly to the Public Employees Retirement System.
(2) The State also paid $20,000 directly to the County Attorney for the State's share of salary.

		Debit		Sub	Credit
(140)					
1000-242000	Expenditures	$ 1,000			
1000-510300.140	Other Unallocated Costs		$ 1,000		
1000-172000	Revenues				$1,000
1000-336020	On behalf Payments			$ 1,000	
(141)					
1000-242000	Expenditures	$20,000			
1000-411000.110	Planning & Research Services		$20,000		
1000-172000	Revenues				$20,000
1000-336020	On behalf payments			$20,000	

(To record on behalf payments from the State for contributions to PERS and salary payments made directly to the County Attorney. These entries require the preparation of a General Journal Voucher.)

INVENTORIES

ENTERPRISE AND GOVERNMENTAL FUNDS (BARS 151100 and 151200)

Introduction

The concept discussion that follows is generally applicable to proprietary funds as well as governmental funds. Most inventories are held for use in operations, but some are held for resale. A number of activities are involved in the use of inventories. The most common of which have been water, sewer, road, bridges, weed, hospital and nursing home activities. These activities are usually accounted for in either enterprise funds or special revenue funds. From a budget standpoint, appropriations for inventory costs should be created under operations and not under capital outlay -- whether the item is a valve for the water utility or a culvert for the road and/or bridge department(s).

Concept Discussion and Policy and/or Procedural Steps

There are two methods in use by which to account for the inventories of supplies for use in operations and those for resale: the purchase method and the consumption method. The governing body should establish a formal policy on what methods and procedures they wish to use in accounting for consumable inventories.

The purchase method is the method under which inventories are recorded as an expense when acquired, and the simplest to apply. The consumption method is the method under which inventories are recorded as an expense when used, and the more laborious to apply.

Either method is acceptable. However, less accountability (internal control) is achieved with the purchase method, and more accountability (internal control) is achieved with the consumption method.

The method applied should be related to the significance (materiality) of the inventories and the degree of internal control required in the circumstances. For most, however, the purchase method would be the most appropriate as well as the most practical. The consumption method is the preferred method under GAAP.

Regardless of method, inventories should be valued at the lower of cost or market. However, practical wisdom suggests that they be valued at cost. There are several valuation methods available to determine the cost of inventories. For example, the first-in, first-out (FIFO) method assumes that the oldest inventories on hand are used or sold first. Whereas the last-in, first-out (LIFO) method assumes that the newest inventories are used or sold first. The FIFO method may well be the most practical of all the methods.

INVENTORIES

ENTERPRISE AND GOVERNMENTAL FUNDS - cont.

Concept Discussion and Policy and/or Procedural Steps – cont.

If the purchase method is used, at year-end a physical count and the valuation of all inventories must take place. If the values of the inventories are significant, then such values must be recorded as an asset on the general accounting records. If the inventories are judged to be insignificant, then nothing further is required.

If the consumption method is used, the inventory items would be recorded as an asset on the general accounting records when purchased. And, they would be recorded as an expense when issued for use in operations or when sold. In addition to recording the inventory items purchased in the general accounting records, perpetual (subsidiary) inventory records would also be kept where dollars as well as physical quantities would be maintained. Periodically, at least at year-end, a physical count and the valuation of all inventories would take place, and the general ledger and perpetual accounts adjusted accordingly. Any material differences should be investigated.

Enterprise - Illustrative Accounting Entries

A. The City of XYZ Water Utility has been using the purchase inventory method to account for inventories.

B. All inventories had been used for operations and none available for resale.

C. At year-end, a physical count of all inventories was taken and they were valued at cost on the FIFO method.

D. The value of the inventories at year-end was $20,000, considered material, and the general ledger inventories account reflected a balance of $10,000.

E. In the fiscal year that followed, the City decided to use the consumption inventory method to account for inventories and make available some inventories for resale.

   - The City purchased $20,000 of related inventory items during the period. Of this amount, $18,000 was for use in operations and $2,000 was for resale.

   - The general ledger supply inventory account reflected a balance of $10,000 and the stores inventory account reflected a zero balance at the beginning of the current fiscal year.

INVENTORIES

ENTERPRISE AND GOVERNMENTAL FUNDS - cont.

Enterprise - Illustrative Accounting Entries – cont.

- During the period, the Water Utility used $16,000 of the supply inventory for operations and sold $1,000 of the store's inventory. The supply inventory was consumed as follows: Facilities ($10,000), Source of Supply ($3,000) and Transmission and Distribution ($3,000). Stores inventory sales were ($1,250). Such inventory sold had a markup of 25 percent and was taken at the point of sale ($1,000 x 1.25 = $1,250).

- At year-end, a physical inventory count was taken and valued at cost on the FIFO method. However, the value of the supply inventory was actually $11,990, and the value of the store's inventory was actually $990.

- Analysis of Inventory Accounts:

	Supply Inventory	Stores Inventory
Beginning account balances	$ 10,000	$ -0-
Add inventory purchased for period	18,000	2,000
Less inventory consumed for period	(16,000)	(1,000)
Equals account balances per books	$ 12,000	$ 1,000
Less actual physical count	11,990	(990)
Equals amounts to be adjusted	$ 10	$ 10

	Debit	Credit	Sub
(142)-5210-151100 - Invent. of supplies	$10,000		
5210-242000 - Expenses		$10,000	
5210-430520-200 - Facilities			$5,000
5210-430530-200-Source of supply			2,500
5210-430550-200 – Transmission and distribution			2,500

(To record the value of supply inventories (purchases method) at year-end. It is the difference between the value of the physical count and the existing general ledger inventories account. It requires the preparation of a General Journal Voucher.)

	Debit	Credit
(143)-5210-151100 - Inventory of supplies	$18,000	
5210-151120 - Inventory of stores	2,000	
5210-101000 - Water operating cash		$20,000

(To record inventories purchased (consumption method) and resulting liability incurred. Ordinarily, this entry would be recorded as a part of the cash disbursement process.)

INVENTORIES

ENTERPRISE AND GOVERNMENTAL FUNDS - cont.

Enterprise - Illustrative Accounting Entries – cont.

	Debit	Sub	Credit
(144)-5210-430520 - Facilities	$10,000		
5210-430530 - Source of supply	3,000		
5210-430550 - Transmission and Distribution	3,000		
5210-242000 - Expenses		$16,000	
5210-151100 - Inventory of supplies			$16,000

(To record supply inventories (consumption method) used in operations as an expense. It requires the preparation of a General Journal Voucher.)

	Debit	Credit	Sub
(145)-5210-101000 - Water operating cash	$1,250		
5210-151120 - Inventory of stores		$1,000	
5210-172000 - Revenue		250	
5210-343024 - Sale of materials			$250

(To record the cost of stores inventories (consumption method) sold. Ordinarily, this entry would be recorded as a part of the cash receipt process.)

	Debit	Sub	Credit
(146)-5210-430520 - Facilities	$ 20		
5210-242000 - Expenses		$ 20	
5210-151100 - Inventory of supplies			$ 10
5210-151120 - Inventory of stores			10

(To record the slippage of inventories (consumption method) for the period as an expense. It requires the preparation of a General Journal Voucher.)

Governmental - Illustrative Accounting Entries

The illustrations set forth in the enterprise section on inventories also apply to governmental funds, but with some exception. That is, when the purchases method is used any significant amount of inventories reported on the balance sheet should be off-set by a reservation of fund balance to identify that those assets do not represent expendable available financial resources. The literature is quite clear on the reservation of fund balance for inventories under the purchases method. It is not so clear, however, when the consumption method is used. For example, some advocates believe that it is necessary to reserve fund balance by an amount equal to the carrying value of inventories under the consumption method as well. Others would not routinely reserve fund balance under the consumption method since they believe the inventories represent expendable available financial resources. Practice varies with regard to reserving fund balance under the consumption method. Consequently, it may be advisable that when the consumption method is used any significant amount of inventories reported on the balance sheet would be offset by a reservation of fund balance.

INVENTORIES

ENTERPRISE AND GOVERNMENTAL FUNDS - cont.

Governmental - Illustrative Accounting Entries – cont.

A. The County of XYZ had been using the purchase inventory method to account for road department inventories.

B. All inventories had been used for operations and none available for resale.

C. At year-end, a physical count of all inventories was taken and they were valued at cost on the FIFO method.

D. The value of the inventories at year-end was $20,000, considered material, and purchased in the current year.

E. Previous inventories had not been offset by a reservation of fund balance.

	Debit	Credit	Sub
(147)-2110-151100 - Inventory of supplies	$20,000		
2110-242000 - Expenditures		$20,000	
2110-430200200 - Supplies			$20,000

(To record the value of supply inventories (purchase method) at year-end. It requires the preparation of a General Journal Voucher.)

	Debit	Credit
(148)-2110-271000 - Unreserved fund balance	$20,000	
2110-250100 – Reserve for Inventory of Supplies		$20,000

(To record the reservation of fund balance for inventories (purchase method) at year-end. It requires the preparation of a General Journal Voucher.)

LEASES

PROPRIETARY AND GOVERNMENTAL FUNDS

Concept Discussion

Leases are classified as either capital or operating. Capital leases should be capitalized and operating leases expensed. A lease is considered a capital lease if it meets any one of the following criteria:

1. The lease transfers ownership of the property to the lessee by the end of the lease term;

2. The lease contains a bargain purchase option;

3. The lease term is equal to 75% or more of the estimated economic life of the leased property;

4. The present value of the lease equals or exceeds 90% of the fair value of the leased property less any investment credit retained by the lessor.

The amount to be recorded as an asset and as an obligation under a capital lease is the lesser of the present value of the rental and the lease payments, or the fair value of the leased property. Simply, present value is a future worth "discounted" to a present worth. Present value is determined by using the annuity factor known as the Present worth of One per Period. It calculates the present worth of a series of future payments. Compound interest and capital recapture are built into the factor, which calculates and deducts compound interest from these future payments, converting the series of payments into a single capital sum.

There are a number of ways to calculate present value, and you need not be a mathematician to do so. All that is necessary is access to standard compound interest and annuity tables. The table used for leases is the Present worth of One per Period Table (PW1/P). No complicated formulas are involved just the use of simple arithmetic. Three facts must be known, the applicable interest rate, the number of periods months/years) of the lease, and whether lease payments are due at the beginning of the period or at the end of the period. Almost all PW1/P printed tables assume that payments will be made at the end of the period. Therefore, if lease payments are due at the end of the period, then it is just a matter of matching the applicable interest rate with the number of periods on the table to locate the factor. Once located, the factor is multiplied by the amount of monthly/yearly payments the result is present value. When payments are due at the beginning of the period, however, one less period (month/year) is used in the calculation. Still, it is just a matter of matching the applicable interest rate with one less period on the table to locate the factor. This factor is multiplied by the amount of monthly/yearly payments. Present value is then determined by adding this product with one monthly/ yearly payment.

LEASES

PROPRIETARY AND GOVERNMENTAL FUNDS – cont.

Concept Discussion – cont.

Leased assets are depreciated (amortized) in a manner consistent with the government's normal depreciation policy for similar owned assets. The depreciation (amortization) period is restricted, however, to the term of the lease, rather than the service life of the asset unless the lease provides for transfer of title or includes a bargain purchase option. The periodic rental payments are treated as payments of the lease obligation and interest is recorded on the remaining balance of the obligation.

Refer to FASB Statement 13, for guidance.

Enterprise - Illustrative Accounting Entries

The City of XYZ Water Utility entered into a seven year (84 month) lease agreement for a General Plant maintenance vehicle. The terms of the lease require monthly payments of $225, ($225 x 84 = $18,900) and at the end of the lease term the vehicle may be purchased for $500. Assuming that the $500 purchase option constitutes a "bargain purchase price", the lease meets the criteria for classification as a capital lease. Therefore, at vehicle acquisition date, the lease should be recorded as an asset at the present value of the future lease payments. The interest rate is 10 percent (Present Worth Of One Per Period factor is 60.2366). Therefore, the present value of the lease payments is $13,553. (60.2366 x $225 = $13,553, rounded to $13,550). (See following Present Worth of One Per Period Table.) The estimated service life of the vehicle is 10 years, with zero salvage value. The vehicle was placed in service on July 1. The straight-line method of depreciation is the applicable method to be used.

	Debit	Credit
(149)5210-189500 - Water general plant	$13,550	
5210-235300 - Water lease agreement		$13,550

(To record present value of the maintenance vehicle lease and offsetting liability. (Present Worth Of One Per Period factor 60.2366 x $225 = $13,553, rounded to $13,550). It requires the preparation of a General Journal Voucher.)

	Debit	Sub	Credit
(150)5210-235300 - Water lease agreement	$112.05		
5210-242000 - Expenses	112.95		
5210-430510620 - Interest		$112.95	
5210-101000 - Water operating cash			$225.00

(To record first payment of principal and interest on the maintenance vehicle lease. Ordinarily, this entry would be recorded as a part of the cash disbursement process. See amortization schedule that follows.)

PRESENT WORTH OF ONE DOLLAR PER PERIOD

PAYABLE AT END OF EACH PERIOD

Months	9% Nominal Annual Rate	92% Nominal Annual Rate	10% Nominal Annual Rate	102% Nominal Annual Rate	Months
1	0.9925 558 313	0.9921 455 147	0.9917 355 372	0.9913 258 984	1
2	1.9777 229 094	1.9764 982 370	1.9752 749 129	1.9740 529 352	2
3	2.9555 562 377	2.9531 193 752	2.9506 858 640	2.9482 556 978	3
4	3.9261 104 096	3.9220 696 571	3.9180 355 677	3.9140 081 267	4
5	4.8894 396 125	4.8834 093 332	4.8773 906 456	4.8713 835 209	5
6	5.8455 976 303	5.8371 981 810	5.8288 171 692	5.8204 545 437	6
7	6.7946 378 464	6.7834 955 082	6.7723 806 637	6.7612 932 279	7
8	7.7366 132 471	7.7223 601 570	7.7081 461 127	7.6939 709 818	8
9	8.6715 764 239	8.6538 505 071	8.6361 779 630	8.6185 585 941	9
10	9.5995 795 771	9.5780 244 800	9.5565 401 286	9.5351 262 395	10
11	10.5206 745 182	10.4949 395 419	10.4692 959 953	10.4437 434841	11
Years					
1	11.4349 126 731	11.4046 527 080	11.3745 084 251	11.3444 792 903	12
2	21.8891 461 374	21.7796 154 308	21.6708 548 343	21.5628 579 898	24
3	31.4468 052 513	31.2178 556 172	30.9912 355 853	30.7669 175 659	36
4	40.1847 818 852	39.8039 469 792	39.4281 600 915	39.0573 435 886	48
5	48.1733 735 210	47.6148 273 362	47.0653 690 238	46.5248 271 560	60
6	55.4768 487 987	54.7204 880 355	53.9786 654 781	53.2510 569 874	72
7	62.1539 645 614	61.1846 011 272	60.2366 673 594	59.3096 130 374	84
8	68.2584 385 567	67.0650 899 136	65.9014 884 480	64.7667 714 055	96
9	73.8393 815 990	72.4146 479 855	71.0293 549 100	69.6822 293 478	108
10	78.9416 926 690	77.2812 113 962	75.6711 633 697	74.1097 583 204	120
11	83.6064 201 276	81.7083 882 043	79.8729 860 841	78.0977 921 990	132
12	87.8710 919 527	85.7358 492 351	83.6765 282 329	81.6899 571099	144
13	91.7700 176 535	89.3996 835 607	87.1195 418 633	84.9255 486 669	156
14	95.3345 642 925	92.7327 218 849	90.2362 005 974	87.8399 618 366	168
15	98.5934 088 351	95.7648 307 314	93.0574 388 230	90.4650 781 326	180
16	101.5727 688 569	98.5231 800 700	95.6112 587 322	92.8296 143 759	192
17	104.2966 134 662	101.0324 867 800	97.9230 082 574	94.9594 368 354	204
18	106.7868 561 361	103.3152 361 317	100.0156 326 622	96.8778 441 854	216
19	109.0635 310 001	105.3918 832 718	101.9099 022 844	98.6058 223 765	228
20	111.1449 540 271	107.2810 365 164	103.6246 186 917	100.1622 742 056	240
21	113.0478 703 751	108.9996 240 957	105.1768 012 971	101.5642 260 987	252
22	114.7875 891 060	110.5630 458 436	106.5818 562 849	102.8270 143 674	264
23	116.3781 063 488	111.9853 111 918	107.8537 295 244	103.9644 529 767	276
24	117.8322 178 982	113.2791 647 047	109.0050 449 899	104.9889 846 594	288
25	119.1616 221 582	114.4562 002 803	110.0472 300 598	105.9118 170 306	300

PRESENT WORTH OF ONE DOLLAR PER PERIOD

PAYABLE AT END OF EACH PERIOD

Months	9% Nominal Annual Rate	92% Nominal Annual Rate	10% Nominal Annual Rate	102% Nominal Annual Rate	Months
26	120.3770 142 561	115.5269 650 404	110.9906 289 393	106.7430 451 905	312
27	121.4881 720 852	116.5010 538 404	111.8446 053 313	107.4917 621 573	324
28	122.5040 349 687	117.3871 952 467	112.6176 353 760	108.1661 583 380	336
29	123.4327 755 771	118.1933 297 510	113.3173 917 811	108.7736 111 255	348
30	124.2818 656 772	118.9266 809 231	113.9508 199 769	109.3207 656 018	360
31	125.0581 362 438	119.5938 201 398	114.5242 070 530	109.8136 072 301	372
32	125.7678 324 144	120.2007 254 688	115.0432 441 614	110.2575 273 315	384
33	126.4166 637 319	120.7528 352 371	115.5130 830 035	110.6573 820 619	396
34	127.0098 500 785	121.2550 967 625	115.9383 869 633	111.0175 455 349	408
35	127.5521 636 696	121.7120 106 849	116.3233 773 942	111.3419 576 712	420
36	128.0479 674 465	122.1276 712 959	116.6718 755 176	111.6341 672 982	432
37	128.5012 501 767	122.5058 032 263	116.9873 403 506	111.8973 709 722	444
38	128.9156 584 436	122.8497 948 219	117.2729 030 387	112.1344 479 457	456
39	129.2945 264 844	123.1627 285 055	117.5313 979 333	112.3479 916 646	468
40	129.6409 020 116	123.4474 083 975	117.7653 907 251	112.5403 381 384	480
41	129.9575 717 344	123.7063 854 434	117.9772 039 086	112.7135 914 945	492
42	130.2470 832 776	123.9419 802 718	118.1689 398 351	112.8696 469 959	504
43	130.5117 657 767	124.1563 039 890	118.3425 015 791	113.0102 117 738	516
44	130.7537 486 163	124.3512 770 963	118.4996 118 270	113.1368 235 023	528
45	130.9749 785 610	124.5286 466 991	118.6418 299 763	113.2508 672 197	540
46	131.1772 354 176	124.6900 021 620	118.7705 676 128	113.3535 904 794	552
47	131.3621 463 530	124.8367 893 511	118.8871 025 215	113.4461 169 975	564
48	131.5311 989 853	124.9703 235 895	118.9925 913 694	113.5294 589 454	576
49	131.6857 533 520	125.0918 014 444	119.0880 811 857	113.6045 280 221	588
50	131.8270 528 511	125.2023 114 483	119.1745 197 543	113.6721 454 274	600

Pages 5 and 6 are located
on the Excel Worksheet Labeled
<u>AMORTIZATION SCHEDULE</u>

LEASES

PROPRIETARY AND GOVERNMENTAL FUNDS – cont.

Enterprise Illustrative Accounting Entries – cont.

	Debit	Sub	Credit
(151)-5210-242000 - Expenses	$1,355		
5210-430510-830 - Depreciation expense		$1,355	
5210-189510 - Allowance for depreciation			$1,355

(To record the annual depreciation expense and allowance for depreciation on the maintenance vehicle lease agreement. It requires the preparation of a General Journal Voucher. Determined as follows):

$$\frac{\$13{,}550 \text{ Present Value of Lease}}{10 \text{ yr. Service Life}} = \$1{,}355 \text{ annual charge}$$

Governmental Funds

Concept Discussion

The scenario used in the enterprise lease example will also be used for governmental funds modified as necessary. The governmental setting, however, is the City's public works department and the applicable fund is the general fund. Both account groups are involved in the exercise as well.

Illustrative Accounting Entries

General Fund

	Debit	Sub	Credit	Sub
(152)-1000-242000 - Expenditures	$13,550			
1000-430200-900 - Capital outlay		$13,550		
1000-172000 - Revenue			$13,550	
1000-380XXX - Other financial sources $13,550				

(To record the capital lease transaction. It requires the preparation of a General Journal Voucher.)

General Fixed Assets Account Group

	Debit	Credit
(153)-9000-186000 - Equipment	$13,550	
9000-280000 - Invest. fixed assets		$13,550

(To record the capital lease asset. It requires the preparation of General Journal Voucher.)

LEASES

PROPRIETARY AND GOVERNMENTAL FUNDS – cont.

Governmental Funds – cont.

Illustrative Accounting Entries – cont.

General Fixed Assets Account Group

	Debit	Credit
(154)-9500-174300 – Amounts to be provided	$13,550	
9500-235300 - Lease agreement		$13,550

(To record the capital lease liability. It requires the preparation of a General Journal Voucher.)

General Fund

	Debit	Sub	Credit
(155)-1000-242000 - Expenditures	$225.00		
1000-432000-610 - Principal		$112.95	
1000-432000-620 - Interest		112.05	
1000-101000 - Cash			$225.00

(To record payment of principal and interest on lease. Ordinarily, this entry would be recorded as a part of the cash disbursement process.)

ACCOUNTING POLICIES

INTERFUND TRANSACTIONS

INTRODUCTION

Interfund transactions are an important part of fund accounting and often are difficult for external financial statement users to understand. Certain interfund transactions constitute fund revenues, expenditures or expenses in a strict fund accounting context, But are not revenues, expenditures or expenses of the reporting entity. Most interfund transactions are reported twice within the financial statements of a single reporting entity -- once in the fund that receives the assets and once in the fund that disburses the assets. NCGA Statement 1 addresses interfund transactions.

Interfund transactions can be divided into two main categories with various subcategories.

1. Revenues and expenditures/expenses
   A. Quasi-external transactions
   B. Reimbursements

2. Reallocations of resources
   A. Temporarily -- interfund loans and advances
   B. Permanently
      (1) Capitalized (contributed capital)
      (2) Liquidated (discontinued funds)
      (3) Consumed (operating subsidies)

These distinctions are important since the accounting and reporting for interfund transactions vary depending on the above analysis.

Quasi-External Transactions

Concept Discussion

A quasi-external transaction is one of two transaction types classified by NCGAS 1 which do not constitute transfers, but are appropriately accounted for as fund revenues, expenditures or expenses (payments for services). NCGAS 1 defines these transactions as those that would be treated as revenues, expenditures or expenses. The following are the most common examples of quasi-external transactions:

- Enterprise fund charges for goods or services to other funds based on actual costs incurred (the general fund receives an invoice for utility services from an enterprise fund).

- Internal service fund charges for goods or services to other funds usually based on actual costs incurred (the general fund receives an invoice for data processing services from the data processing internal service fund).

Quasi-External Transactions – CONT.

Illustrative Accounting Entries

The City of XYZ General Fund billed the Water Utility of the City $300, as administrative charges for the quarter ending June 30. The bill was approved and paid in the same fiscal year.

General Fund

	Debit	Credit	Sub
(156)-1000-101000 - Water operating cash	$300		
1000-172000 - Revenue		$300	
1000-341000 - Administrative charges			$300

(To record receipt of administrative charges as revenue. This entry would require the preparation of a General Journal Voucher.)

Water Utility (Enterprise Fund)

	Debit	Sub	Credit
(157)-5210-242000 - Expenses	$300		
5210-430510-390 - Administrative charges		$300	
5210-101000 - Cash			$300

(To record payment of the administrative charges as an expense. This entry would require the preparation of a General Journal Voucher.)

ACCOUNTING POLICIES

INTERFUND TRANSACTIONS

REIMBURSEMENTS

Concept Discussion

NCGAS 1 defines reimbursements as transactions that constitute repayments to a fund for expenditures/expenses initially made from it that are properly applicable to another fund. For example, expenditure properly chargeable to a special revenue fund is made initially by the general fund. The amount of this transaction subsequently is reimbursed by the special revenue fund and, therefore, should be recorded as an expenditure in the special revenue fund (the reimbursing fund) and as a reduction of an expenditure in the general fund (the fund that is reimbursed).

A transaction would be reported as a reimbursement when an accounting error has been made or when a single fund, usually the general fund, pays a bill or payroll for other funds, and then charges back the expenditure/expense to the appropriate individual fund where the cost should be reported. For example, the invoice for telephone services might be paid from general fund resources and then an allocation of the actual or estimated costs by individual fund would be made and would be reimbursed at a later date by the individual funds. This type of interfund transaction occurs as a matter of convenience or expediency rather than as a correction of an error. In addition, the original disbursing fund (the general fund) has not provided any service other than a temporary loan. If the cash reimbursement does not occur prior to the preparation of financial statements, the reimbursement should be reported with the appropriate receivable/payable account adjusted. However, all efforts should be made to eliminate these receivables and payables at year-end.

On occasion, governments provide services from one fund to another and classify the payment as reimbursement revenue. This occurs most often when the general fund charges other funds for services rather than using an interfund service fund for this activity. If the intent is to provide the service by the general fund to the user fund, the transaction revenue should be classified as charges for services rather than reimbursements. However, this type of transaction could be reported as a reimbursement as described above (credited to the appropriate expenditure account). Therefore, if a transaction is reported as a reimbursement, the reimbursement caption should not appear as a revenue source on the operating statement.

Local governments receive a number of intergovernmental type revenues from the state that are commonly referred to as reimbursements. Some of them include the proceeds received for the state assumption of district court expenses, and those received for the support of the county assessor and related staff. While the basis for these payments may well be on some reimbursable formula, the proceeds that result are, under NCGA statement 1, considered revenues to recipient governments.

Statement 1, succinctly, points out that the term reimbursements has to do with only interfund transactions; and that so called reimbursements received from outside parties are, consequently, revenues and not reductions to expenditures.

REIMBURSEMENTS – cont.

Illustrative Accounting Entries

The general fund of the County of XYZ paid for gas and oil that was actually used by the special revenue road fund. The amount charged to the general fund as an expenditure was $500. The general fund was reimbursed by the special revenue road fund the month in which the expenditure was made.

Special Revenue Road Fund

	Debit	Sub	Credit
(158)-2110-242000 - Expenditures	$500		
2110-430XXX-230 - Repairs & maintenance		$500	
2110-101000 - Road fund cash			$500

(To record reimbursement to the general fund as a road fund expenditure. It requires the preparation of a General Journal Voucher.)

General Fund

	Debit	Credit	Sub
(159)-1000-101000 - General fund cash	$500		
1000-242000 - Expenditures		$500	
1000-410XXX-230 - General government			$500

(To record reimbursement from the special revenue road fund as a general fund expenditure reduction. It requires the preparation of a General Journal Voucher.)

INTERFUND TRANSACTIONS

INTERFUND LOANS AND ADVANCES

Concept Discussion

NCGAS 1 does not specifically address interfund loans. However, it is recommended that if material interfund loans are made, the governing body of the reporting entity should authorize the loans, including the amount, the estimated dates of repayment and whether or not interest costs will be charged.

Short-term loans from one individual fund to another fund or the current portion of long-term loans should not be classified as due from/to other funds since goods were not sold and services were not rendered. The suggested caption is interfund loans receivable/payable.

Another caption, advance from/to other funds, is an asset or liability account used to record the non-current portions of long-term loans between funds within the same reporting entity. Non-current portions of long-term receivables due to governmental funds, classified as advances to other funds, are reported on the governmental fund's balance sheet without regard to the spending measurement focus. However, special reporting treatments are used to indicate that advances to other funds should not be considered available spendable resources, since they do not represent net current assets. The non-current portions of long-term loans receivable should be offset by a fund balance reserve account (250200).

A practical problem occurs regarding the reporting of an advance payable as a long-term liability in a governmental fund type. NCGAS 1 states that all long-term debt of governmental funds should be reported in the GLTDAG. However, it seems clear that NCGAS 1 contemplated that long-term debt from agencies outside the reporting entity would be undertaken for the benefit of the governmental funds, but did not contemplate long-term advances between governmental funds. NCGAS 1 implies that the GLTDAG is to be used for debt of the reporting entity (payable to third parties), not for debt due from one fund to another. Therefore, advance payable should be reported as a fund liability and not reported as a liability in the GLTDAG. Even though this reporting may appear to conflict with the measurement focus used for governmental funds, this treatment is necessary for accurate financial reporting. Reporting long-term advances in the GLTDAG might mislead the report reader to interpret these advances as obligations to other entities based on an arms-length transaction. In addition, the fund balance (the excess of assets over liabilities) of the fund receiving the advance, and for the reporting entity overall, would be increased artificially by the amount of the advance.

INTERFUND LOANS AND ADVANCES – cont.

Illustrative Accounting Entries

The City of XYZ general fund loaned the road (special revenue) fund $15,000, on authorization of the governing body. The interest free loan was made on January 1, to be repaid in three equal installments on June 30, of each succeeding year.

General Fund

	Debit	Credit
(160)-1000-120XXX - Interfund receivable	$ 5,000	
1000-130XXX - Advances	10,000	
1000-101000 - Cash		$15,000

(To record the current portion of the loan as an interfund receivable and the noncurrent portion as an advance. It requires the preparation of a General Journal Voucher.)

	Debit	Credit
(161)-1000-271000 - Unreserved fund balance	$10,000	
1000-250200 - Reserve for loan		$10,000

(To establish a reserve for the non-current portion of the receivable. It requires the preparation of a General Journal Voucher.)

Road Special Revenue Fund

	Debit	Credit
(162)-2110-101000 - Cash	$15,000	
2110-210XXX - Interfund payable current		$ 5,000
2110-233000 - Advances		10,000

(To record the current portion of the loan as an interfund payable and the non-current portion as an advance. It requires the preparation of a General Journal Voucher.)

INTERFUND TRANSACTIONS

TRANSFERS

Concept Discussion

With the implementation of GASB Statement No. 34, there is no distinction or special treatment of transfers based on the nature (operating versus residual equity).

Prior to this time, NCGAS 1 defined residual equity transfers as nonrecurring or non-routine transfers of equity between individual funds. These transfers apply to capitalized assets and discontinued funds. Special reporting treatment is no longer required for these type of transfers. They are simply reported as transfers along with those considered to be operating. Although not referred to as residual equity, the nature of such transfers would related to the establishment of a new fund, with initial capital provided by another fund (the general fund) and the transfer of residual balances of discontinued individual funds to one or more other individual funds.

Operating transfers represents transfers that are made between funds in the normal course of business. With a few exceptions, operating transfers should be reported consistently and the total of the operating transfers in should agree with the total of the operating transfers out between and among the financial statements. Operating transfers are reported as other financing sources or uses in governmental fund type operating statements. Operating transfers in and out should be reported separately and should not be netted.

Illustrative Accounting Entries

The County of XYZ subsidies hospital/nursing home activities with a tax levy. The hospital/nursing home activities were accounted for as an enterprise fund; however, it was not the intent of the governing body to recover all costs through user charges. The proceeds from the tax levy were placed in a special revenue fund and transferred periodically to the enterprise fund. At year-end, $5,000 was transferred out of the special revenue fund to the enterprise fund.

Special Revenue Fund

	Debit	Sub	Credit
(163)-2XXX-242000 - Expenditures	$5,000		
2XXX-521000-820 - Transfer-out		$5,000	
2XXX-101000 - Cash			$5,000

(To record operating transfer-out. It requires the preparation of a General Journal Voucher.)

Enterprise Fund

	Debit	Credit	Sub
(164)-5XXX-101000 - Cash	$5,000		
5XXX-172000 - Revenue		$5,000	
5XXX-383000 - Transfer-in			$5,000

(To record operating transfer-in. It requires the preparation of a General Journal Voucher.)

JOINT VENTURES

PROPRIETARY AND GOVERNMENTAL FUNDS

Concept Discussion

Joint ventures are created by governments for special purposes and are responsible to the public, investors, creditors, the management of the government and the users served by the joint venture.

A joint venture is a legal entity or other contractual arrangement participated in by a government as a separate and specific activity for the benefit of the public or service recipients in which the government retains an ongoing financial interest (i.e., an equity interest in either assets or liabilities) and/or responsibility.

Financial reporting by participant governments for joint ventures should conform to the following:

1. Proprietary Funds
   The joint venture should be included in the investing funds financial statements using the equity method of accounting.

2. Governmental Funds
   The joint venture should be disclosed in the notes to the financial statements, if not reported utilizing the equity method of accounting.

The notes to the financial statements should contain the following disclosures for both proprietary and governmental fund joint ventures:

a. A general description of each joint venture, including:
   1. Identifying the participants and their shares.
   2. Describing the arrangements for selecting the governing body or management.
   3. Disclosing the degree of control the participants have over, budgeting and financing.

b. Condensed or summary financial information on each joint venture, including:
   1. Balance sheet date.
   2. Total assets, liabilities, and equity.
   3. Total revenues, expenditures/expenses, other financing sources (uses), and net increase (decrease) in fund balance/retained earnings.
   4. Reporting entity's share of assets, liabilities, equity, and changes therein during the year, if known.

c. Joint venture debt, both current and long-term, and the security for the debt.

PROPRIETARY AND GOVERNMENTAL FUNDS – cont.

Concept Discussion – cont.

The equity method of accounting for joint ventures, as described in APB No. 18 (Equity Method for Investments in Common Stock) should be followed, even though there is no common stock issued. The equity method is defined by this pronouncement in the following manner:

> A method of accounting for an investment under which an investor initially records an investment in the stock of an investee at cost, and adjusts the carrying amount of the investment to recognize the investor's share of the earnings or losses of the investee after the date of acquisition. The amount of the adjustment is included in the determination of net income by the investor and such amount reflects adjustments similar to those made in preparing consolidated statements including adjustments to eliminate intercompany gains and losses, and to amortize, if appropriate, any difference between investor cost and underlying equity in net assets of the investee at the date of investment. The investment of an investor also is adjusted to reflect the investor's share of changes in the investee's capital. Dividends received from an investee reduce the carrying amount of the investment. Under the equity method, an investment in common stock is generally shown in the balance sheet of an investor as a single amount. Likewise, an investor's share of earnings or losses from its investment is ordinarily shown in its income statement as a single amount.

Simply put, this means that the initial investment in a joint venture should be recorded based on the value of the resources contributed to the joint venture by each participating enterprise fund. And when the joint venture determines its income or loss for the period, each participating enterprise fund increases or decreases its investment account and recognizes its share of the joint venture's net income or loss.

If the joint venture distributes assets to the participants, the carrying value of the investment in the joint venture should be reduced. And if the joint venture incurs substantial losses that reduce the participants' investment to zero, the equity method should not be used to account for subsequent losses sustained by the joint venture unless each enterprise fund is responsible for financing deficits or guaranteeing loans held by the joint venture.

JOINT VENTURES– cont.

PROPRIETARY AND GOVERNMENTAL FUNDS – cont.

Policy and/or Procedural Steps

1. A formal agreement should be executed for each joint venture by the participating governments.

2. Each agreement should contain the purpose of the joint venture and spell-out the ongoing financial interest and/or responsibility for each participant government.

Enterprise - Illustrative Accounting Entries

a. The Tri-Cities of A, B & C formed a joint venture for the purpose of operating a central water pumping plant.

b. An agreement was executed and signed by the participating governments.

c. The agreement requires that the participating governments share equally the ongoing financial interest and responsibility.

d. The initial investment for each participating government was $200,000.

e. In the first year of operations, the joint venture's net income was $6,000, and in the second year of operations it sustained a net-loss of $3,000.

	Debit	Credit
(165)-5210-160000 - Investment in joint venture	$200,000	
5210-101000 - Water operating cash		$200,000

(To record initial investment in the joint venture. Ordinarily, this entry would be -made as a part of the cash disbursement process. A similar entry would be made by each participating government.)

	Debit	Credit	Sub
(166)-5210-160000 - Investment in joint venture	$2,000		
5210-172000 - Revenue		$2,000	
5210-343027 - Miscellaneous water revenue			$2,000

(To record return on the joint venture, by increasing the investment in the joint venture and a corresponding offset to revenue. It is based on a one-third interest in the net income of the joint venture for the first year of operations. No distribution of joint venture assets is actually made. The entry requires the preparation of a General Journal Voucher. A similar entry would be made by each participating government.)

PROPRIETARY AND GOVERNMENTAL FUNDS – cont.

Enterprise - Illustrative Accounting Entries – cont.

	Debit	Sub	Credit
(167)-5210-242000 - Expenses	$1,000		
5210-430560-811 - Losses		$1,000	
5210-160000 - Investment in joint venture			$1,000

(To record the loss sustained on the joint venture, by increasing expenditures and decreasing the investment in the joint venture. By agreement, losses sustained by the joint venture must be equally shared by participating governments. This loss was sustained in the second year of operations. The entry requires the preparation of a General Journal voucher. A similar entry would be made by each participating government.)

SUBSEQUENT CHANGES IN ACCOUNTING FOR JOINT VENTURES

GASB Statement 14, effective for periods beginning after December 15, 1992, requires major changes in accounting for joint ventures. This statement distinguishes between joint ventures and other organizations that appear similar. A further distinction is made between joint ventures in which there is an equity interest and joint ventures in which there is no equity interest. A different level of reporting is required for each of the situations. In addition, other types of arrangements with two or more participants are discussed.

A joint venture is defined as a legal entity or other organization that results from a contractual arrangement and that is owned, operated, or governed by two or more participants as a separate and specific activity subject to joint control, in which the participants retain (a) an ongoing financial interest or (b) an ongoing financial responsibility. Generally, the purpose of a joint venture is to pool resources and share the costs, risks, and rewards of providing goods or services to the venture participants directly, or for the benefit of the general public or specific service recipients. Joint control means that no single participant has the ability to unilaterally control the financial or operating policies of the joint venture. If the organization is jointly controlled but the participants do not have an ongoing financial interest or ongoing financial responsibility, it is a jointly governed organization, rather than a joint venture.

Ongoing Financial Interest

An ongoing financial interest in a joint venture includes an equity interest, and any other arrangement that causes a participating government to have access to the joint venture's resources. Access to the joint venture's resources occurs directly, such as when the joint venture pays its surpluses to the participants, or indirectly, such as when the joint venture undertakes projects of interest to the participants. For example, indirect access occurs when the participating governments are able to influence the management of the joint venture so that the joint venture uses its surplus resources to undertake special projects for the participants' citizenry.

SUBSEQUENT CHANGES IN ACCOUNTING FOR JOINT VENTURES – cont.

Ongoing Financial Responsibility

A participating government has an ongoing financial responsibility for a joint venture if it is obligated in some manner for the debts of the joint venture, or if the joint venture's continued existence depends on continued funding by the government. Often, joint ventures are created by two or more governments to provide goods or services directly to the governments or to provide goods or services to their constituencies on behalf of the governments. Consequently, a participating government is responsible for financing the operations of the joint venture, either by purchasing the joint venture's goods or services for its own use or by subsidizing the provision of the joint venture's services to the citizenry. For example, if a city/county public safety operation and facility is dependent on ongoing funding by the city and the county, the city and the county both have an ongoing financial responsibility. Similarly, the continued existence of a regional sewer utility that provides sewage treatment services to three cities (in relatively equal proportions) is dependent on the ongoing revenues from each of the three cities; therefore, each of the cities has an ongoing financial responsibility. On the other hand, an electric utility cooperative that generates power for sixteen cities (in relatively equal proportions) does not depend on the revenues from any single participant to continue in existence. Thus, one can conclude that none of the sixteen participants has a financial responsibility for the utility, unless one or more of the participants is obligated in some manner for the debt of the utility.

Equity Interest

For financial reporting purposes, there are two types of joint ventures: (a) joint ventures whose participants have equity interests and (b) joint ventures whose participants do not have equity interest. An equity interest in a joint venture is manifest in the ownership of shares of joint venture stock or by otherwise having an explicit, measurable right to the net resources of a joint venture that is usually based on an investment of financial or capital resources by a participating government. An equity interest may not change over time as a result of an interest in the net income or loss of the joint venture. An equity interest is explicit and measurable if the joint venture agreement stipulates that the participants have a present or future claim to the net resources of the joint venture and sets forth the method to determine the participants' shares of the joint venture's net resources. If the government has an equity interest in the joint venture, that equity interest should be reported as an asset of the fund that has the equity interest.

SUBSEQUENT CHANGES IN ACCOUNTING FOR JOINT VENTURES – cont.

Reporting on Joint Ventures In Which There Is An Equity Interest

Proprietary Funds The investment in joint venture account reported in a proprietary fund should report the participating government's equity interest calculated in accordance with the joint venture agreement. Initially, the investment in the joint venture should be reported at cost. If the joint venture agreement provides for the participating government to share in the operating results of the joint venture, the equity interest should be adjusted for the participant's share of the joint venture's net income or loss, regardless of whether the amount is actually remitted. In calculating the participant's share of the net income or loss of the joint venture, any profit on the operating transactions between the proprietary fund and the joint venture should be eliminated. Non-operating transactions between the joint venture and the proprietary fund should increase or decrease the equity interest. The equity interest should be reported in the proprietary fund's balance sheet as a single amount, and the fund's share of the joint venture's net income or loss should be reported in its operating statement as a single amount.

Governmental Funds Because the equity interest in a joint venture generally represents equity primarily in capital assets and otherwise does not meet the definition of a financial resource, it is inappropriate to report the entire net investment in joint venture as an asset in a governmental fund. All or a portion of the equity interest should be reported in the general fixed assets account group (GFAAG). The participating government's total equity interest should be calculated in accordance with the joint venture agreement. The amount that should be reported in the GFAAG is the total equity interest adjusted for any portion of the equity interest that is included in the balance sheet of a governmental fund. For example, if the general fund reports an amount payable to, or receivable from, the joint venture, the net investment account in the GFAAG should be adjusted by that amount. Thus, the combination of amounts reported in the governmental funds and in the GFAAG should equal the total equity interest in the net assets of the joint venture. Governmental fund operating statements should report changes in joint venture equity interests only to the extent that the amounts received or receivable from the joint venture or the amounts paid or payable to the joint venture satisfy the revenue or expenditure recognition criteria for governmental funds.

JOINT VENTURES– cont.

SUBSEQUENT CHANGES IN ACCOUNTING FOR JOINT VENTURES – cont.

Disclosure Requirements For Joint Venture Participants

Regardless of whether there is an equity interest, joint venture participants should make these disclosures in the notes to the financial statements:

a. A general description of each joint venture, including:
   (1) Description of the participating government's ongoing financial interest (including its equity interest, if applicable) or ongoing financial responsibility. This disclosure should also include information to allow the reader to evaluate whether the joint venture is accumulating significant financial resources or is experiencing fiscal stress that may cause an additional financial benefit to or burden on the participating government in the future.
   (2) Information about the availability of separate financial statements of the joint venture.

b. The participating government should also disclose any other information required by GASB Cod. Sec. 2300.105f (related party transactions).

Joint Building of Finance Authorities

Because of the accounting requirements for capital leases, some joint ventures are, in substance, the same as undivided-interest arrangements except that a formal organization is created. Depending on the specific language of the joint venture agreement, there may or may not be an equity interest in the joint authority (a debt service reserve, for example). A common example is a joint building authority whose sole purpose is to construct or acquire capital assets for the participating governments and subsequently lease the facilities to the governments. In accounting for these capital lease arrangements, the participating governments already should have reported their respective shares of the assets, liabilities, and operations of the joint venture. As a result, it is unnecessary to calculate and report a participant's equity interest (if any) in the joint building authority. Similarly, the above disclosures are not required because they would duplicate other disclosures required in GASB Cod. Sec. L20 (leases).

Jointly Governed Organizations

The laws in many states provide for the creation of regional governments or other multi-governmental arrangements that are governed by representatives from each of the governments that create the organization. These organizations may appear similar to joint ventures -- they provide goods or services to the citizenry of two or more governments - -but many do not meet the definition of a joint venture because there is no ongoing financial interest or responsibility by the participating governments. If a participant does not retain an ongoing financial interest or responsibility in the organization, only the disclosures in the paragraph above are required.

SUBSEQUENT CHANGES IN ACCOUNTING FOR JOINT VENTURES – cont.

Component Units And Related Organizations With Joint Characteristics

An organization may have several participants, but if one participating government appoints a voting majority of the organization's governing body (and joint control is precluded because that participant has the power to make decisions unilaterally), the organization is either a component unit or a related organization of that participating government and should be reported in that participating government's financial statements. However, the other (minority) participants should report their participation in the organization in accordance with the requirements for proprietary funds and jointly governed organizations. The organization itself, when included as a component unit in the majority participant's financial reporting entity, should report any equity interest of the minority participants as fund balance or retained earnings reserved for minority interest. In addition, there may be instances where a jointly controlled organization (such as a regional government) is considered a component unit of one of the participating governments because it is fiscally dependent on that participating government. This type of organization should be reported by all participants in the manner described earlier in this paragraph.

Pools

A pool is another multi-jurisdictional arrangement that has the characteristics of a joint venture, but has additional features that distinguish it for financial reporting purposes. For example, an investment pool generally has open membership; that is, governments are free to join, resign, and increase or decrease their participation in the pool without the knowledge or consent of the other participants. Furthermore, a participant's equity interest in the pool (for example, its share of investments in an investment pool) should already be recognized in its financial statements; thus, calculating and reporting an equity interest would be redundant. Additionally, because of the broad based, constantly changing membership shares in a pool, the required disclosures would likely not provide useful information and are, therefore, not required. Entities participating in a public entity risk (insurance) pool should follow the accounting and reporting guidance provided in GASB Cod. Sec. C50 (Claims and Judgments).

SUBSEQUENT CHANGES IN ACCOUNTING FOR JOINT VENTURES – cont.

Undivided Interests

An undivided interest (also known as a joint operation) is an arrangement that resembles a joint venture but no entity or organization is created by the participants. An undivided interest is an ownership arrangement in which two or more parties own property in which title is held individually to the extent of each party's interest. Implied in that definition is that each participant is also liable for specific, identifiable obligations (if any) of the operation. Because an undivided interest is not a legal entity, borrowing to finance its operations often is done individually by each participant. An additional consequence of the absence of a formal organizational structure is that there is no entity with assets, liabilities, expenditures/expenses, and revenues -- and thus, equity – to allocate to participants. A government participating in this type of arrangement should report its assets, liabilities, expenditures/expenses, and revenues that are associated with the joint operation. Reporting disclosures are not required for undivided interests. Some joint venture agreements may result in hybrid arrangements; they create separate organizations but provide for undivided interests in specific assets and liabilities and equity interests in the other net resources of the organization. In these situations, the participants should report their undivided interest in accordance with the provisions of this paragraph and their equity interest in accordance with proprietary funds and governmental funds.

Cost-Sharing Arrangements

Cost-sharing projects (such as highway projects financed by federal, state, and local governments) should not be considered joint ventures because the participating governments do not retain an ongoing financial interest or responsibility in the projects. Joint purchasing agreements, in which a group of governments agree to purchase a commodity or service (for example, water or electricity) over a specified period of time and in specified amounts, also should not be considered joint ventures. In addition, multiple-employer PERS are not considered joint ventures. Reporting and disclosure requirements for multiple-employer PERS are included in GASB Cod. Sec. Pe5 (Pension Funds -- Accounting) and Pe6 (Pension Funds -- Disclosure).

REFUNDS

GAAFR defines a refund, for the most part, as an amount paid back because of an over collection or because of the return of an object sold; or to pay back an amount because of an over collection or because of the return of an object. Refunds are, perhaps, more akin to external governmental transactions than they are to interfund governmental transactions. Authoritative guidance on the subject is, however, sparse.

The above definition seems to present two situations, one where a government would be the receiver of cash, and the other where a government would be the payer of cash. In the first instance, any related transactions would be treated as offsets to expenditures, and in the other instance the transactions would be treated as offsets to revenues - insofar
as the current year is concerned. Like transactions occurring in subsequent periods, however, would be treated as increases to expenditures and/or to revenues - so long as the amounts were not material. In that event, material transactions would be treated as prior period adjustments.

THE CHECK/WARRANT

Concept Discussion and Procedural Steps

Under Section 7-6-4302, a city or a town is allowed to pay its accounts and demands by check or warrant. However, a check can only be used when there are sufficient funds on deposit to cover the check. (No such statutory option exists for a county). A check is defined as a bill of exchange, a negotiable instrument, drawn on a bank and payable on demand. A warrant, on the other hand, is not a negotiable instrument it is merely a promise to pay when money is or becomes available and is drawn on the treasury of the government.

There are obvious advantages when the check/warrant can be used as a check. For example, it can be charged directly against the appropriate cash fund account at the time of its issuance. And, it need not be redeemed by the issuance of another instrument as does a warrant. Its use also eliminates the need to establish interim warrant accounts and reduces related accounting entries. The use of the so-called check/warrant is not new in concept. Traditionally, the check/warrant has been used by towns and done so successfully.

When the check/warrant cannot be used as a check, its character becomes that of warrant and it must be so treated. Routinely, warrants are issued and redeemed when money is available. But, when money is not available such warrants must be registered and paid in order of their registration.

The most viable alternative to the continual registration of warrants, internally and externally, is the issuance of tax and revenue anticipation notes, authorized under Section 17-5-1606. The notes may be sold at public or private sale. Most are sold at private sale to the Montana Economic Development Board via the Municipal Finance Consolidation Act.

Illustrative Accounting Entries

The City of XYZ issued and sold $50,000, of tax and revenue anticipation notes, at six percent interest, on August 1. The City redeemed all such notes on February 1, including the payment of interest thereon.

	Debit	Credit
(168)-1000-101000 - Cash	$50,000	
1000-204XXX - Notes payable		$50,000

(To record proceeds received on the sale of tax and revenue anticipation notes. Ordinarily, this entry would be recorded as a part of the cash receipt process.)

THE CHECK/WARRANT – cont.

Illustrative Accounting Entries – cont.

	Debit	Sub	Credit
(169)-1000-204XXX - Notes payable	$50,000		
1000-242000 - Expenditures	1,500		
1000-490500-620 - Interest		$1,500	
1000-101000 - Cash			$51,500

(To record payment of the tax/revenue anticipation notes and related interest expense. Ordinarily, this entry would be recorded as a part of the cash disbursement process.)

THE GENERAL JOURNAL VOUCHER

Concept Discussion and Procedural Steps

The General Journal Voucher is a form used for the recording of certain transactions or information in place of, or supplemental to, regular journals or registers. It is most often employed in the recording of accruals, the correction of errors, the internal transfer of funds, and in yearend adjusting and closing entries.

The use of journal vouchers is a substitute for maintaining a formal General Journal. They make possible the grouping of similar entries for direct posting to the General Ledger and provide written authorization for such entries. Each journal voucher, after being posted to the General Ledger, should be filed and properly maintained -- since it is considered a permanent accounting record.

A General Journal Voucher must embody certain basic information, i.e.:

1. A consecutive number.

2. The dual effect of the accounting transaction(s).

3. Appropriate General Ledger and Subsidiary Ledger account references.

4. Explanations and references to documentary evidence supporting the entry or entries.

5. Dates of issuance and that of recording.

6. Signatures or initials of those authorized to prepare and approve such journal voucher. (Approval should take place prior to recording.)

An example of a General Journal voucher (BARS Standard Form D21) is reproduced on the following page.

City/County of____

GENERAL JOURNAL VOUCHER

DATE ISSUED ________________ ACCOUNTING COPY VOUCHER NO.__________

DATE OF RECORD ______________

Fund Number	Account Number	Description		Debit				Credit			
				General Ledger		Subsidiary Ledger		General Ledger		Subsidiary Ledger	

Explanatory Memorandum: ____

____

____

____

Prepared by:______ ______________________________________

Approved by: ______________________

07/04

ACCOUNTING POLICIES

THE TRIAL BALANCE

Concept Discussion and Procedural Steps

The trial balance is simply a list of balances of the accounts in a ledger kept by double entry. The purpose of which is to determine the equality of the posted debits and credits and/or establish a basic summary for financial statements.

Where the accounting system is automated, the taking of the trial balance merely requires the running of the trial balance program for each fund. If the totals of the debit and credit columns (for each fund) are equal, the general ledger is said to be in balance.

In the manual system environment, the taking of the trial balance is normally done in one of the following ways:

1. By preparing a worksheet, listing the (general ledger) debit and credit balances (for each fund) in separate columns. If the totals of the debit and credit columns (for each fund) are equal, the ledger from which the figures were taken is said to be in balance.

2. By separate adding machine tape runs of the (general ledger) debit balances and credit balances (of each fund). If the debit tape totals and the credit tape totals (for each fund) are equal, the ledger from which the figures were taken is said to be in balance.

3. By an adding machine tape run, where all of the (general ledger) debit balances are added and all credit balances are subtracted therefrom (for each fund). If the tapes (for each fund) result in a zero balance, then the ledger from which the figures were taken is said to be in balance.

When the general ledger accounts do not balance, there are some devices that can be employed in locating the more common types of errors; those include:

1. A recheck of the trial balance items with the account balances appearing in the ledger, and a refooting of the trial balance columns (Manual System).

2. A difference equal to a single digit may be caused by errors of addition in the ledger; a recheck of the ledger additions and balances since the last correct trial balance may disclose it (Manual System).

3. Where the difference is divisible by 2, a posting equal to one-half the difference may have been made on the wrong side of the ledger (Automated and Manual Systems).

4. The difference may indicate a posting completely omitted (Automated and Manual Systems).

ACCOUNTING POLICIES

CHECKLIST FOR YEAR-END CLOSING ENTRIES

GENERAL

1. Review year-end budget to actual expenditure report for budget overdrafts. Cover budget overdrafts by a resolution of the governing body authorizing the transfer of appropriations per Section 7-6-4031, MCA. However, total budget appropriations should remain the same within each fund.

2. Verify that Operating Transfers In (383XXX) equal Operating Transfers Out (521XXX) within all funds.

3. Verify that interfund loans receivable (13XXXX) equal interfund loans payable (211XXX or 233XXX).

4. Verify that the trial balance for each fund is in balance.

5. Verify that the expenditure detail is equal to the expenditure control (242000), and that the revenue detail is equal to the revenue control (172000) in those systems where control accounts are used.

6. Taxes/Assessments Receivable

   A. Reconcile all taxes/assessment receivable accounts (11XXXX) with the County Treasurer's receivables, including protested taxes.

   B. Adjust deferred revenue accounts (223XXX) to the corresponding receivable accounts for real, personal, protested and special assessments, and offset to the appropriate revenue accounts. (Do not defer taxes for proprietary funds.)

   C. Reconcile the deferred assessment receivable account (119000) for each S.I.D. district with the future year's principal assessments. (Verify that all prepaid assessments have been deducted from the deferred assessment receivable account.)

GOVERNMENTAL FUNDS AND ACCOUNT GROUPS

1. Review payroll and claims expenditures for possible accruals, if deemed material. This would include any goods or services received prior to the end of the fiscal year. Also, review debt service funds for accruing any bond interest payable at year-end or for bond principal payable within the next fiscal year. (Reclassify principal from general long-term debt account group to short-term payable of debt service fund.)

CHECKLIST FOR YEAR-END CLOSING ENTRIES- cont.

GOVERNMENTAL FUNDS AND ACCOUNT GROUPS – CONT.

2. Review revenue accounts for possible accruals, if deemed material. But, keep in mind that these revenues must meet the revenue recognition criteria of measurable and available. Revenue for federal and/or state grants that are reimbursed upon expenditure, should be recognized when the expenditure is made. (Some revenue susceptible to accrual may be interest on investments, state shared revenue, P & I on delinquent taxes, etc.)

3. If inventory of supplies is deemed material, establish or adjust inventory account (15XXXX) and offset to reserve for inventory of supplies (250100).

4. Capital assets purchased by governmental funds, including infrastructure, should be added to the general fixed asset account group (GFAAG). Any assets traded-in or disposed of should be deleted. The balance in this account group should be reconciled with the fixed asset inventory. Depreciation is required to be recorded in the GFAAG for all assets other than land and construction in progress at the functional level if possible. **(Note: The GFAAG is no longer required to be reported under GASB #34 but is maintained to generate information for the government-wide statements)**

5. Prepare worksheet on unused vacation, sick leave, compensatory time and employer's related payroll obligation. Adjust compensated absences payable account within the general long-term debt account group (GLTDAG). **(Note: The GLTDAG is no longer required to be reported under GASB #34 but is maintained to generate information for the government-wide statements)**

6. Adjust the appropriate long-term liability account (GLTDAG) for principal paid from governmental funds on contracts, loans, lease-purchase agreements, general obligation bonds and/or special improvement district (S.I.D.) bonds. Also for revenue bonds, if payments are made from governmental funds.

7. Adjust the appropriate amount available account (173XXX) in GLTDAG to the corresponding fund balance in the debt service fund types (3XXX) for general obligation bonds and special improvement district (S.I.D.) bonds.

8. Adjust appropriate amount to be provided account (174XXX) for all long-term liability accounts within GLTDAG. This includes contracts, notes, lease purchases, compensated absences, G.O. bonds and S.I.D. bonds payable.

9. Close out revenue and expenditure accounts to fund balance (271000).

CHECKLIST FOR YEAR-END CLOSING ENTRIES- cont.

PROPRIETARY FUNDS

1. If interim revenue accounts are used for bond/loan proceeds and/or capital grants, close these accounts to the appropriate general ledger account. (23XXXX for bond/loan proceeds and 26XXXX for contributions.)

2. If interim expense accounts are used for fixed asset acquisition or principal payments, close these accounts to the appropriate general ledger account. (18XXXX for fixed asset purchases and 23XXXX for principal payments.)

3. Prepare journal vouchers for accrual of revenue and/or expenses, if deemed material.
   a. Utility charges
   b. Interest receivable on investments
   c. Other revenue accruals
   d. Claims payable
   e. Payroll payable
   f. Interest payable
   g. Reclassify long-term payable to short-term
   h. Prepaid expenses

4. Reconcile accounts receivable and deposits payable with detail of customer records.

5. If inventory of supplies is deemed material, adjust inventory and offset to supply expense account(s).

6. Reconcile appropriate capital asset account with capital asset schedules. Adjust for assets traded in, sold or disposed of.

7. Prepare depreciation schedule for fiscal year. Prepare journal voucher for depreciation expense for each proprietary fund.

8. Adjust reserved retain earnings accounts (25XXXX) to agree with appropriate restricted cash accounts (102XXX).

9. Determine the changes in closure and postclosure costs and liability for the solid waste fund and adjust the necessary accounts appropriately. (Determined from an new engineer's estimate).

10. If interest expense is to be capitalized for assets constructed with tax exempt borrowings, close appropriate interest earnings/interest expense on borrowings to the appropriate asset account. (Limited to construction period only.)

11. Adjust compensated absences payable per schedule and offset to payroll expense.

12. Close revenue and expense accounts to retained earnings (272000).

CAPITAL ASSET SYSTEM POLICY GUIDELINES

DISCUSSION OF GASB STATEMENT NO. 34

Governmental Accounting Standards Board (GASB) Statement No. 34, when implemented, will require prospective reporting of general infrastructure in the statement of net assets at the effective dates of the Statement. Retroactive reporting of all major general infrastructure assets is encouraged at that date. Phase 1 governments as described in paragraph 143 should retroactively report all major general infrastructure assets for fiscal years beginning after June 15, 2005. Phase 2 governments should retroactively report all major general infrastructure assets for fiscal years beginning after June 15, 2006. Phase 3 governments are encouraged but are not required to report major general infrastructure assets retroactively.

CAPITALIZATION THRESHOLD CONSIDERATIONS

In recent years, more and more governments have come to reexamine their capitalization thresholds. Often cost/benefit considerations lead governments to conclude that a higher capitalization threshold may be appropriate in their circumstances. Indeed, the GFOA recently issued a recommended practice that urges governments to refrain from using capitalization thresholds of less than $1,000 for any individual item. When a government decides to apply a new capitalization threshold, it should remove all existing fixed assets that no longer qualify under the new threshold. For example, if a government chooses to raise its capitalization threshold from $500 to $2,000, all assets valued between $500 and $2,000 should be removed from the GFAAG. Such a change in the capitalization threshold should be reported as an adjustment to the beginning balance of fixed assets reported in the schedule of changes in fixed assets presented in the notes to the financial statements.

Inadequate capital asset records continue to be one of the major causes of deficiencies in most local government's financial statements. Failure to maintain a capital asset system usually results in a qualification in the independent auditors report (opinion) on the government. And, often times, causes unnecessary confusion by users of the financial statements. This record keeping inadequacy may also jeopardize stewardship of the capital assets for which management is responsible.

On the other hand, an adequate capital asset system can result in measurable benefits that provide:

1. Conformity with generally accepted accounting principles.

2. Reliable information about fixed assets now owned. Because capital budgets are best developed on a long-term basis, such information is invaluable in projecting future requirements.

3. Assistance in maintaining accountability for the custody of individual items and in determining who is responsible for their care and maintenance.

4. Information necessary to perform regular inventories to determine physical condition, theft, or unauthorized transfers.

5. The ability to identify worn out or obsolete equipment on a concurrent basis. Provision for replacement can be included in a budget before emergency replacement or unwarranted repairs are necessary.

6. A basis for adequate insurance coverage on insurable fixed assets. Although cost is not the only determinant of insurable value, it could be a necessary consideration.

7. Property records that furnish information about the investment taxpayers have made for the future benefit to users of government property.

CAPITAL ASSET SYSTEM POLICY GUIDELINES- cont.

A number of critical decisions must be made, however, before an adequate capital asset policy can be established and implemented. Some of those decisions are:

1. Which assets should be accounted for individually and which should be grouped? For example, should the cost of a fire engine include hoses, ladders and other associated equipment?

2. What should the capitalization policy be? This sets the requirements for minimum costs to be accounted for and useful lives.

3. What are the expected useful lives for the different kinds of capital assets?

4. What depreciation method is best?

5. When should depreciation begin for assets acquired during the year? For example, depreciation can begin the month the asset is put into service, or a full year's depreciation can be reported for assets received in the first six months and none for those received during the balance of the year. Still other governments use the half year convention where 50 percent of the year's depreciation is taken in the year of addition and in the year of disposition.

6. What information is needed to begin and maintain the system? Determine data base requirements, the coding system and required reports.

7. What forms are needed to secure the required information? Their design must ensure complete information and efficient processing.

8. How will the system be established? A work plan should fix responsibilities and establish time estimates. In particular, the initial inventory must be planned thoroughly.

9. What other policy decisions should be established? All policy decisions should be made before beginning work on the capital asset system. This includes all aspects of the remaining steps – assigning carrying values, and maintaining the system.

Some of the more appropriate aspects of the above items are discussed below.

<u>Item 1</u>

Infrastructure assets are defined as public domain capital assets -- such as roads, bridges, curbs and gutters, street and sidewalks, drainage systems, lighting systems and similar assets that are immovable and of value only to the governmental unit. GASB Statement #34 specifically requires governments to report infrastructure capital assets in the GFAAG.

CAPITAL ASSET SYSTEM POLICY GUIDELINES- cont.

Item 2

Generally, capital assets should be accounted for individually. However, where associated assets are necessary to place the primary asset in its intended location and/or intended use -- then there is acceptance for grouping and accounting for those assets as a single unit. A utility plant and all of its machinery and equipment is a good example.

Item 3

Each government should establish its own capital asset capitalization policy - one that will balance information and control needs.

Establishing a capitalization policy (determining what to record and report as capital assets) is an important part of a fixed asset system. The criteria for capitalizing an asset usually are governed by two factors: the cost of the asset and its useful life. Some schools of thought suggest capitalizing all capital assets acquired that benefit future periods, without regard to cost. Others suggest capitalizing such capital assets based upon a dollar threshold limit, without regard to useful life.

Both of these methods have merit. However, if a government favors a capitalization dollar limit over the more conservative approach, then there are several factors that should be considered before a decision is made. These factors include such things as the number of assets involved, the volume of transactions, the effect of dollar levels on financial status and the level of effort necessary to maintain an accurate capital asset inventory.

Often, a capitalization dollar threshold may be set low to reflect more investment on the books. Also, it may be set low in the hope of forcing adequate property management. However, the lower the capitalization value - the larger the number of assets. The larger the number of assets, the greater the amount of time required to track and control these assets. There are basically three reasons for recording, or at least tracking capital assets: (1) For insurance coverage to provide evidence to the insurer of the existence of assets in the event they are destroyed, (2) For control purposes, to insure that assets are located where they are intended to be and that they are not abused or stolen, and (3) For financial reporting to present financial statements prepared in accordance with Generally Accepted Accounting Principles (GAAP). The capitalization threshold needs to be established to accomplish number (3). The level at which the threshold is established is a management decision but should be considered as being relative to the dollar volume of transactions common to the entity.

CAPITAL ASSET SYSTEM POLICY GUIDELINES- cont.

Item 3 – cont.

It may be important to control some property items that cost less than the capitalization level, because of their portable and theft prone nature. This could be accommodated by use of control listings. These control listings could be maintained for items of high theft incidence, such as projectors, adding machines, fans, cameras, tape recorders, typewriters, calculators and other portable items.

Additions and betterments, to existing capital assets, that significantly prolong a capital asset's life or expand its usefulness should be capitalized. Normal repairs that merely maintain the asset in its present condition should be recorded as expenditures/ expenses and should not be capitalized. See table that follows.

SUMMARIZATION TABLE FOR ADDITIONS, BETTERMENTS, AND REPAIRS AND MAINTENANCE

	Additions	Betterments	Extraordinary Repairs & Maintenance	Ordinary Repairs & Maintenance
Increases the physical size of a facility	Yes	No	No	No
Cost capitalized.	Yes	Yes	Yes	Yes
Extends usefullife.	Yes	Yes	Yes	No
Benefits a future period.	Yes	Yes	Yes	No
May involve Replacement	.No	Yes	Yes	Yes
May involve substitution	No	Yes	No	No
Makes facility better than when it was acquired	Yes	Yes	Maybe	No

CAPITAL ASSET SYSTEM POLICY GUIDELINES- cont.

Item 3 – Terminology – cont.

Addition - an extension, enlargement or expansion made to an existing asset. Examples: an extra wing or room added to a building or the addition of a production unit to an existing machine.

Betterment - constitutes the removal of a major part or component of plant or equipment and the substitution of a different part or component having significantly improved performance capabilities. Betterments have the effect of extending the useful life of an existing fixed asset, increasing its normal rate of output, lowering its operating costs, or otherwise adding to the worth of benefits it can yield. Betterments ordinarily do not increase the physical size of a facility but do make the facility better than when it was acquired. Costs are capitalized and the cost of anything removed is eliminated. Examples: replacement of an old shingle roof with a modern fireproof tile roof or installation of an improved electrical system in a building.

Extraordinary (Major) Repairs and Maintenance - a capital expenditure to repair deterioration due to neglect or postponement of ordinary repairs and maintenance to restore the property to a usable condition and prolong its life. Examples: replacing or adding exterior siding, replacing a floor, strengthening the foundation of a building, major improvements in an electrical system, or major overhauls.

Ordinary Repairs and Maintenance - expenditures that keep a unit of property in efficient condition without prolonging its useful life. They are recorded as current expenditures. Examples: repainting, repairing plaster or inside walls, patching or spot repairs, replacing tires, oil, spark plugs, etc., on motor vehicles or repairing an electrical circuit.

Item 4

As a component of the depreciation computation, the estimated useful life of each asset must be considered. The depreciable life of an asset may be expressed in several ways.

- Total Estimated Life -- the expected economic useful life of an asset from the date placed in service to the projected retirement date.
- Expired Life -- the number of years elapsed since the date depreciation began to the present time.
- Remaining Life -- the number of years from present to anticipated retirement date.

CAPITAL ASSET SYSTEM POLICY GUIDELINES- cont.

Item 4 – cont.

Several considerations are necessary to make plausible estimates of the useful lives of various kinds of assets. The most common are:

1. The physical environment in which the asset is to be used.

2. The prevailing characteristics of use, which include such things as continuous stressful use, intermittent operation, seasonal use, fixed or portable use, operating conditions relative to weight, force or friction encountered during use.

3. The physical resilience or ability to withstand operation at full utility or capacity with only minor maintenance, as opposed to progressive and visible deterioration with use, regardless of planned and consistent maintenance.

4. Existence of a maintenance policy that establishes guidelines for consistent maintenance of certain assets at regular intervals.

5. The levels of employee experience in operating specific assets, as well as the existence of training programs to provide new employees an acceptable level of expertise in the operation of these assets.

6. The potential for obsolescence or susceptibility to the economic loss in value as a result of technological advances, state of the art, fashion or other economic factors that could reduce the suitability of an asset for its intended use.

The estimated economic life is usually based on industry standards for the asset, if available, or based on the government's actual experience with similar assets. The general guidelines for asset lives promulgated for tax purposes by the Internal Revenue Service (IRS) frequently are used in financial accounting as well. The asset depreciation range (ADR) guidelines are contained in IRS Revenue Procedure 7710. In general, experience serves as a guide to estimating normal life expectancy, but governments also should take into account present conditions as well as the asset's expected utility.

CAPITAL ASSET SYSTEM POLICY GUIDELINES- cont.

Item 5

Proprietary Fund Type Capital Assets

Depreciation is an important element in the income determination process. The method used to allocate the cost of a capital asset over its estimated service life should be as equitable as possible to the periods which services are obtained from the use of the asset. By far, the most common approach used in practice is the straight-line method. Other methods may also be acceptable. However, the straight-line method may be the simpler method to apply.

The straight-line method of depreciation simply requires that the cost of the capital asset (less projected salvage value) be divided by the number of years of estimated service life to arrive at the annual depreciation charge. Because salvage value is difficult to predict, it is often ignored in depreciation computation.

General Fixed Assets Account Group (GFAAG)

Depreciation on general fixed assets has long been the subject of much debate. With the implementation of GASB Statement #34, accumulated depreciation and the related expense needs to be determined for reporting purpose only so that it may be included within the government-wide statements required to be presented as part of the basic financial statements. Therefore, it is appropriate to utilize the GFAAG to develop this information. As previously mentioned, the GFAAG is no longer required to be reported with the financial statements, however, the use of the account group to develop the required information facilitates the reporting requirement of GASB #34. The depreciation expense, however, is not actually recognized in a governmental fund since GASB #34 still requires governmental funds to be accounting for on a modified accrual basis. This non-recognition of depreciation is due to the spending measurement focus applied to governmental funds (governmental funds are intended to account for and report the sources and uses of financial resources) and not the measurement of income. Although acquisitions of general capital assets require the use of financial resources (recorded as expenditures) and sales of general capital assets provide financial resources (recorded as revenues or as other financing source), depreciation expense, however, is neither a source nor a use of governmental fund financial resources and thus should not be recorded in the accounts of those funds.

Item 5 – cont.

The straight-line method of depreciation is recommended since it is the simplest to administer and develop. The entries made in the GFAAG would increase the accumulated depreciation account(s) and increase interim expense accounts at the functional level (preferred). At year-end, the interim expense accounts would be closed into the investment in general capital assets account.

Item 6

Depreciation should be computed when the asset is put into service. However, the alternatives presented are all viable and available options. Whatever the alternative, it should be consistently applied.

Item 7

To establish capital asset inventory records, a coding system should be adopted to gather, measure and disseminate information. Reports and input forms should reflect the adopted coding system. The coding system should be built based on the survey of user needs and the determination of data elements.

When reviewing the data elements that will be recorded for each capital asset record, certain elements can be recorded using a common coding structure rather than detailed descriptive information. In a systems environment, these elements are organized into tables. The asset record contains the code, while the table stores additional descriptive and detail information that give meaning to the code. Elements which are logical choices for a common consistent coding structure include:

1. Organization responsible for asset
2. Asset's specific location
3. Unique asset reference number (tag number when appropriate)
4. Asset classification
5. Fund and/or specific financing source
6. Method of acquisition
7. Cost valuation method

CAPITAL ASSET SYSTEM POLICY GUIDELINES

Item 8

In order to establish and maintain capital asset inventory records, a number of standardized input forms are needed for:

- Capital asset inventory
- Information on new acquisitions
- Additions or adjustments to a previously recorded capital asset
- Transfer of an asset from one department to another
- All retirements

Well-designed forms ensure that all needed information will be available to process transactions without undue burden.

Item 9

Taking a complete physical inventory requires extensive planning. A written plan and timetable should identify the inventory teams, departments, locations and inventory times. The teams should know about existing departmental fixed asset records and how the identification and tagging of assets should be conducted. Also, they should be aware of potential problems.

Issues to be addressed in developing the inventory plan include:

- Who should take the initial physical inventory?
- How should the inventory be taken?
- How much and what type of training is appropriate for inventory personnel?
- What types of inventory tags should be used?
- How should asset numbers be assigned?
- How should the inventory be phased?

Inventories can be accomplished using in-house personnel, or by engaging professional contractors. Contracting with reliable outside contractors can mean such advantages as having the project completed within the established time frame and no interference with established priorities.

CAPITAL ASSET SYSTEM POLICY GUIDELINES

Item 10

Assigning Values

Once the physical inventory is completed, the next step is to assign values to the capital assets. This step can be the most difficult part of establishing a capital asset accounting and reporting system. To conform to generally accepted accounting principles, governments should record capital assets at actual or estimated historical cost, or for contributed assets, at fair market value on the acquisition date.

Governments can determine historical cost using (1) Direct Costing where cost is determined fro invoices or other documentation, (2) Standard Costing where cost is determined using historical sources such as old vendor catalogs, etc. and (3) Normal Costing where cost is determined by deflating current cost using available computer programs designed to accomplish this computation.

Maintaining the System

A critical step in establishing a capital asset accounting and reporting system is to establish procedures that will keep the records current. All previous efforts will become outdated and useless unless the information can be updated.

Most importantly, governments need to prepare a detailed and comprehensive property manual that documents the entire system. It should include specifications and illustrations of all fixed asset accounting policies, information flows, codes, forms, reports and processing instructions. This manual, which also should describe the property procedures for all transactions, is essential for a useful and efficient system.

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