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The Basics of Governmental/Fund Accounting

Summer 2023 MAMC Conference

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Fundamental Elements of Governmental Accounting

Overview of Today's Session



Overview of Funds –
Definitions – Observations



Basis of Accounting



Fund Balance



Historical Review



Fundamental Elements of Governmental Accounting

Overview of Today's Session



State Revenue Sharing



Act 51



Property Taxes



Budget Cycle



Financial Reporting



What is the key differentiator in governmental accounting?

Introduction to Governmental Fund Accounting

FUNDS!

Definition

A fund is defined as an independent fiscal and accounting entity with a self-balancing set of accounts recording cash and/or other resources together with all related liabilities, obligations, reserves and equities that are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with specific regulations, restrictions or limitations.



Introduction to Governmental Fund Accounting

Difference between Private Business and Government Unit

Private business enterprise:

- Viewed as a single economic entity with one group of assets, liabilities and equity accounts that are normally reflected in a single set of financial statements

Governmental unit:

- Normally has several entities or funds, each of which has its own assets, liabilities and fund equities.
- Is a combination of several distinctly different operations, each of which functions, and must be reported on, independently from any other fund.



Types of Funds

Governmental Funds	General fund Special revenue funds Debt service funds Capital project funds Permanent funds
Proprietary Funds	Enterprise funds Internal service funds
Fiduciary Funds	Trust funds (Pension and other employee benefit, Investment, Private purpose) Agency funds
Component Unit	Must meet certain criteria (follow GASB 61)



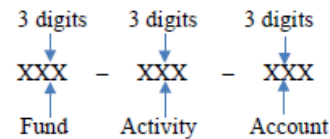
Uniform Chart of Accounts

State of Michigan – Uniform Chart of Accounts

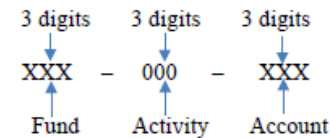
- Available at Michigan.gov
- Provides guidance on creating full account string – based on fund, activity, and account type

What an Account Number should look like:

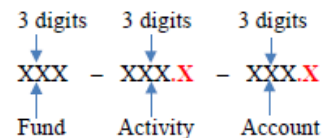
- 1) The major structure of an account number is comprised of three sets of three digits, which are a three-digit fund number, a three-digit activity number, and a three-digit account number. Please see below:



- 2) For funds that do not need detailed activity information (explained in the following paragraphs), the activity number can be replaced with three zeros as the second set of three digits. Please see below:



- 3) For local units that do have needs for tracking detailed information on activities and accounts, they could use the POINT OFF¹ option (explained in the following paragraphs). They may choose to POINT OFF activity and/or account numbers. Please see below:





Uniform Chart of Accounts - Funds

A summary table of the fund numbers is provided as follows:

Fund Type	Category	Fund Number
Governmental Fund Types	General Funds	101-149
	Permanent Funds	151-199
	Special Revenue Funds	201-299
	Debt Service Funds	301-399, 851-899
	Capital Projects Funds	401-499, 801-850
Proprietary Fund Types	Enterprise Funds	501-599
	Internal Service Funds	600-699
Fiduciary Fund Types	Custodial Funds	701-725
	Pension (and other employee benefit) Trust Funds	726-750
	Investment Trust Funds	751-755
	Private Purpose Trust Funds	756-799
Year-End Government-Wide Full Accrual		900-975



Uniform Chart of Accounts Conversion

Recommended Implementation Date	Deadline FYE for Implementation
November 1, 2021	October 31, 2022
December 1, 2021	November 30, 2022
January 1, 2022	December 31, 2022
February 1, 2022	January 31, 2023
March 1, 2022	February 28, 2023
April 1, 2022	March 31, 2023
May 1, 2022	April 30, 2023
June 1, 2022	May 31, 2023
July 1, 2022	June 30, 2023
August 1, 2022	July 31, 2023
September 1, 2022	August 31, 2023
October 1, 2022	September 30, 2023



Governmental Funds

General Fund

- Accounts for all revenue and expenditures that are not accounted for elsewhere and is usually the operating fund of a governmental entity.



Governmental Funds

Special Revenue Funds

used to account for the proceeds of earmarked revenue or financing activities requiring separate accounting because of legal or regulatory provisions. In many cases, the use of the separate fund is mandatory.

GASB 54 changed the definition slightly and requires that *to be a SRF a substantial portion of revenues must be from a committed or restricted source.*



Special Revenue Fund Examples

- Major Streets (202)
- Local Streets (203)
- Municipal Streets (204)
- Public Safety (205)
- separate Fire (206)
- separate Police (207)
- Parks and Rec (208)
- Cemetery (209)
- Street Lighting (219)
- Rubbish (226)
- Mosquito Control (240)
- Building Dept (249)
- Indigent Defense Fund (260)
- Federal Forfeitures (262)
- Library (271)
- CARES Act (282)
- Airport (295)



Governmental Funds

Debt Service Funds

Used to account for the annual payment of principal, interest and expenses in connection with certain long-term debt

Debt payable is recorded at the full accrual level.

In many cases, the use of Debt Service Funds is optional.



Governmental Funds

Capital Projects Funds

Used to account for the development of capital facilities other than those financed by an Enterprise Fund. In many cases, the use of Capital Projects Funds is optional.



Governmental Funds

Permanent Funds

Permanent Funds are used to account for resources that are permanently restricted.

Examples

Cemetery Trust Funds

Endowment Funds



Proprietary Funds

Enterprise Funds

Enterprise Funds are used to account for activities that provide a good or service to citizens that is financed primarily by a user charge for the provision of that good or service.



Enterprise Fund Examples



ICE ARENA



WATER AND
SEWER UTILITY



GOLF COURSE



SANITATION
OR LANDFILL



PARKING
SYSTEM



Proprietary Funds

Internal Service Funds

Internal Service Funds are set up to account for goods and services provided by designated departments on a fee basis to other departments and agencies within a single governmental unit.



Internal Service Fund Examples

INFORMATION
TECHNOLOGY
OPERATIONS

EQUIPMENT
REVOLVING

MOTOR POOL
OPERATIONS

RISK
MANAGEMENT
PROGRAM

INVESTMENT
POOL

EMPLOYEE
BENEFITS

RETIREE
HEALTH
SAVINGS PLAN
ACTIVITIES

MERS (DB)
RETIREMENT

MERS (DC)
RETIREMENT



Fiduciary Funds

Fiduciary Funds

- Include only those activities where the government acts as a trustee or agent for organizations outside the government.
- Should not be used to hold assets that may be used to support this government's programs.



Fiduciary Fund Examples

Trust and Agency

Pension

OPEB

Tax Collection



Component Units

A legally separate organization for which the elected officials of the primary government are financially accountable and organizations whose exclusion would cause a government's financial statements to be misleading.

Various criteria are applied to determine what type of component unit:

Discretely Presented Component Unit

- Shown in a column or columns separate from the primary government's activities

Blended Component Unit

- Aggregated within the same columns as the primary government



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Component Unit Examples

Discretely Presented Component Units

Downtown Development Authority (DDA)

Brownfield Redevelopment Authority (BRA)

Tax Increment Finance Authority (TIFA)

Local Development Finance Authority (LDFA)

Economic Development Corporation

Land Bank Authority



Blended Component Units

Building Authority



Basis of Accounting

There are two basic methods of accounting for funds

Full-accrual basis

Modified accrual basis



Full-accrual Basis

- Revenue is recorded in the accounts at the time it is earned.
- Expenditures are recorded when the liability for them is initially incurred.
- Provides a superior method of accounting for the inflow and outflow of economic resources in any organization because:
 - it relates the costs and expenditures to the time period in which benefits of the outlays are received
 - it provides a more accurate matching of these benefits with any associated revenue.



Modified-Accrual Basis

Revenue is recorded when it is **earned, measurable, and available**. This generally means that revenue is accrued if received within 30 to 60 days from year-end.

Under a modified-accrual basis of accounting, expenditures are recorded on an accrual basis except that:

- Land, buildings and equipment items are expensed when purchased.
- Inventory items may be considered expenditures at the time of purchase or when used.
- Interest on long-term debt is expensed when due.
- Prepaid expenses are normally expensed when incurred.



Comparison of Governmental Fund and Commercial Accounting

Similarities

- Periodic balance sheets, income statements and statements of changes in fund balances are prepared by both.
- The double entry system (debits & credits) is utilized by both.
- The historical cost principle, consistency principle and, for the most part, generally accepted accounting principles are used by both.
- Several of the fund types use the “full-accrual basis” method of accounting.



Comparison of Governmental Fund and Commercial Accounting

Similarities

- When reported in total, the governmental activities also use the “full-accrual basis” method of accounting.
- Fund accounting and commercial accounting use the same accounting terminology. However, fund accounting has some terminology unique to it (e.g., fund balance).



Basis of Accounting

	(1) Full Accrual Basis	(2) Modified Accrual Basis
Revenues are recorded when:	Measurable (the amount can be determined) and Earned (the service has to be provided)	Measurable, Earned, and... Available (the revenue was collected in the current fiscal year or will be collected soon enough after the close of the fiscal year to pay liabilities of the current year).



Basis of Accounting

	(1) Accrual Basis	(2) Modified Accrual Basis
Expenses/ expenditures are recorded when:	(Expenses) Measurable (the amount can be estimated) and Incurred (the goods or services have been received)	(Expenditures) Measurable, Incurred, and... A current financial resource is or is about to be reduced.



Basis of Accounting

	(1)	(2)
	Full Accrual Basis	Modified Accrual Basis
Fixed assets are reported as:	An asset in the fund where the purchase is made	An operating expenditure in the fund where the purchase is made
Depreciation is reported:	As an expense in the fund using the fixed asset	N/A



Basis of Accounting

	(1) Full Accrual Basis	(2) Modified Accrual Basis
The issuance of debt is reported:	As a liability in the fund where the debt is issued	As an “other financing source” on the operating statement
The payment of debt is reported:	As a reduction of the liability	As an operating expenditure, usually in the Debt Service Fund
Measurement focus used:	Capital Maintenance	Spending



Basis of Accounting

The basis of accounting for each of the various funds are:



Full-accrual Basis

Enterprise Funds

Internal Service Funds

Fiduciary Funds

Component Units



Modified-accrual Basis

General Fund

Special
Revenue Funds

Debt Service
Funds

Capital Projects
Funds

Permanent
Funds

Component
Units



What is fund balance?

- Accounting 101 tells us that we have:
 - » Assets (things we own); and
 - » Liabilities (amounts we owe others);
 - » The difference between assets and liabilities is equity. In the governmental funds, this equity is called fund balance.
- Since governmental funds generally report only assets that are available (cash or will be cash within 30-60 days), and only report liabilities that are current claims, the resulting fund balance represents amounts available to be spent.



Types of Fund Balance

1. Unspendable – Why? It's already spent.
2. Restricted – By someone or something outside the municipality
3. Committed – Highest internal level of authority
4. Assigned – Highest internal level of authority or their designee
5. Unassigned – Whatever is left. It's a Free-for-all.



How much fund balance should my local unit have?*

- There is not a single answer to that question, so let's start with some concepts:
 - » **Zero is not an option.** You need some level of fund balance for cash flow purposes, and some level for responses to emergencies.
 - » There is an appropriate range of fund balance, because it is possible to have too little, but it is also possible to have too much.
 - » The right amount is dependent on several factors.



*This is the most popular question in any accounting presentation we give.



Is Fund Balance Available To Be Spent As Our Governing Body Sees Fit?

Maybe – but not
necessarily

The governing body
always has the
authority to re-
commit or re-assign
fund balances.



Net Position categories:

- Net Investment in Capital Assets
- Restricted
- Unrestricted

At the fund level for enterprise funds, internal service funds, and component units.

At the Government-wide level for Governmental, Business-type, and Component Units



Significant revenue sources

- *Revenue Sharing*
- *ACT 51*
- *Property Taxes*



Revenue Sharing Overview

Transportation Financing

Revenue Sharing



Revenue Sharing Overview

Programs are either constitutional or nonconstitutional

Constitutional Portion

This allocates for cities, villages and townships; 15% of gross collections from the first 4% of sales tax collections and are distributed on a population basis.

This amount is fixed by the constitution and cannot be modified without a vote of the people.

Estimated \$1B Million in FY 2022-23.

Nonconstitutional Portion

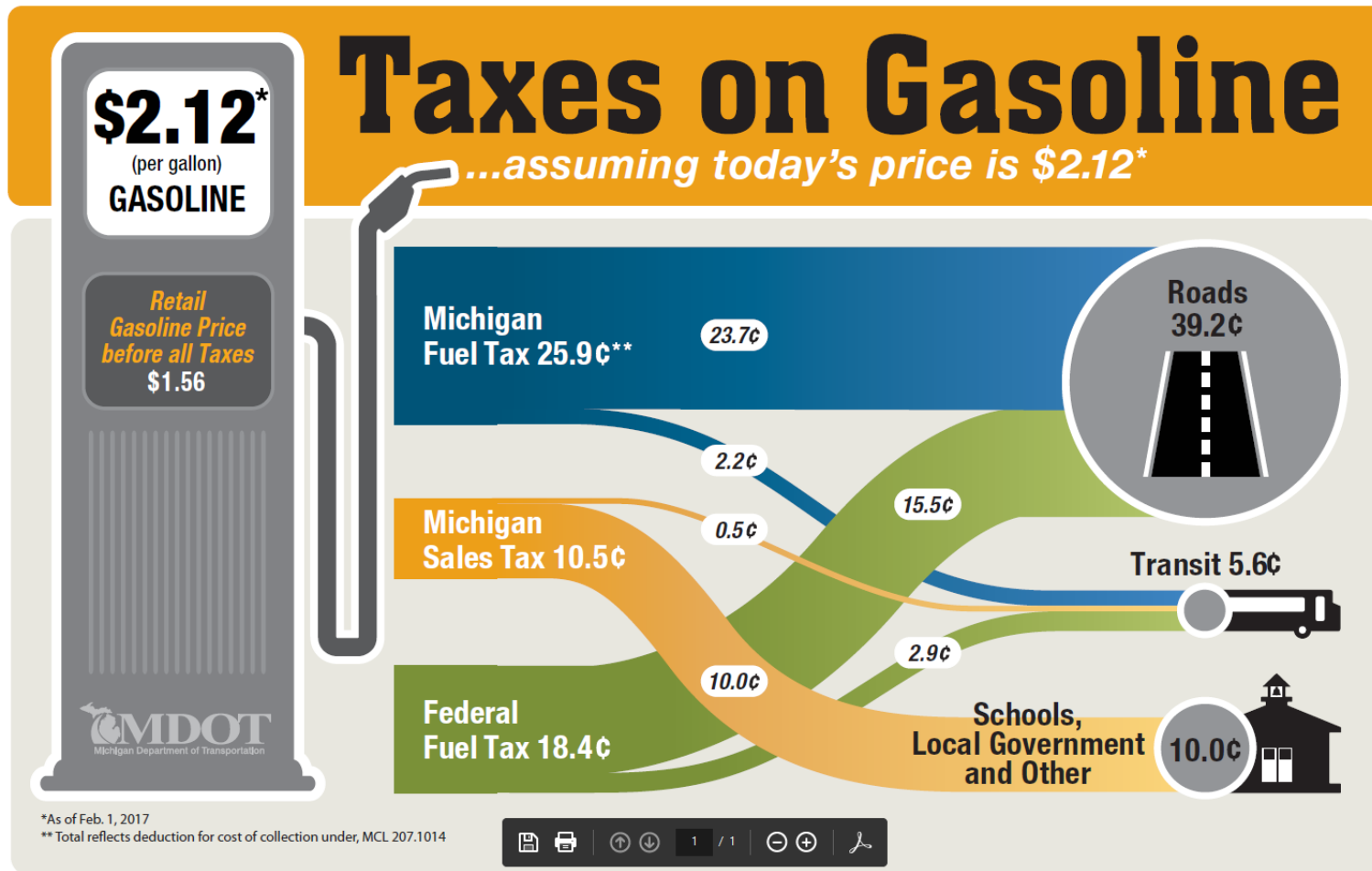
Cities/Villages/Townships receive an additional amount based on population

This amount is allocated and can be adjusted at any time.

CVTRS allocation for FY 2022-23 is \$282 Million.



Highway Funds Act 51 of 1951 Selected Financial Requirements





Highway Funds Act 51 of 1951 Selected Financial Requirements

- Separate funds are required for major and local road monies.
- Transfers of major road, gas and weight tax receipts to local road funds are allowed up to 50% a year.
- Transfers in excess of 50% are allowed, with an appropriate council resolution and a Transportation Asset Management Plan. Section 13(d)(2) also allows transfers of locally raised monies from major to local.
- Administrative charges are limited to 10% of each fund's receipts exclusive of transfers from major to local.
- **If you are in a pinch, do not lend your Act 51 money to other funds!**



Assessed value represents 50% of the market value of property.

Capped value – Under Proposal A of 1994, the constitutional amendment passed by Michigan voters limited (capped) any increases in taxable value to 5% or the rate of inflation (Typically closer to 2-2.5%).

Taxable value is the lesser of assessed value or capped value.

Unless the assessed value drops below the taxable value, the homeowner will not see a corresponding decrease in taxes.

The Property Tax Equation

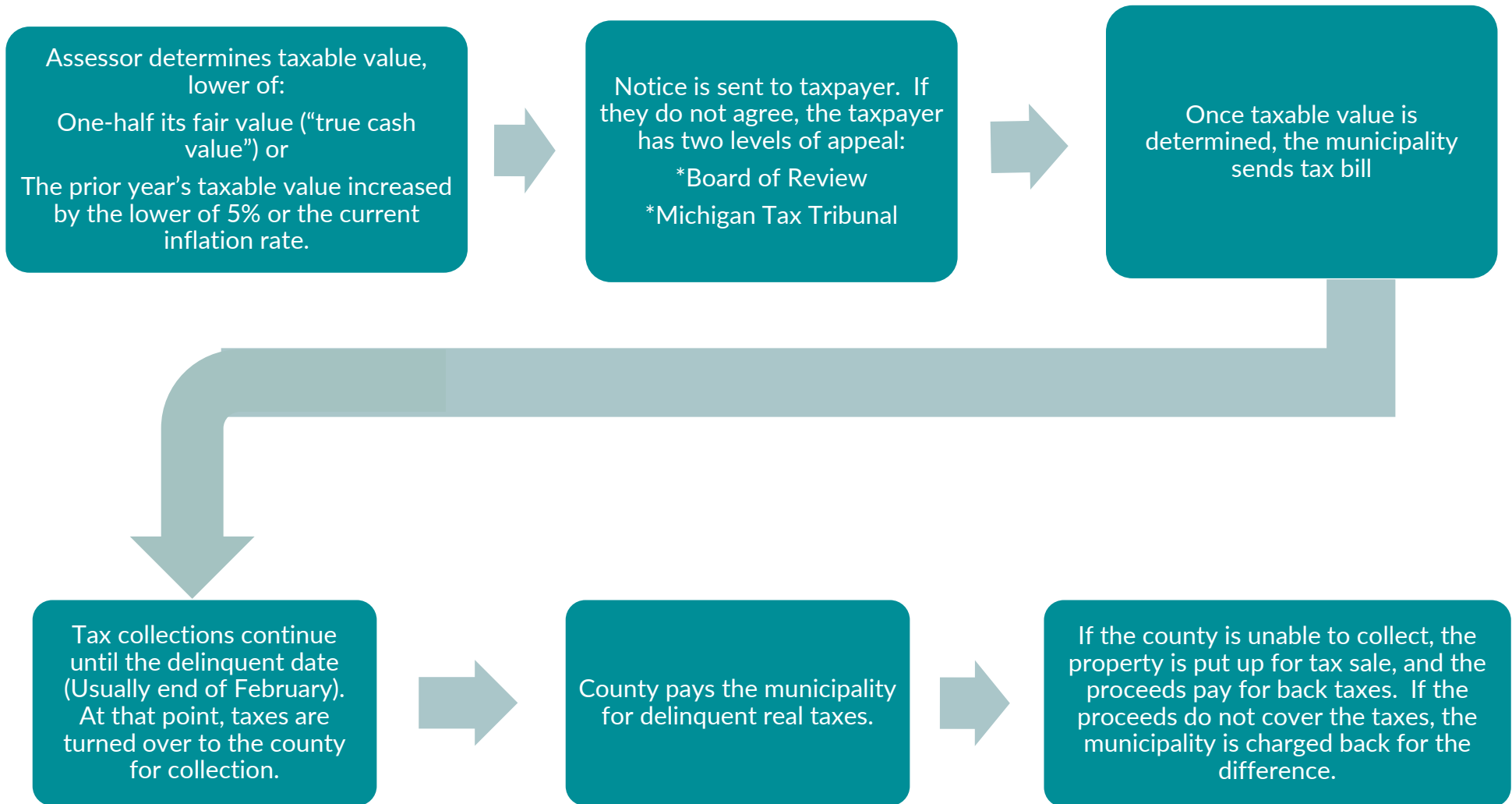


Property Tax Billing

$$\begin{array}{|c|} \hline \text{Taxable} \\ \text{Value} \\ \hline \end{array} \times \begin{array}{|c|} \hline \text{Millage} \\ \text{Rate} \\ \hline \end{array} = \begin{array}{|c|} \hline \text{Property} \\ \text{Tax} \\ \text{Bill} \\ \hline \end{array}$$



Property tax cycle

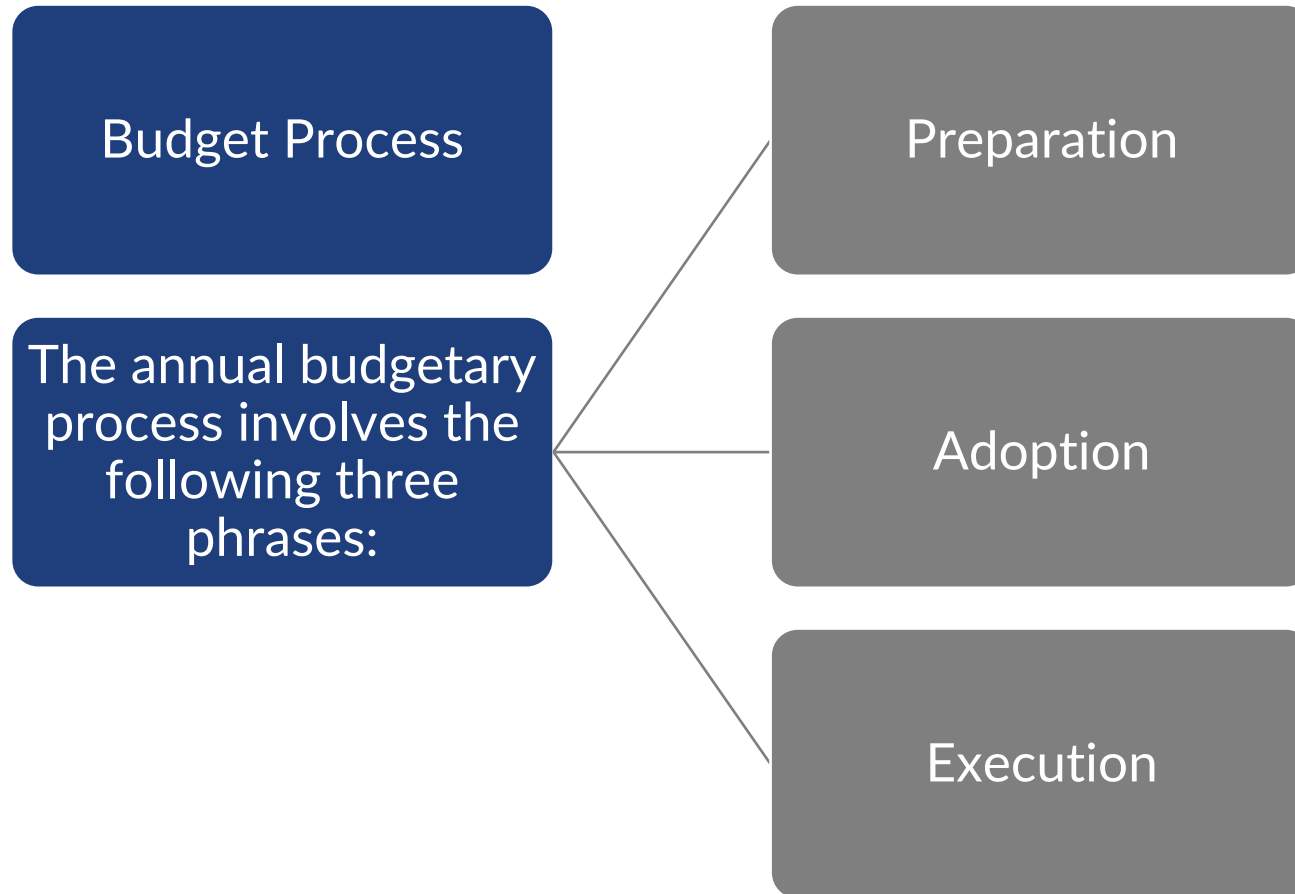




Budget Concept



Budget Concept





Audited Financial Statements



Audit Requirements

What is an audit?

An audit is the set of procedures that a CPA goes through to enable her or him to express an opinion that the governmental unit's financial statements are fairly stated (as opposed to a "certification" that the accounting records are "accurate").

In light of the cost-benefit relationship, it involves looking at a sample of transactions and documentation, as opposed to examining each transaction or document throughout the year.

State of Michigan requires governmental entities to submit an audit (Public Act 2) within six months of year end.



Financial Reporting

Under the GASB's Reporting Model the Financial Report is split into the following sections:

- Report Letter
- Management's Discussion & Analysis
- Government Wide Statements
- Fund Based Statements
 - Governmental Funds
 - Proprietary Funds
 - Fiduciary Funds
 - Component Units
- Notes to Financial Statement
- Required Supplemental Information
- Other Supplemental Information



Management's Discussion and Analysis

3+ page letter describing in prose the major financial events of the year. The purpose is to try to communicate the financial information to the non-accountant.

Required Information:

- An explanation of the objectives of the two levels of reporting
- Condensed comparative government-wide financial statements, including analysis of significant changes
- An analysis of significant variations between the original and final budget for the general fund; an analysis of significant variations between the actual and final budgets for the general fund
- A description of the capital asset and long-term debt activity
- A discussion of whether the financial position has improved or deteriorated during the year
- A description of the currently known facts, decisions or conditions that have had or are expected to have a material effect on financial position or results of operation

Can use MD&A to tell a story to your users - you have the opportunity to focus on items important to your organization.



The Government-Wide Statements

Are Full Accrual (just like a business)

- That means we will count all assets and liabilities, as soon as the underlying event has taken place.
- Capital assets will be depreciated (for cities and villages, this will include roads).
- Employee sick and vacation pay are recognized as a liability as soon as the employees earn it (not 20 to 30 years later when it is paid at retirement).
- A multitude of other “accruals” need to be reflected in the accounting records, in order to better match the recognition of costs over the time period that the citizens are benefited.
- These full accrual statements contains all inflows and outflows of economic resources, short- and long-lived assets, and short-



Why Government- Wide Financial Statements?

To answer a new question:

Fund-based statements answer the question “What did you do with the money we gave you?”

Government-Wide statements are intended to also answer the question “Did this year’s taxpayers pay the full cost of the services you delivered this year?” (or did we pass the obligation on to our grandchildren?)



Fund Level of Reporting

The fund-based level is split into three sections

Governmental

Business-type

Fiduciary



The presentation requires separate columns for each “Major” Governmental or Enterprise fund.



Notes to Financial Statements

- are additional notes and information added to the end of the financial statements to supplement the reader with more information.
- help explain the computation of specific items in the financial statements as well as provide a more comprehensive assessment of a local government's financial condition.
- can include information on accounting policies, debt, capital assets, or contextual information explaining the financial numbers.



Required Supplemental Information (RSI)

Supporting schedules that expands upon the information in the basic financial statements

- Includes budgetary comparison schedules along with other types of data required by various GASB pronouncements

A budget statement would be required for the general fund and each “major” special revenue fund. It would require a column for the original and amended budget.

Also includes pension/OPEB schedules

- Schedule of Contributions
- Schedule of Investment Returns
- Schedule of changes in Net Pension or OPEB liability



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Any Questions?

Thank you!