**Chapter 3**

**Issues of Budgeting and Control**

**Questions for Review and Discussion**

 1. Capital budgets are closely tied to operating budgets in that governments and other not-for-profits must include current year capital expenditures in their operating budgets. In addition, if they issue debt to finance capital projects, they generally must service it out of operating funds. Further, once they complete the projects, they must maintain and repair them out of operating funds.

 2. A flexible budget may be more important to business-type than to government-type activities because business-type activities are driven by the market and can be expected to vary more widely with changes in customer demand. The level of government-type activities, by contrast, is often established by the budget.

 3. The main virtue of an object classification budget is that it facilitates control, specifying in detail how every dollar will be spent. However, by focusing on and controlling individual expenditures, it may ignore the relationship between costs and organizational objectives. It may thereby discourage effective planning and evaluation.

 Performance budgets require the specification of costs and outcomes and therefore encourage managers to consider the benefits or sacrifices that will result from a change in spending. In short, in performance budgeting, the emphasis is on what the entity accomplishes rather than on how it accomplishes it.

 4. Only a cash-basis budget, not an accrual basis budget, permits a government to properly plan its cash receipts and disbursements. Governments must pay for goods and services in cash when their bills come due. The timing of payments is not necessarily concurrent with the economic impact of the related activities. Similarly they must establish the amount and timing of their tax collections so as to be sure that they have sufficient cash on hand to meet their cash requirements.

 5. “Favorable” budget variances are not necessarily indicative of effective governmental management. The goal of a government is neither to maximize revenues nor to minimize expenditures. An excess of actual over budgeted revenues may be evidence that taxes were higher than necessary. An excess of budgeted over actual expenditures may denote that the quantity or quality of the services that the government provided were less than anticipated.

 6. Allotments are periodic allocations of funds to departments or agencies, usually made by the chief executive, to assure that an entire year’s appropriation is not dissipated early in the period. They provide an added measure of control over expenditures.

 7. A government’s year-end results, reported in accordance with generally accepted accounting principles, may not be comparable with its legally adopted budget owing to differences in:

* basis of accounting (e.g., cash versus modified accrual);
* timing of specific revenues and expenditures (e.g., whether goods or services are recognized as expenditures when ordered rather than when received);
* perspective (e.g., program versus line-item), and
* reporting entity (e.g., whether certain legally independent, but economically related, organizations are included).

 8. The variances in budget to actual comparisons may be of no value in revealing the reliability of budget estimates made at the start of the year because they compare the amended budget with actual results. Amendments may be made through the last day of the year and even after year-end. The rationale for this practice is that the comparison is intended to demonstrate legal compliance, not effective management. Governments need only adhere to their budgets as amended, not their initially adopted budgets. However, GASB Statement No. 34 requires that the original budget be presented along with the final budget for reporting purposes.

 9. Budgetary entries have no impact on year-end financial statements. They are closed-out at year-end and not reported on either the balance sheet or operating statement. Encumbrances are also closed-out and have no impact on the operating statement. However, the related reserve for encumbrances is a reservation of fund balance and, accordingly, is reported on the balance sheet as part of fund equity.

10. Appropriation budgets and related budgetary entries are intended mainly to help control expenditures — to assure that governments do not spend more than was authorized in any particular year. Capital projects funds focus on controlling costs by project and may not be intended to control expenditures on the basis of periods. Moreover, necessary control can be adequately established by other means. The resources available for expenditure in a capital projects fund are normally either transferred-in from other funds or received as proceeds from bonds. Expenditures can thus be controlled by limiting the transfers (i.e., through the budgets of the transferring funds) or the amount of the bonds issued.

**Exercises**

EX 3-1

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

EX 3-2

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

**EX 3-3**

a. Journal Entries

(1)

Estimated revenues $860

Fund balance $860

*To record estimated revenues*

Fund balance $850

Appropriations $850

*To record appropriations*

(2)

Encumbrances $ 20

Reserve for encumbrances $ 20

*To record the order of supplies*

(3)

Salaries expenditure $610

Repairs expenditure 40

Rent expenditure 25

Utilities expenditure 41

Other operating expenditures 119

Cash  $835

*To record various expenditures*

(4)

Encumbrances $ 9

Reserve for encumbrances $ 9

*To record the order of equipment*

(5)

Reserve for encumbrances $ 9

Encumbrances $ 9

*To reverse the encumbrance entry*

Equipment expenditures $ 10

Accounts payable $ 10

*To record the expenditure for the purchase of equipment*

(6)

Reserve for encumbrances $ 20

Encumbrances $ 20

*To reverse the encumbrance entry*

Supplies expenditure $ 20

Accounts payable $ 20

*To record the expenditure for supplies*

(7)

Cash  $865

Revenues $865

*To record revenues*

b. Closing entries

Appropriations $850

Fund balance 10

Estimated revenues $860

*To close budgetary accounts*

Revenues $865

Fund balance $865

*To close the revenues account*

Fund balance $865

Salaries expenditure $610

Repairs expenditure 40

Rent expenditure 25

Utilities expenditure 41

Supplies expenditure 20

Equipment expenditures 10

Other operating expenditures 119

*To close expenditure accounts*

c. It would make no difference in the year-end financial statements if the county had not made the budgetary entries. The budget entries were reversed at year-end and would have had no impact on either the balance sheet or the statement of revenues and expenditures.

**EX 3-4**

a. Journal entries

2011

(1)

Cash  $310

Bond proceeds $310

*To record the issuance of the bonds*

(2)

Encumbrances $310

Reserve for encumbrances $310

*To encumber the cost of constructing the sports complex*

(3)

Expenditure $114

Accounts Payable $114

*To record the construction expenditure*

Reserve for encumbrance $114

Encumbrances $114

*To reverse the encumbrance entry for the portion of the contract completed*

(4)

Accounts Payable $114

Cash  $114

*To record the cash payment*

(C/E 1 — 2011)

Fund balance $310

Expenditures $114

Encumbrances 196

*To close expenditures and encumbrances*

(C/E 2 — 2011)

Bond Proceeds $310

Fund balance $310

*To close bond proceeds*

2012

(5)

Expenditures $190

Accounts payable $190

*To record the construction expenditure*

(6)

Accounts payable $190

Cash  $190

*To record the cash payment*

(C/E — 2012)

Reserve for encumbrance $190

Expenditures $190

*To close expenditures*

2013

(7)

Expenditures $ 7

Accounts payable $ 7

*To record the construction expenditure*

Note: Some governments would require an approved revenue source and a legislative appropriation before authorizing the cost overrun.

(8)

Cash  $ 1

Transfer-in from general fund $ 1

*To record transfer of cash from general fund*

(9)

Accounts payable $ 7

Cash  $ 7

*To record the cash payment*

(C/E 1 — 2013)

Reserve for encumbrance $ 6

Fund balance 1

Expenditures $ 7

*To close expenditures*

(C/E 2 — 2013)

Transfer-in from general fund $ 1

Fund balance $ 1

*To close the transfer-in account*

b. The transfer from the general fund would, of course, be recorded in the general fund. The construction in process, and the completed stadium would be recorded in the schedule of general fixed assets. The bonds payable would be recorded in the schedule of general long-term debt. Both would, of course, also be reported on the government-wide statements.

**EX 3-5**

1. Budgetary entries

Estimated revenues—property taxes $ 7.5

Estimated revenues—sales taxes 2.1

Estimated revenues—other 1.6

Fund balance $11.2

*To record estimated revenues*

Fund balance $10.6

Appropriations—wages and salaries $ 6.2

Appropriations—supplies 3.1

Appropriations—other 1.3

*To record appropriations*

2. Actual revenues and expenditures

Cash  $11.5

Revenues—property taxes $ 7.6

Revenues—sales taxes 2.4

Revenues—other 1.5

*To record revenues*

Expenditures—wages and salaries $ 6.1

Expenditures—supplies 3.0

Expenditures—other 1.2

Cash  $10.3

*To record expenditures*

3. Closing entries

Revenues—property taxes $ 7.6

Revenues—sales taxes 2.4

Revenues—other 1.5

Estimated revenues—property taxes $ 7.5

Estimated revenues—sales taxes 2.1

Estimated revenues—other 1.6

Fund balance 0.3

*To close revenues and estimated revenues*

Appropriations—wages and salaries $ 6.2

Appropriations—supplies 3.1

Appropriations—other 1.3

Expenditures—wages and salaries $ 6.1

Expenditures—supplies 3.0

Expenditures—other 1.2

Fund balance 0.3

*To close appropriation and expenditures*

4. The net change in fund balance equals $1.2 — the difference between actual revenues and expenditures.

**EX 3-6**

1. Journal Entries

Year 1

Fund balance $6.0

Appropriations $6.0

*To record the budget (i.e., appropriate the required resources)*

Encumbrances $6.0

Reserve for encumbrances $6.0

*To encumber the estimated cost of repairs*

Expenditures $5.2

Cash  $5.2

*To record repairs expenditures*

Reserve for encumbrances $5.0

Encumbrances $5.0

*To reverse the encumbrances upon recognition of the repairs expenditure ($3.0 million on Bridge 1 and $2.0 million on Bridge 2.)*

Appropriations $6.0

Fund balance 0.2

Encumbrances $1.0

Expenditures 5.2

*To close the appropriation, expenditure and encumbrance accounts*

Year 2

Fund balance $1.0

Appropriations $1.0

*To record the budget (i.e., reappropriate the funds to complete the repairs on Bridge 2)*

Encumbrances $1.0

Fund balance $1.0

*To restore the encumbrances of the prior year*

Expenditures $0.7

Cash  $0.7

*To record remaining repairs expenditures*

Reserve for encumbrances $1.0

Encumbrances $1.0

*To reverse the encumbrances for the entire remaining balances in the encumbrance and reserve for encumbrance accounts.*

Appropriations $1.0

Expenditures $0.7

Fund balance 0.3

*To close the appropriation and expenditure accounts*

2. The balance in the fund balance restricted account is $4.1 million — equal to the initial fund balance of $10.0 million less total repair expenditures of $5.9 million ($3.2 million on Bridge 1 plus $2.7 million on Bridge 2).

**EX 3-7**

1.

Schedule of Changes in Unassigned Fund Balance

Revenues (a) $6,400

Expenditures (b) 5,380

Excess of revenues over expenditures 1,020

Less: Increase/(decrease) in reserve for encumbrances (c) 800

Net change in unassigned fund balance

 during the year [increase/(decrease)] 220

 Add: Beginning of year balance 400

 End of year balance $ 620

(a) The revenues would be the actual revenues; the budgeted revenues are irrelevant.

(b) Expenditures are the actual costs of the goods received and used — $5,200 plus $180.

(c) The increase in the reserve for encumbrances represents the required reserve at the end of the year for goods still on order ($1,000) less the reserve at the beginning of year ($200). That is:

Reconciliation of Beginning and Ending Balances – Reserve for Encumbrances

Beginning balance $ 200

Add: Goods ordered during year 6,000 $6,200

Less: Goods received during year

 (at amount of initial encumbrance)

 Prior year $ 200

 Current year 5,000 5,200

Ending balance $1,000

2.

Fund balance:

 Committed $1,000

 Unassigned 620

 Total fund balance $1,620

3. Yes, the total fund balance equals the revenues less the expenditures:

Total fund balance, beginning of year $ 600

Add: Revenues 6,400

 7,000

Less: Expenditures 5,380

Total fund balance, end of year $1,620

**Continuing Problem**

**City of Austin: FY 2008**

1. The actual to budget comparisons for the major funds are reported as required supplementary information (pg.106).
	1. The City of Austin prepares its annual operating budget based on cash and available resources (budget basis), not on a GAAP basis. The schedule shows the actual amounts on both a GAAP and a budget basis (with a column indicating the differences). However, the variances are the differences between actual and budget on a budget basis.
	2. The variances are computed as the difference between the actual amounts and the final budgeted amounts
2. The CAFR does include budget-to-actual comparisons of nonmajor funds. These, which are not required per GASB Statement No. 34, are included in the section of the report that presents combining financial statements and supplemental information. (pg. 114)
3. Austin does encumber goods that are on order but have not yet been received. They are reported on the governmental funds balance sheet as reservations (should be committed under GASB 54) of fund balances (pg.20). Encumbrances are not reflected on the government-wide financial statements (pg.17).
4. Notes relating to the general fund actual to budget comparisons refer to expenditures charged against prior year’s encumbrances and to outstanding prior year encumbrances, thereby implying that encumbrances do not lapse and the associated expenditures do not have to be re-budgeted. (pg.106)

**Problems**

**P. 3-1**

1.

 Accrual Cash

 (in thousands)

Revenues:

 Government grants $5,000 $4,700

 Private contributions 600 530

 5,600 5,230

Expenditures

 Grants 5,000 5,000

 Furniture and equipment/Depreciation 66\* 80

 Building/Depreciation 32 0

 Wages and salaries 340 320

 Other operating costs 90 80

 5,528 5,480

Excess of revenues over expenditures $ 72 ($ 250)

\* ($80,000+$250,000)/5 = $66,000

2. The answer to this question depends in large measure on what is meant by “economic” cost. Still, the accrual-based budget better captures the long-term costs and provides a better match between revenues and costs. Notably, the organization will be fully reimbursed for its awards to subrecipients. Yet the cash-based budget shows what is apparently a loss. Of the $5 million in reported expenditures for grants made in the forthcoming year, only $4.5 million will be matched by revenues. Similarly, the full cost of the furniture and equipment, which will last for 5 years, is reported as a cost in the year of acquisition.

3. All three groups will find the accrual-based budget useful in that it provides a long-term perspective on the institute and offers assurance that over an extended period the entity is covering its costs. Nevertheless, they would likely be more concerned with the cash-based budget. Organizations must pay their bills with cash. Most not-for-profits are engaged in a constant struggle to meet their day-to-day cash needs. Hence, managers, trustees and creditors are interested mainly in cash flows and see allocations of previous costs (i.e., depreciation) as being of little relevance to the decisions that they must make.

**P. 3-2**

(1)

Fund balance - Unassigned $55

Estimated expenditures (Appropriations) $55

*To record the budgeted expenditures*

(2)

Encumbrances $50

Reserve for encumbrances $50

*To record encumbrances (based on credits to reserve for encumbrances)*

(3)

Expenditures $30

Vouchers Payable $30

*To record expenditures (based on debits to expenditure account)*

(4)

Reserve for encumbrances $32

Encumbrances $32

*To reverse encumbrances (based on debits to reserve for encumbrances; note that the expenditures are only $30, indicating that the goods or services received cost less than the amount for which they were encumbered)*

(5)

Vouchers payable $28

Cash  $28

*To record payment of vouchers (based on credits to cash account)*

**P. 3-3**

(1)

Estimated revenues $120

Fund balance - Unassigned $120

*To record the budget revenues (based on credits to fund balance)*

(2)

Fund balance - Unassigned $115

Appropriations $115

*To record the budgeted expenditures (based on debits to fund balance)*

(3)

Cash $117

Revenues $117

*To record revenues (based on debits to cash)*

(4)

Encumbrances $93

Reserve for encumbrances $93

*To record encumbrances (based on credits to reserve for encumbrances)*

(5)

Expenditures $54

Vouchers Payable $54

*To record expenditures (based on credits to vouchers payable)*

(6)

Reserve for encumbrances $58

Encumbrances $58

*To reverse encumbrances (based on credits to encumbrances; note that the expenditures are only $54, indicating that the goods or services received cost less than the amount for which they were encumbered)*

(7)

Vouchers payable $70

Cash  $70

*To record payment of vouchers (based on debits to vouchers payable)*

**P. 3-4**

1. The city is most likely having difficulty balancing its general fund budget. The charge to the special revenue fund would indeed increase revenues of the general fund and thereby help the city balance its general fund budget.

2. The new charge will increase the general fund’s reported as well as budgeted revenues (or reduce its expenditures ) and, of course, correspondingly increase the special revenue fund’s reported as well as budgeted expenditures (or transfers-out). As long as the city has no intention of transferring the revenues back to the visitors’ bureau (i.e., treating the transfer as a loan), the impact would be the same irrespective of whether the funds were accounted for on a cash or accrual basis.

3. On government-wide consolidated statements, the charge would have no impact on either consolidated revenues or consolidated expenditures and, therefore, no effect on the reported net assets.

4. The charge would have a substantive impact if the visitors’ bureau responded to it by reducing its other expenditures or raising additional revenues or if the city were now able to balance its general fund budget and thereby avoid the legal consequences of an unbalance budget or improve its credit standing with lenders.

5. Overhead costs are ordinarily considered to be indirect costs. However, in this case it might be argued that the administrative services provided by the city substitute for services that the visitors’ bureau would have otherwise had to purchase from outsiders or provide itself. Therefore, the overhead charge might be justifiable in that it is in lieu of costs that would otherwise qualify as direct.

**P. 3-5**

1. It is difficult to determine whether or not the arena is fiscally self-sustaining. Based on the information provided, it appears as if overall expenditures may exceed revenues.

Excess of revenues over expenses as reported $0.3

Additional hotel occupancy taxes $0.1

Additional sales taxes 0.4 0.5

 0.8

Less:

Additional debt service and infrastructure maintenance 0.6

Additional police costs 0.1

Additional administrative costs 0.1

Additional sanitation, fire, and medical costs 0.2 1.0

 Net excess of revenues over expenditures ($0.2)

Moreover, the condensed statement doesn’t take into consideration the cost of the facility. There is no provision for depreciation and recognition that the $20 million in bond principal will someday need to be repaid.

2. Whereas the arena is accounted for in a proprietary fund, most of the other revenues and expenditures would be reported in the general fund (albeit in different sections of the budget and accounts). The hotel occupancy tax would be accounted for in a special revenue (restricted) fund; the medical costs may be accounted for in a hospital (proprietary) fund.

3. A budget and related account structure in which revenues and expenditures are classified by fund and object classification fail to identify the revenues and expenditures that cut across fund lines. Therefore, they do not facilitate an evaluation of the economic costs and benefits of activities or projects such as the arena.

4. Program-type budgets transcend both fund and organizational barriers and identify revenues and costs with programs and activities. These budgets do not, however, report upon legal compliance. Moreover, they often are not effective in controlling costs and assessing performance because some costs are mainly — or at least partially — within the purview of organizations other than those which administer the project or activity. For example, the police costs are controlled by the police department, not the arena.

**P. 3-6**

1.

**Year 1**

Fund balance—unassigned $12,000

Appropriations—education and training $12,000

*To record appropriations*

Encumbrances $10,000

Fund balance—committed for encumbrances $10,000

*To encumber contracts with consultants*

Expenditures—education and training $10,000

Cash  $10,000

*To record expenditures*

Fund balance—committed for encumbrances $10,000

Encumbrances $10,000

*To reverse-out encumbrances upon receipt of services*

Encumbrances $ 1,800

Fund balance—committed for encumbrances $ 1,800

*To encumber order for books and training materials*

Appropriations $12,000

Fund balance—unassigned $12,000

*To close appropriations account*

Fund balance—unassigned $10,000

Fund Balance-committed 1,800

Expenditures $10,000

Encumbrances 1,800

*To close expenditures and encumbrances*

**Year 2**

Fund balance—unassigned $13,500

Appropriations—education and training $13,500

*To record appropriations*

Encumbrances $ 1,800

Fund balance—committed $ 1,800

*To restore encumbrances from Year 1 for goods still on order*

Expenditures—education and training $ 1,700

Cash  $ 1,700

*To record expenditures*

Fund balance—committed for encumbrances $ 1,800

Encumbrances $ 1,800

*To reverse-out full balance in encumbrances upon receipt of materials (all encumbered materials have been received)*

Encumbrances $10,500

Fund balance—committed for encumbrances $10,500

*To encumber commitments to employees*

Expenditures—education and training $10,800

Cash  $10,800

*To record expenditures*

Fund balance—committed for encumbrances $10,500

Encumbrances $10,500

*To reverse-out full balance in encumbrances upon receipt of reimbursement requests (all encumbered commitments have been fulfilled; no special recognition need be given to the excess of expenditures over the amount encumbered)*

Appropriations $13,500

Fund balance—unassigned $13,500

*To close appropriations account*

Fund balance—unasssigned $12,500

Expenditures $12,500

*To close expenditures*

2.
 Year 1 Year 2

Balance sheet

Cash  ($10,000) ($22,500)

Fund balance

Fund balance—unassigned ( 10,000) ( 22,500)

 ($10,000) ($22,500)

Statement of revenues and expenditures

Expenditures—education and training $10,000 $12,500

3. The only difference would be that at the end of year 1 “fund balance—unassigned” would be $10,000 and there would be no reserve for encumbrances.

4. If the appropriations for goods on order do not lapse, then the entries for year 1 would not change. In year 2, however, the entry to restore the encumbrance of $1,800 would not be made. Then, the receipt of the materials would be recorded as follows:

Expenditures—education and training (Year 1) $1,700

Cash  $1,700

*To record expenditures applicable to Year 1*

Fund balance—committed for encumbrances $1,800

Expenditures—education and training (Year 1) $1,700

Fund balance 100

*To close the year 1 expenditure account, to reverse-out the full balance in encumbrances upon receipt of reimbursement requests (all encumbered commitments have been fulfilled) and to restore the difference to unassigned fund balance*

The statement of revenues and expenditures and the balance sheet would, of course, be the same in year 1. In year 2, however, the expenditures would be recorded in two parts: $1,700 for year 1 and $10,800 for year 2.

If the appropriations for goods or services on order lapsed, then the department would have available for expenditure in year 2 only $11,800 — the $13,500 of the year 2 appropriation less the $1,700 spent on the materials ordered in year 1. If, by contrast, the appropriations did not lapse, then it would have available $13,500 — the full amount of its year 2 appropriation.

**P. 3-7**

1.

a. Amended budget to actual results on a budget basis

 Actual

 Results Variance

 Amended (Budget Favorable

 Budget Basis) (unfavorable)

Total revenues $67.2 $72.5 $ 5.3

Total expenditures 66.6 65.7 0.9

Excess of revenues over expenditures $ 0.6 $ 6.8 $ 6.2

b. Original budget to actual results on a budget basis

 Actual

 Results Variance

 Original (Budget Favorable

 Budget Basis) (unfavorable)

Total revenues $60.0 $72.5 $12.5

Total expenditures 59.9 65.7 ( 5.8)

Excess of revenues over expenditures $ 0.1 $ 6.8 $ 6.7

Required adjustments to the budget (and to actual results on a budget basis) to place them on a reporting basis:

 For property taxes and wages and salaries payable — subtract the beginning of year balances and add the end of year balances (since end of year balances will be recognized as a revenue or expenditure for reporting purposes during that year)

 For encumbrances and supplies inventory — subtract end-of-year balance and add beginning-of- year balance (since end-of-year balances will be recognized as expenditures for reporting purposes in the following year)

Revenues:

Property taxes $0.8

 Amount to be added to revenues $0.8

Expenditures

Encumbrances 1.6

Supplies inventory 0.8

Wages and salaries payable 0.2

 Amount to be added to expenditures 2.6

 Amount to be subtracted from excess of

 revenues over expenditures $1.8

c. Amended budget on a reporting basis to actual results on a reporting basis

 Actual

 Restated Results Variance

 Amended (Reporting Favorable

 Budget Basis) (unfavorable)

Total revenues $68.0 $73.3 $ 5.3

Total expenditures 69.2 68.3 .9

Excess of revenues over expenditures ($ 1.2) $ 5.0 $ 6.2

d. Original budget on a reporting basis to actual results on a reporting basis

 Actual

 Restated Results Variance

 Original (Reporting Favorable

 Budget Basis) (unfavorable)

Total revenues $60.8 $73.3 $12.5

Total expenditures 62.5 68.3 ( 5.8)

Excess of revenues over expenditures ($ 1.7) $ 5.0 $ 6.7

2. “Favorable” budget variances do not necessarily indicate sound fiscal management or effective cost controls. The objective of government is not to earn profit. Hence, a favorable revenue variance may indicate only that the government did not properly estimate its revenues. A favorable expenditure variance may indicate that it did not provide adequate services. If anything, budget variances, whether favorable or unfavorable, are a sign of ineffective budgeting.

3. The comparison of the amended budget on a budget basis to the actual results on a budget basis best demonstrates legal compliance. Indeed, legal compliance is defined by adherence to the legal budget.

4. Economic costs and revenues are better captured by GAAP comparisons. Managers should be held accountable for their original budgetary estimates. Comparisons between the original budget and results, both stated on GAAP basis, better capture effective management — at least to the extent that the managers’ budgetary estimates were on target.

**P.3-8**

1.

(a)

Estimated revenues 12,800

 Appropriations 12,500

 Fund balance 300

*To record the budget*

(b)

Encumbrances 11,900

 Reserve for encumbrances 11,900

*To record the encumbrance of goods and services*

(c)

Expenditures 10,700

 Cash 10,700

*To record the cost of goods and services received*

Reserve for encumbrances 10,400

 Encumbrances 10,400

*To reverse the encumbrance entry upon receipt of goods and services*

(d)

Cash 12,000

 Revenues 12,000

*To recognize revenues*

2.

Appropriations 12,500

Fund balance 300

 Estimated revenues 12,800

*To close the appropriations and estimated revenue accounts*

Fund balance 12,200

 Expenditures 10,700

 Encumbrances 1,500

*To close the expenditure and encumbrance accounts*

Revenues 12,000

 Fund balance 12,000

*To close the revenue accounts*

3. 1. Fund balance-(Unassigned)

 Revenues $12,000

 Less: expenditures $10,700

 encumbrances 1,500 (12,200)

 Net change during the year ( 200)

 Beginning balance 1,200

 Ending balance $ 1,000

 2. Reserve for encumbrances: $1,500

4. Schedule of budgets versus actual revenues and expenditures

|  |  |  |  |
| --- | --- | --- | --- |
|  |  |  |  |
|  |  |  |  Variance  |
|  |  |  |  Favorable/  |
|  |  Budgeted  |  Actual  |  (Unfavorable)  |
|  ***Revenues***  |  |  |  |
|  Property taxes  |  $ 7,900  |  $ 7,800  |  $ (100) |
|  Sales taxes  |  3,900  |  3,600  |  (300) |
|  Licenses  |  300  |  200  |  (100) |
|  Other  |  700  |  400  |  (300) |
|  |  12,800  |  12,000  |  (800) |
|  |  |  |  |
| ***Expenditures***  |  |  |  |
|  General government  |  3,000  |  2,800  |  200  |
|  Public safety  |  6,000  |  4,900  |  1,100  |
|  Recreation  |  1,200  |  900  |  300  |
|  Health and sanitation  |  2,300  |  2,100  |  200  |
|  |  12,500  |  10,700  |  1,800  |
|  Excess of revenues over ex-  |  |  |  |
|  penditures/appropriations  |  $ 300  |  $ 1,300  |  $ 1,000  |

5. The budget to actual schedule indicates a favorable expenditure variance of $1,800. However, $1,500 of this variance is attributable to goods and services that are on order but have not yet been received. To be sure the $1,500 does not represent resources that were actually consumed during the year. But it’s possible that the goods and services on order were not received during the year owing to factors beyond the government’s control.

**P. 3-9**

1.

a. The budget ordinance is by department (“Budget control on expenditures is limited to departmental totals and project totals….”). Therefore, expenditures might include police, fire, sanitation, and general government.

b. The line item budget is by object classification. Therefore, expenditures might include salaries, benefits, supplies, travel, maintenance, and rent.

2. Budgetary control is not exercised in either trust or agency funds because it is unnecessary. The main revenues of a trust fund are from investments. The funds likely distribute all (or a pre-established percentage) of their revenues. Hence, budgets would be of little use to management in controlling either revenues or expenditures. Moreover, assuming that the trust funds are not subject to legal requirements (such as a balanced budget) that have to be satisfied, they would do nothing to demonstrate legal compliance. Agency funds have neither revenues nor expenditures. All transactions are undertaken for the benefit of third parties. Therefore, budgets would be of little use to either managers or statements users.

3. The note indicates that the city’s budget is prepared on a modified accrual basis — the same as required by GAAP. Hence, there are probably no differences to reconcile.

4. The general fund is subject to annual appropriation. Hence, all expenditures must be appropriated each year and presumably new budget entries are made (and closed) each year. By contrast, the capital projects fund, which accounts for projects that extend beyond a year, is subject only to appropriation by project. Hence, new budget entries need not be made and closed each year (or, if they are closed at year-end, they can simply be reversed at the start of the following year).

5. The basic financial statements would include a statements that shows actual versus budgeted (both original and amended) revenues and expenditures.

**P. 3-10**

1.

a. General Fund

2011

Fund balance $72,000

Appropriations $72,000

*To record an appropriation for the full amount of the contract*

Encumbrances $72,000

Reserve for encumbrances $72,000

*To establish a reserve for encumbrances*

Expenditures $18,000

Cash  $18,000

*To record expenditures for three months of services*

Reserve for encumbrances $18,000

Encumbrances $18,000

*To reverse entry establishing encumbrances*

Appropriations $72,000

Fund balance $72,000

*To close the budgetary account*

Fund Balance $72,000

Expenditures $18,000

Encumbrances $54,000

*To close encumbrances and expenditures*

2012

Fund balance $54,000

Appropriations $54,000

*To record the budget for nine months of services*

Encumbrances $54,000

Fund balance $54,000

*To restore encumbrances*

Expenditures $50,000

Cash  $50,000

*To record expenditures for nine months of services*

Reserve for encumbrances $54,000

Encumbrances $54,000

*To reverse entry establishing encumbrances*

Appropriations $54,000

Fund balance $54,000

*To close the budgetary account*

Fund balance $50,000

Expenditures $50,000

*To close expenditures*

b. Capital Projects Fund

2011

Fund balance $72,000

Appropriations $72,000

*To record the budget for 12 months of services (the full cost to be incurred over the period of the contract)*

Encumbrances $72,000

Reserve for encumbrances $72,000

*To establish a reserve for encumbrances*

Expenditures $18,000

Cash  $18,000

*To record expenditures for three months of services*

Reserve for encumbrances $18,000

Encumbrances $18,000

*To reverse entry establishing encumbrances*

2012

Expenditures $50,000

Cash  $50,000

*To record expenditures for nine months of services*

Reserve for encumbrances $54,000

Encumbrances $54,000

*To reverse remaining balances in encumbrances and reserve for encumbrances*

Appropriations $72,000

Fund balance $72,000

*To close the budgetary account*

Fund balance $68,000

Expenditures $68,000

*To close expenditures*

2. The general fund accounts for operations that are managed and controlled on an annual basis. The city is mandated to prepare an annual budget and all appropriations must be approved annually. All costs, irrespective of whether they were initially committed to in a previous year, must be budgeted for, appropriated, and charged as expenditures in the year in which the goods or services are received. Therefore, budget entries as well as the expenditures and encumbrances with which they are associated must be prepared and closed-out each year.

 To be sure, the city expected to charge only $18,000 as expenditure in the first year of the contract. Consistent with the modified basis of accounting, it would have to budget — and appropriate — only $18,000. Nevertheless, in few cities would managers be permitted to encumber more than was appropriated? For that reason, the problem requires an initial appropriation of $72,000 rather than $18,000.

 By contrast, the capital projects fund accounts for projects that are managed and controlled on a project basis. A budget is prepared for the entire project, not for each particular year during which construction will take place. Hence, there is no need to make annual budgetary entries each year to close-out encumbrance and expenditure accounts. Indeed, the annual statements of the capital projects funds can be compared to the interim statements of the general fund.

**P. 3-11**

1.

January 1

Fund balance $78,000

Appropriations $78,000

*To record appropriations*

January 1

Encumbrances $ 7,900

Reserve for encumbrances $ 7,900

*To restore encumbrances from prior year*

January 5

Expenditures $ 3,000

Vouchers payable (or cash) $ 3,000

*To record the receipt of goods or services previously encumbered*

Reserve for encumbrances $ 4,000

Encumbrances $ 4,000

*To reverse the encumbrance for the goods or services received (which cost less than the amount for which they were encumbered)*

January 14

Expenditures $ 4,500

Vouchers payable (or cash) $ 4,500

*To record the receipt of goods or services not previously encumbered*

February 5

Encumbrances $ 6,000

Reserve for encumbrances $ 6,000

*To encumber for goods or services for which commitments have been made*

February 15

Expenditures $ 3,400

Vouchers payable (or cash) $ 3,400

*To record the receipt of goods or services that had been previously encumbered*

Reserve for encumbrances $ 3,200

Encumbrances $ 3,200

*To reverse the encumbrance for the goods or services received (which cost more than the amount for which they were encumbered)*

2. To better assure that amounts appropriated are not dissipated early in the year, the city could institute a system of allotments — periodic allocations of funds to departments or agencies, usually made by the chief executive.

**P. 3-12**

1. The state’s budget is most likely on a cash basis — at least with respect to the collection of sales taxes. If sales taxes were on an accrual basis, then the comptroller’s recommendation would have no impact.

2. The state is better-off in economic substance only to an immaterial extent. By advancing collections, it will have use of the $215 million for about 30 days more than it would otherwise. If the state’s borrowing rate were 5 percent, then the value of the funds for that period would be approximately $896,000. It may also, of course, be better-off if the change enables it to avoid the adverse consequences of more severe fiscal measures such as tax increases, cuts in services or a violation of budgetary laws.

3. The comptroller is correct. The “savings” could be “rolled-over” from one year to the next as long as the speed-up policy remains in force. The practice is comparable to an individual receiving a cash advance from an employer and each month repaying it with a new cash advance. There is, of course, a price to be paid by someone — in this case the merchants who would otherwise have use of the cash. What is gained by the state is lost by them.

**P. 3-13**

1. The state currently maintains a reserve fund into which it is required to contribute specified amounts of lottery revenue. The proposal would repeal the fund and the contribution requirement, allowing all lottery revenues to go directly to the general fund. The proposal would affect the well-being of the state in that it would release, for general expenditure, resources that would otherwise be kept in “savings” for periods of economic downturn.

2. Were the state to prepare a consolidated budget, the measure would have no impact on reported revenues since general fund revenues would be combined with the lottery fund revenues.

3. The advantage of budgeting (and maintaining) individual funds is that it permits the state to restrict resources for specific purposes. In this case, it would enable the state to set aside resources for an economic downturn. The amount in the lottery fund would be unavailable for general purposes. The disadvantage is that the individual budgets do not present a complete picture of the entity as a whole. In the case at hand, the state is apparently short of resources available for general purposes but has an excess of resources in the reserve fund. Were the state to budget on a consolidated basis, it would have greater flexibility to use its resources as officials and legislators of any particular year deem appropriate — flexibility that could be seen as both an advantage and a disadvantage.

**Questions for Research, Analysis and Discussion**

1. Paras. 130 and 131 of GASB Statement No. 34 address how budgetary comparisons should be presented. Para. 130, states, in part:

Budgetary comparisons should be presented for the general fund and for each major special revenue fund that has a legally adopted annual budget. Governments are encouraged to present such budgetary comparison information in schedules as a part of RSI. However, a government with significant budgetary perspective differences that result in the government’s not being able to present budgetary comparisons for the general fund and each major special revenue fund is required to present budgetary comparison schedules as RSI based on the fund, organization, or program structure that the government uses for its legally adopted budget *(Amendment Statement 34)*. 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 inflows, outflows, and balances, stated on the government’s budgetary basis.

In addition, footnote No. 53 to para. 130 explicitly permits governments to include the budgetary comparisons in the basic statements rather than required supplementary information:

Governments may elect to report the budgetary comparison information in a budgetary comparison statement as part of the basic financial statements, rather than as RSI. If presented, the additional statement should include the same items of information that paragraphs 130 and 131 require to be displayed or disclosed.

1. GASB Codification, Section 1100.111 provides the appropriate guidance. The government should present budgetary comparisons by fund or program as best it can:

Presentation of budgetary comparison schedules the government should prepare

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 comparisons should be presented for the general fund and for each major special revenue fund that has a legally adopted annual budget. Governments are encouraged to present such budgetary comparison information in schedules as a part of RSI. However, a government with significant budgetary perspective differences that result in the government’s not being able to present budgetary comparisons for the general fund and each major special revenue fund is required to present budgetary comparison schedules as RSI based on the fund, organization, or program structure that the government uses for its legally adopted budget. (These governments generally should present budgetary comparisons for the activities that are reported in the general fund and each major special revenue fund.)

Codification sections 1700 and 2400 provide addition guidance.

1. Yes, it should be included. See paragraph 130a of GASB Statement No. 34, which states:

The original budget is the first complete appropriated budget. The original budget may be adjusted by reserves, transfers, allocations, supplemental appropriations, and other legally authorized legislative and executive changes before the beginning of the fiscal year*. The original budget should also include actual appropriation amounts automatically carried over from prior years by law. For example, a legal provision may require the automatic rolling forward of appropriations to cover prior-year encumbrances*. [emphasis added]

1. Yes. It is permitted. See paragraph 130b of GASB Statement No. 34, which states:

The final budget is the original budget adjusted by all reserves, transfers, allocations, supplemental appropriations, and other legally authorized legislative and executive changes applicable to the fiscal year, whenever signed into law or otherwise legally authorized.