

## **Chapter 3**

### **Issues of Budgeting and Control**

#### **TRUE/FALSE (CHAPTER 3)**

1. Capital budgets focus on plans for the acquisition and construction of fixed assets.
2. The accounting cycle for most governments is two to three years and the budgeting process is less than six months.
3. Most budgets are prepared on a cash or modified cash basis.
4. GASB, but not FASB, sets standards for budgetary accounting.
5. State and local governments must prepare their GAAP budgetary comparisons on the modified accrual basis of accounting.
6. When budgets are integrated into a government's accounting system, estimated revenues are debited.
7. Encumbrances and expenditures both reduce total fund balances of state and local governments.
8. Not-for-profit budgets can rely on levies in addition to fund-raising and donations for revenues.
9. State and local governments' budget-to-actual comparisons present both original and final budget amounts.
10. Cash-basis budgets help governments demonstrate interperiod equity.
11. Reserve for encumbrances accounts is a balance sheet account.
12. Capital budgets concentrate on long-lived assets.

**ANSWERS TO TRUE/FALSE (CHAPTER 3)**

1. T
2. F
3. T
4. F
5. F
6. T
7. F
8. F
9. T
10. F
11. T
12. T

### MULTIPLE CHOICE (CHAPTER 3)

1. Which of the following is NOT a function of a budget in the governmental environment?
  - a) Planning.
  - b) Organizing.
  - c) Controlling.
  - d) Evaluating.
  
2. For which of the following funds would flexible budgeting be most valuable?
  - a) Special revenue fund.
  - b) Capital projects fund.
  - c) Agency fund.
  - d) Enterprise fund.
  
3. Property taxes levied on the citizens of the Hill County would most appropriately be budgeted in which of the following budgets?
  - a) Operating budget.
  - b) Capital budget.
  - c) Flexible budget.
  - d) All of the above.
  
4. Character, in relation to expenditures, represents
  - a) The morality of the expenditure.
  - b) The amount of the expenditure.
  - c) The type of fund in which the expenditure is recorded.
  - d) The fiscal period the expenditure will benefit.
  
5. Which of the following is a primary benefit of a performance budget?
  - a) It facilitates control by establishing rigid spending mandates.
  - b) It encourages accomplishment of objectives by associating expenditures with outcomes.
  - c) It encourages planning by requiring management to anticipate every type of expenditure.
  - d) It provides decision-makers with detailed information.
  
6. Which branch of local (city and county) government most commonly prepares the budget?
  - a) Executive branch.
  - b) Legislative branch.
  - c) Judicial branch.
  - d) None of the above.
  
7. An appropriations budget applies to
  - a) The general fund.
  - b) The proprietary fund.
  - c) The fiduciary fund.
  - d) The enterprise fund.

8. Periodic allocations of funds to departments or agencies are generally called
  - i. Appropriations.
  - ii. Allotments.
  - iii. Apportionments.
    - a) III only
    - b) I and II
    - c) II and III
    - d) I, II and III
9. Which of the following bases of accounting has been established by GASB for use in the preparation of the general fund budget?
  - a) Cash basis.
  - b) Modified accrual basis.
  - c) Accrual basis.
  - d) None of the above.
10. Which of the following is the best reason for preparing budgets for government entities on the cash basis?
  - a) Cash basis budgeting helps to achieve interperiod equity.
  - b) Cash basis budgeting helps to ensure that the government will receive no more in revenues than it is required to disburse.
  - c) Cash basis budgeting helps a government plan to have cash on hand to pay bills
  - d) Cash basis budgeting more accurately reflects the economic impact of fiscal activities.
11. Which of the following is NOT true about cash basis budgeting?
  - a) Cash basis budgeting permits a government to balance its budget by delaying cash disbursements.
  - b) Cash basis budgeting permits a government to balance its budget by advancing the recognition of revenue.
  - c) Cash basis budgeting encourages interperiod equity.
  - d) Cash basis budgeting complicates financial accounting and reporting.
12. GASB requires that government entities present their budget-to-actual comparison data on which of the following bases of accounting?
  - a) Budgetary basis.
  - b) Cash basis.
  - c) Modified accrual basis.
  - d) Accrual basis.
13. Which of the following is NOT a reason that legally adopted budgets may not be readily comparable to amounts reported in the GAAP-based financial statements?
  - a) Differences in basis of accounting.
  - b) Differences in timing.
  - c) Differences in reporting entity.
  - d) Differences in recognition.

14. The City of Lakeview adopts its budget on a basis of accounting that permits outstanding purchase commitments to be charged against the budget in the year that the goods are ordered instead of in the year they are received. During 2018, the city received \$4,000 of supplies (of which \$3,000 had been ordered in 2018 and \$1,000 was ordered in 2017) and had \$500 of outstanding purchase commitments for supplies at year-end. In the budget-to-actual comparison, the expenditures for supplies would be:
- \$3,000.
  - \$3,500.
  - \$4,000.
  - \$4,500.
15. A governmental entity has formally integrated the budget into its accounting records. At year-end the ledger account "Estimated Revenues" has a debit balance. Which of the following is the best explanation for the debit balance?
- The entity overestimated property tax revenue it expected to be recognized.
  - The entity underestimated property tax revenue when preparing its budget.
  - The entity collected more in property taxes than it anticipated.
  - There is no logical explanation; revenue accounts usually do not have debit balances.
16. A governmental entity has formally integrated the budget into its accounting records and uses encumbrance accounting. During the year the government ordered but had not yet received a new police car. What effect will this event have on the unencumbered balance in the account "Expenditures—capital outlay, police department"?
- The balance in the account will not be affected until the police car is received.
  - The balance in the account will be increased.
  - The balance in the account will be decreased.
  - Purchase orders never affect any budgetary account balances.
17. A governmental entity has formally integrated the budget into its accounting records. At the end of the third quarter the ledger account "Expenditures--salaries" has a \$100,000 debit balance. Which of the following is a true statement?
- The entity has \$100,000 available to spend on salaries.
  - The entity has incurred salaries in the amount of \$100,000.
  - The entity had paid salaries in the amount of \$100,000.
  - The entity has overspent its budget for salaries by \$100,000.
18. A public school district formally adopted a budget with estimated revenues of \$800 and approved expenditures of \$780. Which of the following is the appropriate entry to record the budget?
- Debit Estimated revenues \$800; Credit Appropriations \$780; Credit Fund balance \$20.
  - Debit Appropriations \$780; Debit Fund balance \$20; Credit Estimated revenues \$800.
  - Debit Encumbrances \$780; Debit Fund balance \$20; Credit Estimated revenues \$800.
  - Memorandum entry only.

19. A city formally adopted a budget at the beginning of the current year. Budgeted revenues were \$500 and budgeted expenditures were \$490. During the year actual revenues were \$520 and actual expenditures were \$480. Fund balance at the end of the current year in comparison to fund balance at the end of the preceding year will be
- \$10 greater.
  - \$30 greater.
  - \$40 greater.
  - \$50 greater.
20. A county general fund budget includes budgeted revenues of \$900 and budgeted expenditures of \$890. Actual revenues for the year were \$915. To close the estimated revenues account at the end of the year
- Debit Estimated revenues \$15
  - Credit Estimated revenue \$15
  - Debit Estimated revenues \$900
  - Credit Estimated revenues \$900
21. A university that formally integrates the budget in the accounting system and uses encumbrance accounting orders some new computers that will cost approximately \$20,000. To recognize this event the university should make which of the following entries?
- Debit Expenditures \$20,000; Credit Encumbrances \$20,000
  - Debit Encumbrances \$20,000; Credit Reserve for encumbrances \$20,000
  - Debit Encumbrances \$20,000; Credit Accounts payable \$20,000
  - No entry required when the order is placed.
22. A county previously encumbered \$15,000 for the acquisition of supplies. The supplies were received at a total cost of \$14,700. To recognize this event the county should make which of the following entries?
- Debit Reserve for encumbrances \$15,000; Credit Encumbrances \$15,000.
  - Debit Reserve for encumbrances \$14,700; Credit Encumbrances \$14,700.
  - Debit Encumbrances \$15,000; Credit Reserve for encumbrances \$15,000.
  - Debit Encumbrances \$14,700; Credit Reserve for encumbrances \$14,700.
23. A city received supplies that had been previously encumbered. The supplies were encumbered for \$5,000 and had an actual cost of \$4,900. To recognize this event the county should make which of the following entries?
- Debit Reserve for encumbrances \$5,000 and Supplies \$4,900; Credit Encumbrances \$5,000 and Vouchers payable \$4,900.
  - Debit Encumbrances \$5,000 and Supplies \$4,900; Credit Reserve for encumbrances \$5,000 and Vouchers payable \$4,900.
  - Debit Reserve for encumbrances \$4,900 and Supplies \$4,900; Credit Encumbrances \$4,900 and Vouchers payable \$4,900.
  - Debit Encumbrances \$4,900 and Supplies \$4,900; Credit Reserve for encumbrances \$4,900 and Vouchers payable \$4,900.

24. To close Encumbrances at the end of the year which of the following entries should be made?
- Debit Encumbrances; Credit Fund balance.
  - Debit Reserve for encumbrances; Credit Encumbrances.
  - Debit Fund balance; Credit Encumbrances.
  - No closing entry needed.
25. To close Reserve for encumbrances at the end of the year which of the following entries should be made?
- Debit Reserve for encumbrances; Credit Fund balance.
  - Debit Reserve for encumbrances; Credit Encumbrances.
  - Debit Fund balance; Credit Reserve for encumbrances.
  - No closing entry needed.
26. During the previous year, Bane County closed its Encumbrances account. At the end of the previous year there was \$5,000 of outstanding purchase commitments. To restore these commitments to the accounts, which of the following entries would be required?
- Debit Reserve for encumbrances \$5,000; Credit Encumbrances \$5,000.
  - Debit Encumbrances \$5,000; Credit Reserve for encumbrances \$5,000.
  - Debit Encumbrances \$5,000; Credit Fund balance \$5,000
  - Debit Fund balance \$5,000; Credit Reserve for encumbrances \$5,000.
27. When Spruce City receives goods at a cost of \$9,700 that were encumbered in the prior year for \$10,000, which of the following entries are required (assume that encumbrances lapse at year end)?
- Debit Expenditures \$9,700; Credit Accounts payable \$9,700; no entry for Encumbrances.
  - Debit Expenditures \$9,700 and Reserve for encumbrances \$10,000; Credit Accounts payable \$9,700 and Encumbrances \$10,000.
  - Debit Expenditures \$10,000 and Reserve for encumbrances \$10,000; Credit Accounts payable \$10,000 and Encumbrances \$10,000.
  - Debit Reserve for encumbrances \$10,000; Credit Encumbrances \$10,000; no entry for Expenditures.
28. At year-end Oakland County had \$3,000 of outstanding purchase commitments on the books. After the appropriate closing entries are made, what is the effect on the *total* fund balance of Oakland County?
- It is \$3,000 greater than it would have been if the purchase commitments had been fulfilled by year-end.
  - It is \$3,000 less than it would have been if the purchase commitments had been fulfilled by year-end.
  - It is the same as it would have been if the purchase commitments had been fulfilled by year-end; it will be reduced by \$3,000 next year.
  - It is the same as it would have been if the purchase commitments had been fulfilled by year-end; it will not change next year.

29. Hill City uses encumbrance accounting to control expenditures. However, it charges the cost of outstanding purchase commitments to expenditures in the year they are received, not in the year they are ordered. If Hill City had \$10,000 of purchase commitments outstanding at the end of Year 1 and received those goods during Year 2 at a cost of \$9,800, what would be the impact on *total* fund balance for Year 2?
- a) Total fund balance at the end of Year 2 would be \$9,800 less than at the end of Year 1.
  - b) Total fund balance at the end of Year 2 would be \$200 less than at the end of Year 1.
  - c) Total fund balance at the end of Year 2 would be \$200 greater than at the end of Year 1.
  - d) Total fund balance at the end of Year 2 would be same as it was at the end of Year 1.
30. The City of Denton uses encumbrance accounting to control expenditures. It charges the cost of outstanding purchase commitments to expenditures in the year they are received, not in the year they are ordered. If the city had \$11,000 of purchase commitments outstanding at the end of Year 1 and received those goods during Year 2 at a cost of \$11,700, what would be the impact on *total* fund balance for Year 2?
- a) Total fund balance at the end of Year 2 would be \$11,700 less than at the end of Year 1.
  - b) Total fund balance at the end of Year 2 would be \$700 less than at the end of Year 1.
  - c) Total fund balance at the end of Year 2 would be \$700 greater than at the end of Year 1.
  - d) Total fund balance at the end of Year 2 would be same as it was at the end of Year 1.



31. Lincoln County uses encumbrance accounting to control expenditures. It charges the cost of outstanding purchase commitments to expenditures in the year they are ordered, not in the year they are received. If the county had \$7,000 of purchase commitments outstanding at the end of Year 1 and received those goods during Year 2 at a cost of \$7,800, what would be the impact on *total* fund balance for Year 2?
- Total fund balance at the end of Year 2 would be \$7,800 less than at the end of Year 1.
  - Total fund balance at the end of Year 2 would be \$800 less than at the end of Year 1.
  - Total fund balance at the end of Year 2 would be \$800 greater than at the end of Year 1.
  - Total fund balance at the end of Year 2 would be the same as it was at the end of Year 1.
32. Why would a government be more likely than a not-for-profit organization to integrate its budget into its accounting system?
- Because the amount of expenditures is likely to be greater.
  - Because the penalties for exceeding budgeted expenditures are more severe.
  - Because governments have more sophisticated accounting systems than not-for-profit organizations.
  - Governments are NOT more likely than not-for-profits to formally integrate their budget into their accounting system.
33. Which of the following is the primary reason why governments formally integrate their legally adopted budget into their accounting systems?
- It is required by GASB.
  - It allows continuous monitoring of revenues and expenses to compare to budgets.
  - It keeps the government from knowing its budget.
  - It helps a government by letting it know when it is in danger of overspending its budget.
34. Washington County received goods that had been approved for purchase but for which payment had not yet been made. Should the following accounts be increased?
- |    | <u>Expenditures</u> | <u>Encumbrances</u> |
|----|---------------------|---------------------|
| a) | No                  | No                  |
| b) | Yes                 | Yes                 |
| c) | Yes                 | No                  |
| d) | No                  | Yes                 |
35. In which of the following cases would the reserve for encumbrances account be decreased?
- Budget revisions are made, decreasing appropriations
  - Payment is made for goods received
  - Goods, related to purchase orders, are received
  - Purchase orders are issued

36. A review of Park City's books shows the following information:
- I. \$2,500 of outstanding vouchers payable
  - II. \$3,000 of outstanding purchase order amounts
- Which of these amounts would you expect to see in the general fund's encumbrances account?
- a) \$2,500
  - b) \$3,000
  - c) \$5,500
  - d) \$500
37. Per GASB standards, a budget-to-actual comparison must include columns for the actual results and
- a) The original budget only.
  - b) The final budget only.
  - c) Both the original and the final budget.
  - d) Both the amended and the final budget.
38. Carolina City places an order for a specific item of equipment and encumbers \$6,000 for that item. The equipment arrives with an invoice for \$5,700. Which of the following entries should the city make upon receipt of the equipment?
- a) A debit to expenditures for \$5,700, a debit to accounts payable for \$300, and a Credit to encumbrances for \$6,000.
  - b) A debit to expenditures for \$5,700, a debit to reserve for encumbrances for \$6,000, a Credit to accounts payable for \$5,700, and a Credit to encumbrances for \$6,000.
  - c) A debit to expenditures for \$5,700, a debit to reserve for encumbrances for \$300, and a Credit to accounts payable for \$6,000.
  - d) A debit to expenditures for \$300, a debit to reserve for encumbrances for \$5,700, and a Credit to encumbrances for \$6,000.

### ANSWERS TO MULTIPLE CHOICE (CHAPTER 3)

1. b
2. d
3. a
4. d
5. b
6. a
7. a
8. d
9. d
10. c
11. c
12. a
13. d
14. b
15. a
16. a
17. c
18. a
19. c
20. d
21. b
22. a
23. a
24. c
25. d
26. c
27. b
28. a
29. a
30. a
31. a
32. b
33. b
34. c
35. c
36. b
37. c
38. b

### PROBLEMS (CHAPTER 3)

1. Assume that the City of Pasco maintains its books and records in a manner that facilitates preparation of the fund financial statements. The city engaged in the following transactions related to its general fund during the current fiscal year. The city formally integrates the budget into the accounting records. The city does not maintain an inventory of supplies. All amounts are in thousands.

REQUIRED: Prepare, in summary form, the appropriate journal entries.

- (a) The city council approved a budget with revenues estimated to be \$800 and expenditures of \$785.
- (b) The city ordered supplies at an estimated cost of \$25 and equipment at an estimated cost of \$20.
- (c) The city incurred salaries and other operating expenses during the year totaling \$730. The city paid for these items in cash.
- (d) The city received the supplies at an actual cost of \$23.
- (e) The city collected revenues of \$795.

2. School District #25 formally integrates the budget into the accounting system and uses the encumbrance system. All appropriations lapse at year-end. At year-end, before closing entries, the district had the following balances in its accounts. All accounts had normal balances.

REQUIRED: (a) Prepare the necessary closing entries.  
(b) Prepare a balance sheet after closing.

Accounts Payable	\$ 75
Appropriations	885
Cash	258
Encumbrances	30
Estimated revenues	900
Expenditures	859
Fund balance	165
Reserve for encumbrances	30
Revenues	892

3. Assume that the County of Katerah maintains its books and records in a manner that facilitates preparation of the fund financial statements. The county formally integrates the budget into the accounting system and uses the encumbrance system. All appropriations lapse at year-end. At the beginning of the fiscal year, the county had the following balances in its accounts. All amounts are in thousands.

REQUIRED: Prepare the necessary entries for the current fiscal year.

Cash	\$200
Fund balance unassigned	50
Reserve for encumbrances (committed or assigned)	150

- (a) The county made the appropriate entry to restore the prior-year purchase commitments.
- (b) The county board approved a budget with revenues estimated to be \$800 and expenditures of \$750.
- (c) The county received the items that had been ordered in the prior year at an actual cost of \$135.
- (d) The county ordered supplies at an estimated cost of \$50 and equipment at an estimated cost of \$70.
- (e) The county incurred salaries and other operating expenses during the year totaling \$600. The county paid these items in cash.
- (f) The county received the equipment at an actual cost of \$75.
- (g) The county earned and collected, in cash, revenues of \$810.

4. Kayla County prepares its general fund financial reports in accordance with generally accepted accounting principles (GAAP) but its budgetary basis for the general fund differs from GAAP. The budget-to-actual comparison for the general fund is presented below. All numbers are in thousands.

REQUIRED: Prepare the GAAP-basis operating statement for the general fund.

- (a) For budgetary purposes, the county recognizes encumbrances as expenditures in the year of the purchase commitment; it recognizes supplies as expenditures when acquired. For budgetary purposes the county recognizes all revenues in the fiscal year collected.

For GAAP-basis financial reporting, the county recognizes supplies as expenditures as consumed. It recognizes property taxes as revenue if they are collected within 60 days of fiscal year-end. All other revenues are recognized on the cash basis for GAAP.

- (b) The following additional information is available.

	<u>Beginning of Year</u>	<u>End of Year</u>
Encumbrances	\$ 60	\$ 100
Supplies inventory on hand	\$ 10	\$ 40
Property taxes expected to be collected within 60 days of year-end	\$ 100	\$ 80

	<u>Amended Budget</u>	<u>Actual (on Budget Basis)</u>
Property tax revenue	\$ 700	\$ 710
Other revenue	500	550
Total revenue	<u>\$1,200</u>	<u>\$1,260</u>
Expenditures	<u>1,190</u>	<u>1,150</u>
Excess of revenues over expenditures	<u>\$ 10</u>	<u>\$ 110</u>

5. Geneva County authorized the issuance of bonds and contracted with the Chessie Construction Company (CCC) to build a new convention center. During 2016, 2017, and 2018, the county engaged in the transactions that follow. All were recorded in the county's capital projects fund.
  - a. In 2016, the county issued \$350 million in bonds (and recorded them as bond proceeds, an account comparable to revenues.)
  - b. The county approved the contract proposal from CCC for \$350 million and encumbered the entire amount.
  - c. CCC billed the county for \$115 for construction to date.
  - d. The county paid CCC the amount due in full.
  - e. In 2017, CCC billed the county for additional construction to date of \$190 million.
  - f. The county paid the amount due in full.
  - g. In 2018, CCC completed construction of the convention center and billed the county an additional \$50 million. The county approved the additional costs, even though the total cost of the center was now \$355 million, \$5 million more than the contract initially provided for.
  - h. The county transferred \$5 million from its general fund to the capital projects fund.
  - i. The county paid the \$50 million in full.

REQUIRED:

1. Prepare the journal entries to record these transactions in the capital projects fund, including closing entries. Assume that amounts originally encumbered are reappropriated each year. Hence the county need not reestablish encumbrances in each year after the first year. Instead, it can close the expenditures of the second and third years to reserve for encumbrances rather than to fund balance.
2. What other funds or schedules would be affected by the transactions listed?



6. The town of Terry began 2016 with an unreserved balance of \$15 million in its street repair fund, a capital projects fund. At the start of the year, the city council appropriated \$9 million to reconstruct portions of the roadbed for two of its major roads—Main Street and Koeller Avenue. Shortly after, the town signed contracts with two construction companies to perform the repairs for a total of \$9 million. During the year, the town received bills from the construction companies as follows:
  - a. \$4.8 million for the entire cost of repairs to Main Street. This amount is \$0.3 higher than expected due to design changes approved by the town. The town did not encumber the additional \$0.3 million.
  - b. \$3.0 million, representing a progress billing for repairs to Koeller Avenue, which were not completed at the end of 2016.

At the beginning of 2017, the town reappropriated the remaining \$1.5 million for the Koeller Avenue repairs. During the year, the town received this bill:

- c. \$0.1 million, representing the final billing for the Koeller Avenue repairs. The final cost was \$0.5 million less than anticipated.

**REQUIRED:**

Prepare journal entries to record the events and transactions over the two-year period. Include entries to appropriate, reappropriate, encumber, and re-encumber the required resources, to record the payment of the bills, and to close the accounts at the end of each year.

Determine the reserve for encumbrances (committed or assigned) and fund balance—unassigned for the capital projects fund at the end of the second year.

7. The Breast Cancer Fund, a not-for-profit organization, receives its funding primarily from government grants and private contributions. In turn, the Fund provides resources to other organizations and individuals for breast cancer research. Many of the government grants it receives are reimbursement-type. That is, the Fund must incur specific costs to be eligible for grants that reimburse those costs. The Fund makes the following estimates as to its next fiscal year:
- a. It will be awarded \$7 million in government grants; all but \$0.5 million will be received during the fiscal year. The balance will be reimbursed in the first six months after year-end. The Fund will also receive \$0.2 million in reimbursement grants related to the previous year.
  - b. It will receive \$600,000 in pledges from private donors. It expects to collect \$450,000 during the year and \$125,000 in the following year. It estimates that \$25,000 will never be received. It also expects to collect \$80,000 in pledges made the prior year.
  - c. It will pay \$7 million for outside research.
  - d. It will purchase new computer equipment costing \$100,000. The Fund currently owns its own building, which it had purchased for \$800,000, and additional furniture and equipment that it acquired for \$250,000. The building has a useful life of twenty years; the furniture and equipment have useful lives of 5 years. It is the Fund's policy to record a full year of depreciation expense in the year that assets are placed in service.
  - e. Employees will earn wages and salaries of \$340,000, of which they will be paid \$320,000 during the year and the balance in the next year. The Fund will also pay another \$15,000 in payroll costs incurred in the prior year.
  - f. It will pay the \$75,000 insurance deductible on an employee-related lawsuit settled the previous year.
  - g. It will incur operating costs of \$90,000, of which it will pay \$70,000 during the year and \$20,000 in the following year. It will also pay another \$10,000 in costs incurred in the previous year.

REQUIRED:

1. Prepare two budgets, one on the cash basis, the other on the full accrual basis. Show both on the same schedule—the full accrual basis in the first column and the cash basis in the second column.
2. Comment on which budget better shows whether the Breast Cancer Fund is covering the economic cost of the services it provides.
3. Which budget is likely to be more useful to Breast Cancer Fund managers?

8. The following schedule shows the amounts related to supplies that the City of Pascal debited and Credited to the indicated accounts during the year (not necessarily year-end balances), *before* closing entries. The city records its budget, encumbers all of its expenditures, and initially vouchers all payments. All revenue was collected in cash.

REQUIRED:

Some information is missing in the schedule below. Determine the missing data by reconstructing (in summary) the journal entries the city must have made during the year.

	<i>(in thousands)</i>	
	<b>Debits</b>	<b>Credits</b>
Cash	\$ 117	\$ ?
Estimated revenues	?	0
Revenues	0	?
Vouchers payable	70	54
Appropriations	0	?
Encumbrances	?	58
Expenditures	?	0
Reserve for encumbrances	?	93
Fund balance	115	120

9. The data presented below were taken from the books and records of the village of Denaville. All amounts are in millions. The village encumbers all outlays. As is evident from the data, some goods or services that were ordered and encumbered have not yet been received. City regulations require that all appropriations lapse at year-end.

	Estimated/ <u>Appropriated</u>	Amounts <u>Encumbered</u>	<u>Amounts Received</u>		Actual <u>Revenues</u>
			<u>Estimated Cost</u>	<u>Actual Cost</u>	
<u>Revenues</u>					
Property taxes	\$8,900				\$8,800
Sales taxes	3,900				3,600
Licenses	300				200
Other	<u>700</u>				<u>400</u>
	<u>\$13,800</u>				<u>\$13,000</u>
<u>Expenditures/Appropriations</u>					
General government	\$3,500	\$3,100	\$2,900	\$3,300	
Public safety	6,000	5,900	5,000	4,900	
Recreation	1,200	1,200	800	900	
Health and sanitation	<u>2,300</u>	<u>2,200</u>	<u>2,200</u>	<u>2,100</u>	
	<u>\$13,000</u>	<u>\$12,400</u>	<u>\$10,900</u>	<u>\$11,200</u>	
Excess of estimated revenues over appropriations	\$800				
Beginning fund balance	<u>1,500</u>				
Estimated ending fund balance	<u>\$2,300</u>				

- I. Prepare summary entries to record:
- the encumbrance of the goods and services and
  - the receipt of the goods and services assuming all invoices were paid in cash.
- II. What would be the year-end:
- fund balance (unassigned)
  - reserve for encumbrances balance

10. Suppose a city accountant prepared a schedule comparing budgeted to actual revenues and expenditures. The city's mayor notes (correctly) that the very favorable variance between budgeted and actual expenditures was not merely a matter of luck – e.g., attributable to factors beyond the control of the city, such as less than usual snowfall and hence lower than usual snow removal costs. Rather, he boasts, it was due to a concerted effort on the part of his administration to “hold the line” on expenditures. Why, in governments and not-for-profit organizations might favorable expenditure variances be an indication of inept rather than competent management?

10. On July 1, the start of its fiscal year, Daze County reported the following balances (\$ in thousands):

Fund balance:	
Committed for encumbrances	\$400
Unassigned	<u>800</u>
Total fund balance	<u>\$1,200</u>

During the year, the county (\$ in thousands):

- Estimated that revenues for the year would be \$12,600.
- Appropriated \$13,000 for operations.
- Ordered supplies estimated to cost \$12,000. Of these, the county received (and used) supplies that it had estimated would cost \$10,000. Actual cost, however, was \$10,600.
- Received (and used) all goods that it had ordered in the previous year. Actual cost was only \$360.
- Recognized actual revenues of \$12,800.

#### REQUIRED

1. Prepare a schedule of changes in unassigned fund balance for the year.
2. Show how the total fund balance (including the unassigned and committed portions) would be displayed at year-end.

## ANSWERS TO PROBLEMS (CHAPTER 3)

### Problem 1

(a) Estimated revenue	800	
Fund balance		15
Appropriations		785
(b) Encumbrances	45	
Reserve for encumbrances		45
(c) Expenditures	730	
Cash		730
(d) Reserve for encumbrances	25	
Encumbrances		25
Expenditures	23	
Cash		23
(e) Cash	795	
Revenues		795

### Problem 2

(a) Appropriation	885	
Fund balance	15	
Estimated revenue		900
(b) Revenues	892	
Fund balance		3
Expenditures		859
Encumbrances		30

<u>Balance Sheet</u>	
Cash	<u>\$258</u>
Accounts payable	\$ 75
Fund balance	
Reserve for encumbrances—	
(committed or assigned)	\$ 30
Unassigned	<u>153</u>
Total liabilities and fund balance	<u>\$258</u>

Problem 3

(a) Encumbrances	\$150	
Fund balance—unassigned		\$150
(b) Estimated revenue	800	
Fund balance—unassigned		50
Appropriations		750
(c) Expenditures	135	
Cash		135
Reserve for encumbrances—(committed or assigned)	150	
Encumbrances		150
(d) Encumbrances	120	
Reserve for encumbrances (committed or assigned)		120
(e) Expenditures	600	
Cash		600
(f) Expenditures	75	
Cash		75
Reserve for encumbrances—(committed or assigned)	70	
Encumbrances		70
(g) Cash	810	
Revenues		810



Problem 4

	<u>Actual (Budget Basis)</u>	<u>Adjustments</u>	<u>Actual (GAAP Basis)</u>
Property tax revenue	\$ 710	-\$100 + 80	\$ 690
Other revenue	<u>550</u>		<u>550</u>
Total revenue	\$1,260		\$1,240
Expenditures		Encumbrances +\$ 60 -\$100	
	<u>1,150</u>	Supplies +\$ 10 -\$ 40	<u>1,080</u>
Excess of revenues over expenditures	<u>\$ 110</u>		<u>\$ 160</u>



Closing entries—2017:

Reserve for encumbrances (committed or assigned)	\$190	
Expenditures		\$190
<i>To close expenditures</i>		

2018

(g) Expenditures	\$ 50	
Accounts payable		\$ 50
<i>To record construction expenditures</i>		

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

(h) Cash	\$ 5	
Transfer-in from general fund		\$ 5
<i>To record transfer of cash from general fund</i>		

(i) Accounts payable	\$ 50	
Cash		\$ 50
<i>To record the cash payment</i>		

Closing entries—2018:

Reserve for encumbrances (committed or assigned)	\$45	
Fund balance—unassigned	5	
Expenditures		\$ 50
<i>To close expenditures</i>		

Transfer-in from general fund	\$ 5	
Fund balance—unassigned		\$ 5
<i>To close the transfer-in account</i>		

2. The transfer from the general fund would, of course, be recorded in the general fund. The construction in process and the completed convention center would be recorded in the schedule of general fixed assets and in the government-wide statement of net position. The bonds payable would be recorded in the schedule of general long-term debt and in the government-wide statement of net position.

Problem 6

1. Journal Entries

Year 2016

Fund balance—unassigned	\$9.0	
Appropriations		\$9.0
<i>To record the budget (that is, appropriate the required resources)</i>		
Encumbrances	\$9.0	
Reserve for encumbrances (committed or assigned)		\$9.0
<i>To encumber the estimated cost of repairs</i>		
Expenditures	\$7.8	
Cash		\$7.8
<i>To record repairs expenditures</i>		
Reserve for encumbrances (committed or assigned)	\$7.5	
Encumbrances		\$7.5
<i>To reverse the encumbrances upon recognition of repairs expenditures (\$4.5 on Main Street and \$3.0 on Koeller Avenue)</i>		
Appropriations	\$9.0	
Fund balance—unassigned	0.3	
Encumbrances		\$1.5
Expenditures		7.8
<i>To close the appropriations, expenditures and encumbrances accounts</i>		

Year 2017

Fund balance—unassigned	\$1.5	
Appropriations	\$1.5	
<i>To record the budget (that is, reappropriate the funds to complete the repairs on Koeller Avenue)</i>		
Encumbrances	\$1.5	
Fund balance—unassigned		\$1.5
<i>To restore the encumbrances of the prior year</i>		
Expenditures	\$1.0	
Cash		\$1.0
<i>To record the remaining repairs expenditures</i>		
Reserve for encumbrances (committed or assigned)	\$0.5	
Encumbrances		\$0.5
<i>To reverse the encumbrances for the entire remaining balances in the encumbrances and reserve for encumbrances accounts.</i>		

Appropriations	\$1.5	
Expenditures	\$1.0	
Fund balance—unassigned		\$0.5
<i>To close the appropriation and expenditure accounts</i>		

2. The balance in the fund balance account is \$6.2 million — equal to the initial fund balance of \$15.0 million less total repairs expenditures of \$8.8 million (\$4.8 million on Main Street plus \$4.0 million on Koeller Avenue).

Problem 7

1.

	<u>Budget Basis</u>	
	<u>Accrual</u>	<u>Cash</u>
	(in thousands)	
Revenues:		
Government grants	\$7,000	\$6,700
Private contributions	<u>575</u>	<u>530</u>
	<u>7,575</u>	<u>7,230</u>
Expenditures:		
Research	7,000	7,000
Furniture and equipment/Depreciation	70*	100
Building/Depreciation	40	0
Wages and salaries	340	335
Claims and judgments	0	75
Other operating costs	<u>90</u>	<u>80</u>
	<u>7,540</u>	<u>7,590</u>
Excess of revenues over expenditures	<u>\$ 35</u>	<u>(\$ 360)</u>

\*  $(\$100,000 + \$250,000) / 5 = \$70,000$

2. The accrual-based budget better captures the long-term costs and provides a better match between revenues and costs. It measures both financial and economic resources. Yet the cash-based budget shows what apparently is a loss. Of the \$7 million in planned expenditures for research, only \$6.5 million will be matched by grant revenues. Similarly, the full cost of the new computers, which will last for 5 years, is reported as a cost in the year of acquisition.
3. Internal managers will find the accrual-based budget useful in that it provides a long-term perspective on the Breast Cancer Fund and offers assurance that over an extended period the entity is covering its costs. Nevertheless, they likely would 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 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.



Problem 9

I. a) The encumbrance of the goods and services

Encumbrances		12,400
Reserve for encumbrances		12,400

b) The receipt of the goods and services assuming all invoices were paid in cash

Expenditures	11,200	
Cash		11,200
Reserve for encumbrances	10,900	
Encumbrances		10,900

II.

a) Fund balance (unassigned)

Beginning fund balance	\$ 1,500
Revenues	13,000
Expenditures	( 11,200)
Encumbrances	<u>( 1,500)</u>
Ending balance	<u>\$ 1,800</u>

b) Reserve for encumbrances balance \$1,500

III.

It is not the objective of a government to minimize expenditures; it is to provide services. A favorable expenditure budget variance may indicate that the government spent less than was appropriated – and thereby thwarted the political process by not providing the services that were expected of it. (Obviously the variance could also indicate that the government provided the services expected of it but did so at less cost and hence more efficiently).



Problem 10

1. Schedule of Changes in Unassigned Fund Balance

Revenues (a)	\$12,800	
Expenditures (b)	<u>10,960</u>	
Excess of revenues over expenditures	1,840	
Less: Increase/(decrease) in fund balance committed for encumbrances (c)	<u>1,600</u>	
Net change in unassigned fund balance during the year [increase/(decrease)]	240	
Add: Beginning of year balance	<u>400</u>	
End of year balance	<u>\$ 640</u>	

- (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 — \$10,600 plus \$360.
- (c) The increase in fund balance committed for encumbrances represents the required balance at the end of the year for goods still on order (\$2,000) less the amount committed at the beginning of year (\$400). That is:

Reconciliation of Beginning and Ending Balances in  
Fund Balance Committed for Encumbrances

Beginning balance	\$ 400	
Add: Goods ordered during year	<u>12,000</u>	\$12,400
Less: Goods received during year (at amount of initial encumbrance)		
Prior year	\$ 400	
Current year	<u>10,000</u>	<u>(10,400)</u>
Ending balance		<u>\$ 2,000</u>

2.

Fund balance:	
Committed for encumbrances	\$2,000
Unassigned	<u>640</u>
Total fund balance	<u>\$2,640</u>

### ESSAYS (CHAPTER 3)

1. Many governments formally integrate the budget into the accounting system. Explain how this is accomplished. Also, explain why a government would formally integrate the budget into the accounting system.
2. Many governments budget on the cash basis. Explain why a government would budget on a cash basis rather than on a GAAP-basis. Discuss the advantages and disadvantages of cash-basis budgets.
3. GAAP require state and local governments to include in their annual financial reports a budget-to-actual comparison showing actual results and original and final appropriated budgets. What are the advantages of requiring both the original and final appropriated budget amounts?
4. Why do many governments not consider it necessary to prepare appropriation budgets for, and incorporate budgetary entries into the accounts of, their capital projects funds?
5. Why may flexible budgets be more appropriate for a government's business-type activities than for its governmental activities?
6. The mayor of the City of Geneva boasts that the budgeted year-end excess of revenues over expenditures for the year just ended was significantly greater than expected. Why is this "favorable" result not necessarily a good thing?
7. In what way will budgetary entries and encumbrances affect amounts reported in year-end GAAP balance sheets and operating statements of state and local governments?
8. What are the possible differences that may occur between a state or local government's budgetary practices and GAAP?
9. A government's unassigned general fund balance at year-end may not be indicative of the amount that the government has available for appropriation in future years. Explain and provide an example to support your answer.
10. For most governments, the "variance" column on general fund budget-to-actual statements is likely to report relatively small amounts. Do you agree? Explain.
11. Some governments and most not-for-profit entities do not integrate their budgets into their accounting systems or encumber the cost of goods or services for which they are committed. Are such practices justifiable? Explain.

## ANSWERS TO ESSAYS (CHAPTER 3)

1. A government formally integrates the budget into the accounting system by making an entry that debits estimated revenues and Credits appropriations. The entry is balanced by a debit or Credit to fund balance or budgetary fund balance depending on whether the government is projecting an operating deficit or surplus.

Generally, revenues subsidiary ledgers have three columns—one for estimated revenues, one for actual revenues, and one for the running balance. If the balance in the revenues account is a debit balance, it means that actual revenues have been less than budgeted or estimated revenues. If the balance in the revenues account is a Credit balance, it means that actual revenues have exceeded the budgeted or estimated revenues.

Generally, expenditures subsidiary ledgers have four columns—one for appropriations (authorized expenditures), one for actual expenditures, one for encumbrances, and one for the running balance. If the expenditures subsidiary ledger account has a Credit balance, it means that the entity still has spending authority. If the expenditures subsidiary ledger account has a debit balance, it means that the entity has overspent or overcommitted its spending authority.

A government would integrate its budget into its accounting system as a control mechanism. The unencumbered account balances continuously reflect the remaining spending authority. Managers can easily see problem areas and concentrate their management efforts on managing the problem areas.

2. A government would budget on the cash basis because spending authority is based on cash. The government must pay its bills and make payments on prior commitments with cash. The government is concerned with its cash balance. Citizens generally do not like to give governments cash well in advance of the government's need for that cash. One example of expenditures that citizens may be reluctant to advance fund are those for accumulating vacation leave that will be taken in future periods. [AUTHOR'S NOTE: The examples that follow are not in the textbook and therefore most students will not refer to these examples.] Two other examples include contributions to finance future employee retirement benefits and advance funding for costs to restore and monitor closed solid waste landfills.

Advantages of cash basis budgets are few. They are easy for many people to understand. They serve as forecasts for cash receipts and disbursements and can highlight cash flow problems. The disadvantages are many. Cash budgets can understate the economic consequences of current actions by the government. [AUTHOR'S NOTE: The example that follows is not in the textbook and therefore most students will not refer to this example.] Many years ago, a large U.S. city accounted for its pension costs on the pay-as-you-go basis (cash basis). Because there were no current period effects of enhanced pension benefits, pension benefits were increased regularly. Then those employees retired and the increased cash burden on the municipality was tremendous. Cash-basis budgets and cash accounting permit manipulations. Governments can delay payment of bills to 'balance the budget' in the current period. Similarly governments can create positive cash flows by advancing the due date of taxes or fees or by selling their own assets to newly created entities and leasing them back. These changes may have long-term adverse consequences.

3. The original budget can, and frequently is, amended during the year to allow spending for unanticipated events. For some governments, the final budget incorporates changes (amendments) authorized only after the government knew that authorized revenues or expenditures had been lower than or higher than original budgeted amounts. If the actual amounts were only compared to the final (amended) budget amounts, the ability of the government to do a good job of budgeting would be camouflaged.
4. Appropriation budgets and related budgetary entries are intended mainly to help control expenditures — to ensure 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. Governments can control expenditures by limiting the amount of transfers-in (through the budgets of the transferring funds) or by the amount of the bonds issued.
5. Flexible budgets are generally more appropriate for business-type activities because the level of their activity is driven by customer demand and can be expected to vary more widely. The level of government-type activities, by contrast, is often established by the budget. Like private enterprises, a government's business-type activities have both fixed and variable costs.
6. "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.
7. Budgetary entries have no effect 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 effect 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.
8. There are four types of differences that may occur—basis of accounting, timing, perspective, and reporting entity differences.

Basis of accounting differences arise when the government prepares its budget on a cash basis or other basis not consistent with the modified accrual basis accounting required for GAAP financial statements of governmental funds.

Timing differences occur when governments appropriate resources for a particular project rather than for a particular period. In addition, governments may permit departments or functions to carry over resources not spent in one period to the next budgetary period.

Perspective differences occur when governments prepare their budgets based on the types of functions or programs they plan to provide, not based on the funds in which they report these activities (which could include several funds).

Reporting entity differences occur when legally separate activities for which the government does not prepare a budget are required by GAAP to be included in the government's financial statements.

9. Unassigned fund balance is computed by rules of the GASB. These rules may differ from those applied by the government for purposes of budgeting. Hence, the reported fund balance may not be indicative of the amount available for appropriation. For example, for purposes of reporting, a government may not recognize an expenditure until supplies inventory is consumed. For purposes of budgeting, the expenditure may have to be recognized when supplies are purchased. Hence, insofar as there are supplies on hand (and the government does not establish a reserve for them) the entire fund balance may not be available for appropriation.
10. The variance column compares actual amounts with budgeted amounts per the final budget. Inasmuch as the budget can be amended until the last day of the year (and sometimes even beyond), the probability of substantial variances is small.
11. As a general rule, integrating budgets into accounting systems and encumbering for commitments are appropriate when the benefits of the added controls outweigh the costs (in dollars and inconvenience). Governments are more likely than not-for-profits to integrate budgets and record encumbrances because governments generally face greater penalties for overspending their budgets. This is especially so for the general fund and special revenue funds, whereas adequate controls may already be in place for capital projects funds and debt service funds. Governments with modern computer systems may be able to avoid the need for formal journal entries even for the general fund by "loading" the budget into their computers. The computer may be programmed to issue a warning when actual expenditures and commitments exceed a specified percentage of budgeted expenditures.