

FINANCIAL MANAGEMENT FOR GEORGIA LOCAL UNITS OF ADMINISTRATION

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NATURE AND PURPOSE

One goal of accounting is to prepare various types of financial statements. The basic financial statements present information concerning:

- A Local Unit of Administration's (LUA) financial position on a certain date.
- Changes in that financial position.
- Results of operations (i.e., revenues and expenditures) during a period ending on that date.

Balance sheets/statements of net position are financial statements that present the LUAs financial position/economic condition at a certain date. Operating statements are statements reflecting changes in a LUAs financial position/economic condition and results of operations during a period ending on a certain date.

This chapter introduces the basic accounting equation, illustrates the relationship between balance sheets/statements of net position and operating statements, introduces fund accounting and illustrates how certain transactions affect the accounting equation.

BALANCE SHEET/STATEMENT OF NET POSITION

The financial position information presented on the balance sheet/statement of net position includes:

- What a LUA owns.
- What a LUA owes.
- The difference between the two which is a measure of the LUAs net worth or equity.

LUAs present balance sheet data as of a particular date (e.g., the fiscal year end, June 30).

We can summarize these elements of financial position and their relationship to each other mathematically in the following basic accounting equation:

$$\text{OWNED} - \text{OWED} = \text{NET WORTH}$$

In accounting terminology, assets are things that are owned, liabilities are things that are owed, and equity is the LUAs net worth. By applying this terminology to the accounting equation, it can be restated as follows:

$$\text{OWNED} - \text{OWED} = \text{NET WORTH or}$$

$$\text{ASSETS} - \text{LIABILITIES} = \text{EQUITY}$$

The Accounting Equation

To illustrate the accounting equation, assume a LUA owns assets valued at \$9,000 and owes liabilities of \$6,000. What is its equity? Since assets (i.e., what is owned) minus liabilities (i.e., what is owed) equals equity, the equity in this example is \$3,000:

$$\text{ASSETS} - \text{LIABILITIES} = \text{EQUITY}$$

$$\$9,000 - \$6,000 = \$3,000$$

To expand on the equation, assume that the same LUA has \$240,000 in the bank (i.e., an asset) at June 30, but it owes salaries to employees (i.e., a liability) of \$165,000 (i.e., for July and August payments). What is its equity? Since equity equals assets minus liabilities, then:

$$\text{ASSETS} - \text{LIABILITIES} = \text{EQUITY}$$

$$240,000 - \$165,000 = \text{EQUITY}$$

$$\$75,000 = \text{EQUITY}$$

If we know the value of liabilities and equity we can determine the value of the assets. In the preceding example, it states that assets minus liabilities equals equity. Using the same amounts as above for equity and liabilities:

$$\text{ASSETS} - \text{LIABILITIES} = \text{EQUITY}$$

$$? - \$165,000 = \$75,000$$

Using simple algebra, the accounting equation may be reorganized by moving "liabilities" from the left side of the equation to the right side of the equation and the sign (i.e., plus or minus sign) of the account moved changes (i.e., the liabilities account changes from minus to plus):

$$\text{ASSETS} - \text{LIABILITIES} = \text{EQUITY}$$

$$\text{ASSETS} = + \text{LIABILITIES} + \text{EQUITY}$$

$$\text{ASSETS} = \$165,000 + \$75,000$$

$$\text{ASSETS} = \$240,000$$

The basic accounting equation now has been stated two ways:

1. $\text{ASSETS} - \text{LIABILITIES} = \text{EQUITY}$

$$\$240,000 - \$165,000 = \$75,000$$

$$\$75,000 = \$75,000$$

2. $\text{ASSETS} = \text{LIABILITIES} + \text{EQUITY}$

$$\$240,000 = \$165,000 + \$75,000$$

$$\$240,000 = \$240,000$$

The accounting equation can change (i.e., be added to or subtracted from) as long as additions and subtractions to both sides of the equation are in the same amount. It is important to remember that the equation always must be equal or balanced on both sides of the "equal sign."

There are instances in some LUAs when the total liabilities are greater than the total assets. In these instances, a negative fund equity, known as a deficit, occurs. For example:

$$\text{ASSETS} - \text{LIABILITIES} = \text{EQUITY}$$

$$\$240,000 - \$255,000 = (\$15,000)$$

See Chapter II-8 for a discussion of LUAs in deficit.

Current Assets and Current Liabilities

The further classification of assets and liabilities according to their degree of liquidity (i.e., how soon they can be converted to cash, consumed or paid) is important. Current assets are assets which are likely to be used up, or converted to cash, within the next year (e.g., cash, investments, most receivables, inventories). Capital assets or non-current assets are longer lived assets, such as land, school buildings and equipment. Similarly, current liabilities are liabilities payable within one year from the balance sheet date and long-term liabilities are the

balance of the liabilities. The difference between current assets and current liabilities is classified as net current assets. It is a measure of a LUAs liquidity. These elements of a LUAs liquid financial position and their relationships to each other can be summarized by the following equation:

$$\text{CURRENT ASSETS} - \text{CURRENT LIABILITIES} = \text{NET CURRENT ASSETS}$$

LUAs may classify portions of certain assets and certain liabilities as both current and non-current. For example, a portion of a liability (e.g., bonds payable) may be due within the current year (i.e., a current liability) and the balance due over the next ten years (i.e., a non-current liability).

HOW GASB 63 AND GASB 65 CHANGE FINANCIAL REPORTING

GASB Statement 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, and GASB Statement 65, *Items Previously Reported as Assets and Liabilities*, made some changes to the current financial reporting model. GASB 63 provides financial reporting guidelines for deferred inflows of resources, deferred outflows of resources, and net position; GASB 65 presents examples that will be presented in the financial statements as deferred inflows and outflows of resources.

GASB Concept Statement No. 4, *Elements of Financial Statements*, issued in June 2007, introduced and defined these terms. The elements of a statement of financial position are defined as follows:

- **Assets** are resources with present service capacity that the government presently controls. For example, cash is an asset with present service capacity that is used by the government to procure services.
- **Liabilities** are present obligations to sacrifice resources that the government has little or no discretion in avoiding. Examples of legally enforceable liabilities arising from contractual relationships include salaries payable, accounts payable for goods and services received, and bonds and notes payable.
- **Deferred outflow of resources** is a consumption of net assets by the government that is applicable to a future reporting period. An example of a deferred outflow of resources is a grant paid in advance of meeting the timing requirement. Examples include the prepaid employer contributions to a multiple employer shared pension plan.
- **Deferred inflow of resources** is an acquisition of net assets by the government that is applicable to a future reporting period. Examples of net assets acquired by the government that are applicable to a future reporting period include, but are not limited, to the following: grants received in advance of meeting timing requirements, taxes received in advance of the period for which they were levied, and “unavailable” revenue in governmental funds, that is not received within a stated time period, generally 60 days, after period end.

- **Net position** is the residual of all other elements presented in a statement of financial position.

Concept Statement No. 4 further explains that *only those items that are identified by the GASB in authoritative pronouncements should be classified as deferred outflows of resources and deferred inflows of resources*. These items are identified in GASB 65. The following table presents some of the significant changes:¹

Exhibit 2-1: GASB 65 Classifications

Classification under GASB 65	Transaction	Example	Prior Classification
ASSETS	Prepayments	Prepaid expenses	Asset (no change)
	The providing of resources under a government-mandated nonexchange transaction or voluntary nonexchange transaction when eligibility requirements (excluding time requirements) have not yet been met	Your organization provides an advance funded grant to another organization on a contingent basis, and that contingency provision has not yet been satisfied.	Asset (no change)
DEFERRED OUTFLOW	Government-mandated nonexchange transaction or voluntary nonexchange transaction wherein all eligibility requirements have been met except time requirements	Your organization provides an advance funded grant to another organization, but all eligibility requirements under GASB 33 have been met other than time.	Asset
LIABILITY	Resources received in advance in an exchange transaction	Government agrees to install a water main in a subdivision and receives payment from residents before main is installed.	Liability (no change)
	Receipt of resources under a government-mandated nonexchange transaction or voluntary nonexchange transaction when eligibility requirements (excluding time requirements) have not yet been met	Your organization receives an advance funded grant on a contingent basis, and that contingency provision has not yet been satisfied.	Liability (no change)
DEFERRED INFLOW	Resources received related to imposed nonexchange transactions before the period resources may be used	Property taxes received before the period for which they are levied	Liability
	Resources received related to government-mandated or voluntary nonexchange transactions meeting all eligibility requirements except time requirements	Grant received in June for which granting agency has indicated eligible expenditures cannot occur until next fiscal year begins	

¹ Plante & Moran, PLLC, "Where Did My Liabilities Go?" www.plantemoran.com/perspectives/articles/2012/pages/government-where-did-my-liabilities-go.aspx. Accessed 10/26/16.

	Unavailable revenue due to the application of period of availability in governmental funds	Government provided a service in December 2011 but has yet to receive the related cash	Liability
	Regulated operations—revenue intended to cover future costs		Liability
OUTFLOW (expenditure/expense)	Debt issuance costs		Asset

In addition, GASB 65 limits the use of “deferred” to refer to deferred outflows and deferred inflows. Therefore, governments are required to change the title of the liability account, deferred revenue, currently used. However, GASB 65 leaves that change up to the individual government. One suggestion is to designate the account “unavailable revenue” or “unearned revenue.”

GASB 63 provides financial reporting guidelines for deferred outflows and inflows of resources as well as net position. Amounts that are required to be reported as deferred outflows of resources should be reported in a statement of financial position in a separate section following assets. Similarly, amounts that are required to be reported as deferred inflows of resources should be reported in a separate section following liabilities. The total for deferred outflows of resources may be added to the total for assets, and the total for deferred inflows of resources may be added to the total for liabilities to provide subtotals.²

The statement of net position should report all assets, deferred outflows of resources, liabilities, deferred inflows of resources, and net position. Governments are encouraged to present the statement of net position in the following format:

$$[(\text{ASSETS} + \text{DEFERRED OUTFLOWS OF RESOURCES}) - (\text{LIABILITIES} - \text{DEFERRED INFLOWS OF RESOURCES}) = \text{NET POSITION}]$$

The balance sheet format also may be used:

$$[(\text{ASSETS} + \text{DEFERRED OUTFLOWS OF RESOURCES}) = (\text{LIABILITIES} + \text{DEFERRED INFLOWS OF RESOURCES} + \text{NET POSITION})]$$

Regardless of the format used, the statement of net position should report the residual amount as net position rather than as net assets or equity. Net position represents the difference between all other elements in a statement of financial position and should be displayed in terms of three components: (1) net investment in capital assets, (2) restricted (distinguishing between major categories of restrictions), and (3) unrestricted.³

² GASB 63, par. 7.

³ GASB 63, par. 8.

OPERATING STATEMENTS

Operating statements are financial statements reflecting changes in the financial position/economic condition. These may be measured and reported in several different ways. Increases and decreases in cash are called receipts and disbursements. An operating statement which summarizes cash flow during a period therefore is called a statement of cash receipts and disbursements.

Revenues and expenditures are increases and decreases in net current assets (i.e., the difference between current assets and current liabilities). Therefore, a statement of revenues and expenditures summarizes a LUA's sources and uses of its net current assets. Since net current assets are considered a measure of liquid or "spendable" resources, this operating statement presents a summary of the spending activities of a LUA during a fiscal period.

Revenues and expenses are increases and decreases in total equity. The principle way in which expenses differ from expenditures is that expenses include the cost of using capital assets over time (i.e., a charge for depreciation) even though the expenditures for those costs (i.e., when the capital assets are purchased) may occur in a different accounting period (the difference between expenses and expenditures is explained in detail in Chapter I-7). Therefore, a statement of revenues and expenses summarizes the effect a LUA's operations have had on its total equity during a fiscal period.

FUND ACCOUNTING

Often different functions of LUA activities require different controls for management purposes. To accommodate this need, separate funds are established to account for resources affected by different types of spending restrictions. The Georgia Department of Education (GADOE) follows the U.S. Department of Education's National Center for Education Statistics handbook, *"Financial Accounting Guide for State and Local School Systems"* for the Fund Accounting structure. This structure requires separate funds for certain activities when unique accounting and reporting requirements exist. Fund accounting is this process.

A LUA organizes its accounting records on the basis of funds, each of which is considered to be a separate accounting entity. The operations of each fund are accounted for by providing a separate set of self-balancing accounts which include its assets, liabilities, fund equity, revenues and expenditures (or expenses), as appropriate.

All individual funds of a LUA are classified broadly into three categories: governmental, proprietary and fiduciary, per the Governmental Accounting Standards Board (GASB) *"Codification of Governmental And Financial Reporting Standards"* section 1300. Chapter I-6 includes a detailed discussion of fund accounting.

Governmental Fund Types

Governmental funds are those through which most LUA functions typically are financed. Generally they report only current assets and current liabilities on their balance sheets and their primary operating statement is the statement of revenues and expenditures. Equity for governmental fund types consists of "fund balance" accounts. A measure of "available spendable financial resources" is their reported fund balance (i.e., net current assets or what is available to spend). Their operating statements present increases (e.g., revenues) and decreases (e.g., expenditures) in net current assets.

Current year revenues always increase fund balance at year-end and current year expenditures always decrease fund balance at year-end as illustrated in the following equation:

FUND					FUND
BALANCE	+	REVENUES	-	EXPENDITURES	= BALANCE
(At start of year)		(During the year)		(During the year)	(At end of year)
\$45,000	+	\$185,000	-	\$190,000	= \$40,000

In other words, the current year's revenues are added to the beginning fund balance which results in the amount of resources available for expenditures.

Beginning fund balance	\$ 45,000
Current year's revenue	<u>185,000</u>
Total resources available for expenditures	<u>\$230,000</u>

Then this amount is reduced by the current year's expenditures which results in the fund balance at the end of the year.

Beginning fund balance	\$ 45,000
Current year's revenues	<u>185,000</u>
Total resources available for expenditure	230,000
Current year's expenditures	<u>(190,000)</u>
Ending fund balance	<u>\$ 40,000</u>

The above equation is expanded to demonstrate the relationship between a governmental fund's operating statement (i.e., statement of revenues and expenditures) and its balance sheet as indicated in the following accounting equation:

FUND				FUND						
BALANCE	+	REVENUES	-	EXPENDITURES	=	BALANCE	=	ASSETS	-	LIABILITIES
(At start of year)		(During the year)		(During the year)		(At end of year)		(At end of year)		(At end of year)
\$45,000	+	\$185,000	-	\$190,000	=	\$40,000	=	\$160,000	-	\$120,000

The first four columns are included on the operating statement and the last three are included on the balance sheet.

Proprietary Fund Types

The second fund category, proprietary funds, is used to account for activities that are financed and operated in a manner similar to private business enterprises (e.g., the local grocery store or hotel) and/or where the intent of the school board is that the activities be financed primarily from user charges (e.g., student bookstore fund).

Therefore, proprietary fund types report all assets and liabilities, whether current or non-current, on their statement of position and their primary operating statement is a statement of revenues and expenses. The fact that the statement of revenues and expenses reflects changes during the year in the LUAs equity is indicated by the following accounting equation:

$$\begin{array}{rcccccc}
 \text{EQUITY} & + & \text{REVENUES} & - & \text{EXPENSES} & = & \text{EQUITY} \\
 \text{(At start of year)} & & \text{(During the year)} & & \text{(During the year)} & & \text{(At end of year)} \\
 \\
 \$10,000 & + & \$300,000 & - & \$285,000 & = & \$25,000
 \end{array}$$

Like the governmental fund types, the equation may be expanded by adding assets and liabilities:

$$\begin{array}{rccccccccc}
 \text{EQUITY} & + & \text{REVENUES} & - & \text{EXPENSES} & = & \text{EQUITY} & = & \text{ASSETS} & - & \text{LIABILITIES} \\
 \text{(At start of year)} & & \text{(During the year)} & & \text{(During the year)} & & \text{(At end of year)} & & \text{(At end of year)} & & \text{(At end of year)} \\
 \\
 \$10,000 & + & \$300,000 & - & \$285,000 & = & \$25,000 & = & \$210,000 & - & \$185,000
 \end{array}$$

Note that the equations for illustrating the relationships of the balance sheet and operating statement for the proprietary fund types and the governmental fund types are similar.

Fiduciary Fund Types

The third fund category, fiduciary funds, is used to account for activities undertaken by a LUA on behalf of, or in a trustee capacity for, some other persons or groups. The relationship of the operating statement and statement of position for fiduciary funds is the same as for the proprietary funds, therefore, no illustration is presented.

EFFECTS OF TRANSACTIONS ON THE ACCOUNTING EQUATION

It is possible to demonstrate the effect of financial transactions on accounts by using the aforementioned accounting equation. Amounts may be added to or subtracted from the equation as long as equal amounts are applied to both sides of the equation. The accounting equation always must be in balance.

Many transactions affect revenues and expenditures/expenses. However, certain types of

transactions affect only asset and liability accounts and hence only the balance sheet. For example,

1. An asset may increase and another asset may decrease by an equal amount.

For example, a LUA purchases investments (i.e., an asset) at a cost of \$15,000 and disburses cash (i.e., an asset). The asset account "Investment" increases, but the asset account "Cash in bank" decreases by the same amount, \$15,000. Hence, the total assets remain the same, as follows:

$$\text{ASSETS} = \text{LIABILITIES} + \text{FUND BALANCE OR EQUITY}$$

Beginning	
Balance	\$60,000 = \$22,000 + \$38,000
Transaction	(\$60,000 + \$15,000 - \$15,000) = \$22,000 + \$38,000
Ending	
Balance	\$60,000 = \$22,000 + \$38,000

2. An asset may increase and a liability may increase by an equal amount.

For example, a LUA borrows \$18,000 by issuing tax anticipation notes (i.e., resulting in a liability) and receives cash (i.e., resulting in an asset). The asset account "Cash" is increased and a liability account "Notes payable" is increased by the same amount, \$18,000, as follows:

$$\text{ASSETS} = \text{LIABILITIES} + \text{FUND BALANCE OR EQUITY}$$

Beginning	
Balance	\$60,000 = \$22,000 + \$38,000
Transaction	(\$60,000 + \$18,000) = (\$22,000 + \$18,000) + \$38,000
Ending	
Balance	\$78,000 = \$40,000 + \$38,000

3. A liability may increase and another liability may decrease by an equal amount.

For example, a LUA borrows \$24,000 by issuing a note payable (i.e., resulting in a liability) to redeem another note currently due (i.e., reducing a liability). Note that "in practice," this transaction is rare. The liability account "Notes payable" is decreased and the same liability account is increased by the same amount, \$24,000, as follows:

$$\text{ASSETS} = \text{LIABILITIES} + \text{FUND BALANCE OR EQUITY}$$

Beginning
Balance \$60,000 = \$22,000 + \$38,000

Transaction \$60,000 = (\$22,000 + \$24,000 - \$24,000) + \$38,000

Ending
Balance \$60,000 = \$22,000 + \$38,000

4. An asset may decrease and a liability may decrease by an equal amount.

For example, a LUA issues checks (i.e., reducing an asset) totaling \$14,000 to vendors to pay accounts payable (i.e., reducing a liability). The liability account "Accounts payable" is decreased and the asset account "Cash" also is decreased by the same amount, \$14,000, as follows:

$$\text{ASSETS} = \text{LIABILITIES} + \text{FUND BALANCE OR EQUITY}$$

Beginning
Balance \$60,000 = \$22,000 + \$38,000

Transaction (\$60,000 - \$14,000) = (\$22,000 - \$14,000) + \$38,000

Ending
Balance \$46,000 = \$8,000 + \$38,000

There are two types of transactions that ultimately (i.e., at year-end) affect fund balance (or equity): revenue transactions and expenditure (or expenses) transactions. Revenues increase fund balance (equity) and expenditures (or expenses) decrease fund balance (equity). The accounting equation now expands to reflect these types of transactions.

$$\text{ASSETS} = \text{LIABILITIES} + ((\text{FUND BALANCE OR EQUITY}) + \text{REVENUES} - \text{EXPENDITURES})$$

(Beginning of Year)

The following sample transaction illustrates the expanded equation.

1. A LUA receives approval from the GA DOE for an unrestricted grant totaling \$17,000. The asset account "Intergovernmental receivable" is increased and the "Revenue" account also is increased by the same amount, as follows:

$$\text{ASSETS (End of Year)} - \text{LIABILITIES (End of Year)} = (\text{FUND BALANCE OR EQUITY (End of Year)} + \text{REVENUES (During the Year)} - \text{EXPENDITURES (During the Year)})$$

$$\$60,000 - \$22,000 = (\$38,000)$$

$$(\$60,000 + \$17,000) - \$22,000 = (\$38,000) + \$17,000 - \$0$$

$$\$77,000 - \$22,000 = (\$38,000 + \$17,000)$$

The above transaction increased the fund balance by \$17,000 (i.e., by increasing revenues which at year-end will be added to the fund balance) while maintaining the balance in the accounting equation since the value of the assets increased by a similar amount.

2. A LUA receives goods and/or services and approves invoices totaling \$14,000. This transaction increases "Expenditures" and it increases the liability account "Accounts payable," as follows:

$$\begin{array}{ccccccc} & & & & \text{FUND} & & \\ \text{ASSETS} & - & \text{LIABILITIES} & = & (\text{BALANCE} & + & \text{REVENUES} & - & \text{EXPENDITURES}) \\ \text{(At end of year)} & & \text{(At end of Year)} & & \text{(At start of year)} & & \text{(During the year)} & & \text{(During the year)} \end{array}$$

$$\$60,000 - \$22,000 = \$38,000$$

$$\$60,000 - (\$22,000 + \$14,000) = (\$38,000 + \$0 - \$14,000)$$

$$\$60,000 - \$36,000 = (\$24,000)$$

The above transaction decreased the fund balance by \$14,000 (i.e., by increasing expenditures which at year-end will be deducted from fund balance) while maintaining the balance in the accounting equation, since liabilities increased by a similar amount.

ACCOUNTING SYSTEM

The accounting system is the system used by an LUA to complete the accounting process. A LUA accounting system can consist of the following sub-systems:

- Accounts Receivable and Revenues.
- Accounts Payable and Expenditures.
- Payroll and Employee Benefits.
- Inventory and Property.
- Budgetary Control.
- General Ledger.

Accounting for these subsystems is discussed in Chapters I-9 through I-12.

SUMMARY

1. A balance sheet/statement of net position presents the financial position/economic condition as of a given date.
2. An operating statement presents the changes in financial position/economic condition and results of operations during a period ending on the balance sheet/statement of net position date.
3. Assets are things a LUA owns.
4. Current assets are assets which could be used up or converted to cash within one year.
5. Liabilities are amounts a LUA owes.
6. Current liabilities are liabilities due within one year and all other liabilities are classified as non-current.
7. Equity is the excess of assets over liabilities.
8. Net current assets is the difference between current assets and current liabilities.
9. Receipts are increases in cash and disbursements are decreases in cash.
10. Revenues are increases in assets which result in an increase in net current assets.
11. Expenditures are decreases in assets or increases in liabilities which result in a decrease in net current assets.
12. Revenues and expenses, respectively, ultimately increase and decrease equity.
13. LUAs use fund accounting to permit accounting separately for resources affected by different types of spending restrictions and/or accounting principles.
14. Governmental fund types generally report only current assets, current liabilities and net current assets.
15. Proprietary fund types report total assets, total liabilities and total fund equity.
16. Fiduciary fund types are accounted for similar to proprietary funds.