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Module 6 Government Accounting

PAD 501

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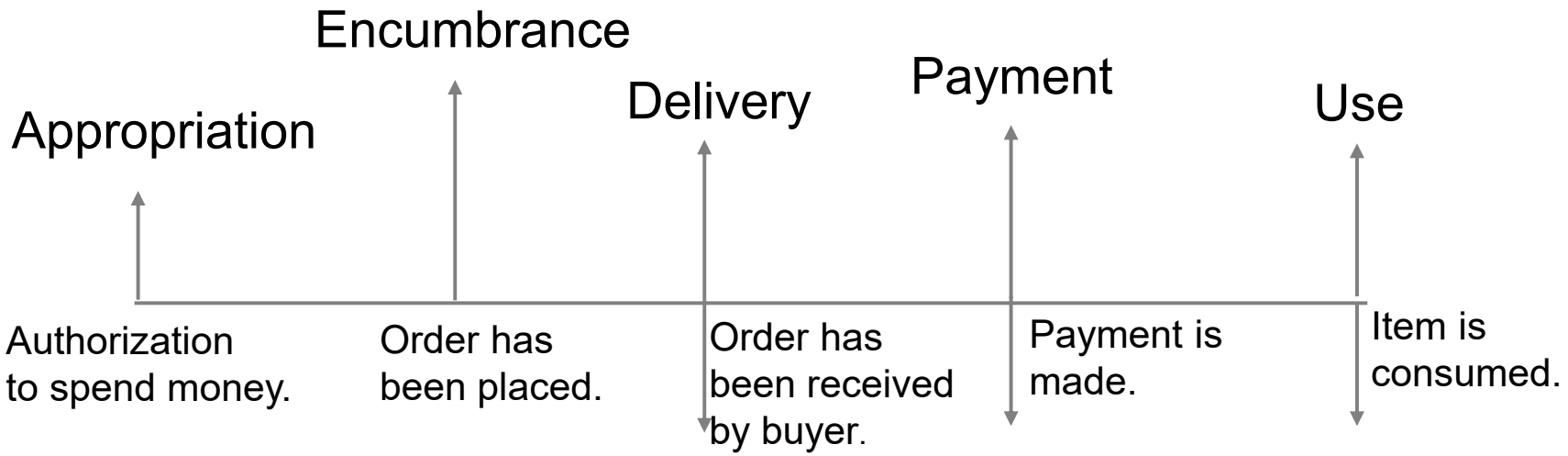
The Third Basis of Accounting: Modified Accrual

- Cash Basis
  - Revenues recognized when cash is received.
  - Expenses recognized when cash is paid.
- Accrual Basis
  - Revenues recognized when earned (goods or services provided).
  - Expenses recognized when resources are used.
- Modified Accrual Basis (Governmental Funds)
  - Expenditures recognized when resources are received (purchase method).
  - Revenues recognized when they are both: Measurable (amount known), and Available (collectible during the year or within ~60 days).
  - Focus: current financial resources — short-term inflows and outflows.

When Are Outflows Recognized? (Expenses vs. Expenditures)



Implications of Modified Accrual Accounting

- Modified accrual focuses only on current financial resources — what can be spent within the fiscal year.
- No Long-Term Assets
  - Purchases of buildings, equipment, or infrastructure are recognized as expenditures when acquired.
  - No capitalization or depreciation — the full cost is recorded immediately.
- No Long-Term Liabilities
  - Debt principal and interest payments are recognized as expenditures when paid.
  - Borrowed funds are treated as available financial resources, not liabilities.
- Modified accrual is used in governmental fund statements.

Differences Between Bases of Accounting

	Accrual	Modified Accrual
Outflows (Expenses or Expenditures)	When resource is used	When resource is acquired, legal obligation to pay exists and payment will come from available resources
Inflows (Revenues)	When resource is earned	When resource is legally owed, measurable and available
Assets	Current and long term	Current
Liabilities	Current and long term	Current

Fund balance

- Fund balances (instead of net assets) are divided into
  - Non-spendable
  - Restricted
    - External restriction (creditors, donors, grantors, laws)
  - Committed
    - Constraints from highest authority (such as city council)
  - Assigned
    - Constraints from lower level authority.
  - Unassigned

Types of funds

- Governmental funds account for the operating activities of governments (Modified Accrual Accounting).
- Proprietary funds account for activities that are run on a business-like basis (Accrual Accounting).
- Fiduciary funds account for the government's activities as trustee and agent (Accrual Accounting).

Governmental funds

- General Fund: used for general services such as administration, police, fire, and education.
- Special Revenue Funds: Used to account for revenues legally restricted for specific purposes — e.g., highway maintenance or public health programs.
- Capital Project Funds: Used for construction or major improvements of long-term assets such as buildings, roads, or parks.
- Debt Service Funds: Used to accumulate resources for paying principal and interest on long-term debt.
- Permanent Funds: Resources that must be maintained intact (e.g., endowments), but the earnings can be used for public purposes.

Proprietary Funds

- Proprietary Funds (Full Accrual Accounting)
  - Used to account for government activities that operate like businesses — focusing on revenues earned and costs incurred.
  - **Internal Service Funds** are established to account for elements of the government that provide services to other governmental units. Examples: IT services, motor pools, or printing departments.
  - **Enterprise Funds** are established to track the activities of governmental units which provide goods and services to individuals and organizations outside of the government. Examples: Water utilities, airports, public transportation systems.

Fiduciary Funds

- Fiduciary Funds (Full Accrual Accounting)
  - Used when the government acts as a trustee or agent — holding and managing resources for the benefit of others, not for its own programs.
  - **Trust Funds** are established whenever money is given to a government under the terms of a trust agreement such as for an employee pension plan.
  - **Agency Funds** are used to account for money that a government is holding for some other operating entity such as tax collections for school districts or fees for other local agencies.

Financial statements for government

	Financial statements	Accrual methods
Government-wide activities	*Statement of net position *Statement of activities	Full
Governmental funds	*Balance sheet *Statement of revenues, expenditures, and changes in fund balances	Modified
Proprietary funds	*Statement of net position, *Statement of revenues, expenses, and changes in fund net position *Statement of cash flow (direct method)	Full
Fiduciary funds	Not included in the government-wide financial statement *Statement of fiduciary net position *Statement of changes in fiduciary position	Full

Funds in governments summary

Types of fund	Include	Accrual methods
Governmental funds (used to operate governments)	General funds Special revenue funds Capital project funds Debt service funds Permanent funds	Modified accrual
Proprietary funds (used for activities that are run on a business-like basis)	Internal service funds Enterprise funds	Full accrual
Fiduciary funds (resources that the government holds for others)	Trust funds Agency funds	Full accrual