

Recognizing Expenditures

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Prim. Sem. 2016-17

Textbook: Government and Not-for-Profit Accounting, Granof

- This presentation contains information, in addition to the material prepared and provided by the professor, from the book Government and Not-for-Profit Accounting, 7th. Ed., Granof which is the textbook assigned for the course CONT 4059 – “Contabilidad para Entidades que no son Negocios” at the University of Puerto Rico, Río Piedras Campus.

Distinction Between Expenditures and Expenses

Distinction Between Expenditures and Expenses

1.1 Distinction

- Expenditures are narrower in scope than expenses.
- An expense is generally recognized when an asset is consumed. Expenses are decreases in net economic resources.
- An expenditure is generally recognized when an asset is acquired. Expenditures are decreases in net current financial resources.

Wages and Salaries

Wages and Salaries

2.1 Salaries - GASB Standard

- Wages and salaries should be recognized in the period in which the employees earn their wages and salaries, as long as the government's obligation will be liquidated with expendable available financial resources.

Wages and Salaries

Example

A city pays its employees for the two-week period ending January 8, 2017, on January 11, 2017. The portion of the payroll applicable to December 2016 is \$40 million, an amount included in the city's 2016 budget.

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2017	DESCRIPTION	DR.	CR.
Dec 31	Payroll expenditures	40,000,000	
	Accrued wages and salaries		40,000,000
	<i>To record the December payroll.</i>		

Wages and Salaries

Example

A city pays its employees for the two-week period ending January 8, 2017, on January 11, 2017. The portion of the payroll applicable to December 2016 is \$40 million, an amount included in the city's 2016 budget.

2017	DESCRIPTION	DR.	CR.
Jan 11	Accrued wages and salaries	40,000,000	
	Cash		40,000,000
	<i>To record the payment of wages and salaries recognized as 2016 expenditures.</i>		

Wages and Salaries

2.2 Vacations - GASB Standard

Wages and Salaries

2.2 Vacations - GASB Standard

- Vacation leave and comparable compensated absences should be accrued as a liability as the benefits are earned by the employees if both of the following conditions are met:
 - The employees' right to receive compensation are attributable to services already rendered.
 - It is probable that the employer will compensate the employees for the benefits through paid time off or some other means, such as cash payments at termination or retirement.

Wages and Salaries

2.2 Vacations - GASB Standard

- Both the vacation pay expenditures and the related fund liabilities should be recognized in the periods in which the payments are due.
- Until those periods, the liabilities should be reported only on the government-wide statement of net position and a schedule of long-term obligations, NOT on a governmental fund balance sheet.

Wages and Salaries

Example - Vacation

City employees earn \$8 million in vacation leave. Of this amount, they are paid \$6 million in 2016 and postpone the balance until future years. The leave vests (employees are legally entitled to it, even if they resign or are discharged) and can be taken any time up to retirement or as additional compensation at the time of retirement.

Wages and Salaries

Example - Vacation

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2016	DESCRIPTION	DR.	CR.
Dec 31	Vacation pay expenditures	6,000,000	
	Cash (or Vacation payable)		6,000,000
	<i>To record vacation pay.</i>		

Wages and Salaries

2.3 Sick Leave - GASB Standard

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- Sick leave should be recorded only to the extent that it will not be paid to employees who are sick.
- Instead, it should be recorded only when expected to be paid to employees on their discharge, resignation, or retirement.
- Sick leave, by contrast to vacation, is beyond the control of both the employer and the employee.

Wages and Salaries

Example – Sick Leave

A city allows employees one day of sick leave a month and permits them to accumulate any sick leave that they do not take. If they terminate after at least 10 years of services, they will be paid for unused sick leave up to 30 days. In 2016, employees earned \$12 million of sick leave that they did not take during the year. The city estimates that of this amount \$8 million will be paid to employees in future years as sick leave, \$1 million will be paid to 10-year employees on their termination, and \$3 million will not be paid.

Wages and Salaries

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2016	DESCRIPTION	DR.	CR.
	GOVERNMENTAL FUND		
	N/A		

Wages and Salaries

Example – Sick Leave

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2016	DESCRIPTION	DR.	CR.
	FOR PURPOSE OF GOVERNMENT-WIDE FINANCIAL STATEMENT		
Dec 31	Sick leave termination benefit	1,000,000	
	Accrued sick leave		1,000,000
	<i>To record sick leave termination benefits</i>		



Pensions and Postemployment Benefits

Pensions and Postemployment Benefits

3.1 GASB Standard

- A government should report as an expenditure in its governmental funds only the amount that will be liquidated with expendable available financial resources.
- By contracts, on its government-wide statements a government would report an actuarially calculated amounts.

Pensions and Postemployment Benefits

Example - Pension

A city is informed by the administrator of its pension plan that per its contractual arrangement its required contribution for the current year is \$55 million. It expects to make the contribution shortly after year-end.

Pensions and Postemployment Benefits

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A city is informed by the administrator of its pension plan that per its contractual arrangement its required contribution for the current year (2016) is \$55 million. It expects to make the contribution shortly after year-end.

2016	DESCRIPTION	DR.	CR.
Dec 31	Pension expenditures	55,000,000	
	Pension liability		55,000,000
	<i>To record the pension expenditure for the year.</i>		



Claims and Judgments

Claims and Judgments

4.1 GASB Standard

- The expenditure would be reported in the period that the liability is liquidated, not when the offending incident took place or a settlement was agreed on or imposed.

Claims and Judgments

Example - Claim

A county is sued for personal injuries resulting from negligence on the part of a road maintenance crew. The case is settled for \$400,000, to be paid in four annual installments of \$100,000 beginning immediately (2016).

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2016	DESCRIPTION	DR.	CR.
Dec 31	Claim and judgment expenditures	100,000	
	Cash		100,000
	<i>To record the first payment of settling claims and judgments.</i>		



Supplies

Supplies

5.1 General

- The acquisition and use of materials and supplies present unique accounting problems in governmental funds.
- Materials and supplies and prepaid items are not strictly expendable available financial resources, in that they will neither be transformed into cash nor can they be used to satisfy governmental fund obligations.
- Nevertheless, having supplies on hand obviates the government from needing to purchase the items in the future.

Supplies

5.1 General

- The government maintains inventories of office supplies, road maintenance and construction materials, spare parts, and other materials needed to carry out day-to-day operations.

Supplies

5.2 GASB Standard

- GASB standard permit a choice. Governments may recognize inventory items either when purchase (the *purchase method*) or when consumed (the *consumption method*).
- However, irrespective of which method is used, significant amounts of inventory should be reported on the balance sheet. Government may not account for inventories on a payment (cash) basis.

Supplies

5.2 GASB Standard

- **Purchase Method**

1. A government would record the purchase on the inventory as an expenditure.
2. But, significant amounts of inventory must be reported on the balance sheet.
3. To comply with 1 and 2 simultaneously, show the inventory as an asset, offset by a fund balance – nonspendable.

Supplies

5.2 GASB Standard

- **Consumption Method**

1. A government would account for inventory the same as would a business (debit asset/credit payable).
2. Then, as it uses the inventory, it would record an expenditure and reduce the balance in the inventory.
3. At year end, a portion of fund balance, equal to the inventory balance, would now have to be designated as nonspendable.

Supplies

Example – Purchase Method

During the year a city purchases supplies that cost \$3.5 million, pays for \$3.0 million of the supplies, and uses \$3.3 million of them. At the start of the year it had no inventory on hand. Hence, at year-end it has \$0.2 million of supplies available for future use.

Supplies

Example – Purchase Method

During the year a city purchases supplies that cost \$3.5 million, pays for \$3.0 million of the supplies, and uses \$3.3 million of them. At the start of the year it had no inventory on hand. Hence, at year-end it has \$0.2 million of supplies available for future use.

2016	DESCRIPTION	DR.	CR.
	Supplies expenditure	3,500,000	
	Accounts payable		3,500,000
	<i>To record the acquisition of supplies.</i>		

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2016	DESCRIPTION	DR.	CR.
Dec. 31	Supplies inventory	\$200,000	
	Fund balance – nonspendable		200,000
	<i>To record the inventory on hand at year-end.</i>		

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2017	DESCRIPTION	DR.	CR.
	Fund balance – nonspendable	50,000	
	Supplies inventory		50,000
	<i>To adjust the supplies inventory and related fund balance designation to</i>		
	Reflect inventory on hand.		

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2016	DESCRIPTION	DR.	CR.
	Supplies inventory	3,500,000	
	Accounts payable		3,500,000
	<i>To record the acquisition of supplies.</i>		

Supplies

Example – Consumption Method

During the year a city purchases supplies that cost \$3.5 million, pays for \$3.0 million of the supplies, and uses \$3.3 million of them. At the start of the year it had no inventory on hand. Hence, at year-end it has \$0.2 million of supplies available for future use.

2016	DESCRIPTION	DR.	CR.
	Supplies expenditure	3,300,000	
	Supplies inventory		3,300,000
	<i>To record the consumption of inventory.</i>		

Supplies

Example – Consumption Method

During the year a city purchases supplies that cost \$3.5 million, pays for \$3.0 million of the supplies, and uses \$3.3 million of them. At the start of the year it had no inventory on hand. Hence, at year-end it has \$0.2 million of supplies available for future use.

2016	DESCRIPTION	DR.	CR.
	Fund balance – unassigned	200,000	
	Fund balance – nonspendable		200,000
	<i>To reclassify fund balance to reflect year-end inventory.</i>		



Prepayment

Prepayment

6.1 GASB Standard

- GASB standards offer governments the same choice in accounting for prepaid expenditures as they do for inventories: they may use either the *purchases* or the *consumption* method.
- “Expenditure for insurance and similar services extending over more than one accounting period need **not** be allocated between or among accounting period”, the standards state. Instead, “may be accounted for as expenditures of the period of acquisition.”

Prepayment

6.1 GASB Standard

- In contrast to the standards for inventories, however the GASB does not prescribe that governments using the purchase method report material amounts of prepayments on the balance sheet.

Prepayment

Example – Purchase Option

On September 1, 2016 a town purchases a two-year insurance policy for \$60,000 (a cost of \$2,500 per month).

Prepayment

Example – Purchase Option

On September 1, 2016 a town purchases a two-year insurance policy for \$60,000 (a cost of \$2,500 per month).

2016	DESCRIPTION	DR.	CR.
	Insurance expenditure	60,000	
	Cash (or Accounts payable)		60,000
	<i>To record purchase of a two-year insurance policy</i>		
	NO more journal entries needed in the future under this option.		

Prepayment

Example – Consumption Option

On September 1, 2016 a town purchases a two-year insurance policy for \$60,000 (a cost of \$2,500 per month).

2016	DESCRIPTION	DR.	CR.
	Prepaid Insurance	60,000	
	Cash (or Accounts payable)		60,000
	<i>To record purchase of a two-year insurance policy</i>		

Prepayment

Example – Consumption Option

On September 1, 2016 a town purchases a two-year insurance policy for \$60,000 (a cost of \$2,500 per month).

2016	DESCRIPTION	DR.	CR.
Each month	Insurance expenditure	2,500	
	Prepaid insurance		2,500
	<i>To record insurance expenditure for one month.</i>		

Capital Assets and Installment Notes

7.1 GASB Standard – Capital Assets

- “General capital assets” are the capital assets of a government that are not specifically related to activities that are reported in proprietary or fiduciary funds.
- Most often they result from the expenditure of governmental fund financial resources.
- GASB standards preclude government from reporting general capital assets on governmental fund balance sheets or from depreciating them.

Capital Assets and Installment Notes

7.2 GASB Standard – Installment Notes

- Long-term obligations are not reported in governmental funds.
- GASB requires that the proceeds of long-term debt be reflected as “other financing sources” in the recipient fund’s operating statement.

Capital Assets and Installment Notes

Example

A village purchases road maintenance equipment for \$90,000. However, the equipment is acquired on an installment basis with three annual installments of \$36,190 (\$27,190 principal + \$9,000 interest).

Capital Assets and Installment Notes

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Cash is received first, and then, the equipment is purchased.

2016	DESCRIPTION	DR.	CR.
	Cash	90,000	
	Other financing sources – installment note proceeds		90,000
	<i>To record a loan.</i>		

Capital Assets and Installment Notes

Example

A village purchases road maintenance equipment for \$90,000. However, the equipment is acquired on an installment basis with three annual installment of \$36,190 (\$27,190 principal + \$9,000 interest).

Cash is received first, and then, the equipment is purchased.

2016	DESCRIPTION	DR.	CR.
	Capital assets – expenditure	90,000	
	Cash		90,000
	<i>To record the acquisition of equipment.</i>		

Capital Assets and Installment Notes

Example

A village purchases road maintenance equipment for \$90,000. However, the equipment is acquired on an installment basis with three annual installment of \$36,190 (\$27,190 principal + \$9,000 interest).

The equipment is purchased with borrowed funds but no cash is received.

2016	DESCRIPTION	DR.	CR.
	Capital assets – expenditure	90,000	
	Other financing sources – installment note proceeds		90,000
	<i>To record the acquisition of equipment.</i>		

Capital Assets and Installment Notes

Example

A village purchases road maintenance equipment for \$90,000. However, the equipment is acquired on an installment basis with three annual installment of \$36,190 (\$27,190 principal + \$9,000 interest).

Annual payment.

2016	DESCRIPTION	DR.	CR.
	Debt service expenditure (note principal)	27,190	
	Debt service expenditure (interest)	9,000	
	Cash		36,190
	<i>To record the first payment of installment note principal and interest (10% of \$90,000)</i>		

Interest on Long-term Debt

8.1 GASB Standard

- In governmental fund neither interest nor principal on long-term debt should be accrued in advance of the year in which it is due.
- Both should be accrued only in the period in which they are due.
- Until then, they are not current liabilities; they will not require the liquidation of expendable available financial resources.

Interest on Long-term Debt

Example

A state issue \$100 million of 20-year bonds on August 1, 2017, at an annual rate of 6%. Interest of \$3 million per semiannual period is payable on January 31 and July 31. The first payment of the interest is due on January 31, 2018.

Interest on Long-term Debt

Example

A state issue \$100 million of 20-year bonds on August 1, 2017, at an annual rate of 6%. Interest of \$3 million per semiannual period is payable on January 31 and July 31. The first payment of the interest is due on January 31, 2018.

2017	DESCRIPTION	DR.	CR.
	NO ENTRY 2017.		

Interest on Long-term Debt

Example

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2018	DESCRIPTION	DR.	CR.
Jan. 31	Debt service, interest – expenditure	3,000,000	
	Bond interest payable		3,000,000
	To record obligation for bond interest due.		

Interest on Long-term Debt

Example

A state issue \$100 million of 20-year bonds on August 1, 2017, at an annual rate of 6%. Interest of \$3 million per semiannual period is payable on January 31 and July 31. The first payment of the interest is due on January 31, 2018.

When debt mature in July 3027

2018	DESCRIPTION	DR.	CR.
Jan. 31	Debt service, principal – expenditure	100,000,000	
	Bond payable		100,000,000
	To record obligation for bond payable.		