Learning Objectives

- Define expenditures
- Understand & apply expenditure recognition guidance
- Understand multiple classifications of expenditures
- Account for typical debt service & capital outlay expenditures
- Understand accounting for capital leases, claims & judgments, compensated absences, pension, and OPEB expenditures
- Account for changes in expenditure accounting principles and error corrections
Expenditures

- Foundation of planning, authorizing, controlling, & evaluating activities of governmental funds
- Measure of fund liabilities incurred (or expendable financial resources used)
- Typically classified as:
  - Current Operations
  - Capital outlay
  - Debt service
When to recognize expenditures

In the accounting period in which the fund liability is incurred except for unmatured principal and interest on long-term liabilities, which should be recognized when due.
## Expenditure / Expense Comparison

<table>
<thead>
<tr>
<th></th>
<th>Expenditures</th>
<th>Expenses</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Operating</strong></td>
<td>Salaries, supplies, utilities, etc.</td>
<td>Salaries, supplies, utilities, etc.</td>
</tr>
<tr>
<td>Chapter 6</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Capital Outlay</strong></td>
<td>Acquisition</td>
<td>Depreciation</td>
</tr>
<tr>
<td>Chapter 7</td>
<td></td>
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</tr>
<tr>
<td><strong>Debt Service</strong></td>
<td>Principal &amp; interest</td>
<td>Interest</td>
</tr>
<tr>
<td>Chapter 8</td>
<td></td>
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</tr>
</tbody>
</table>
### Expenditure / Expense Comparison

#### Economic Resources

**Measurement Focus — Accrual Basis**
- Proprietary Fund Financial Statements
- Government-Wide Financial Statements

**This Year (20X1)**
- Expenses and liabilities are recognized when incurred — regardless of when paid.
- “Current” vs. “Noncurrent” classification only affects the balance sheet.

**Next Year (20X2)**
- Expenditures are recognized when a fund liability is incurred.
- If recognize a fund liability must recognize a fund Expenditure (unless a loan transaction).

**Future Years (20X3–)**
- “Current” liabilities are expected to be paid within one year after the end of 20X1 — a “one year look-out.”
- “Noncurrent” liabilities are expected to be repaid more than one year after the end of 20X1.

**Current Financial Resources**

**Measurement Focus — Modified Accrual Basis**
- Governmental Fund Financial Statements

**Unmatured “general government” noncurrent liabilities are (1) recorded in the General Long-Term Liability accounts and (2) reported in the government-wide financial statements.

**Expenditures are recognized when the “general government” noncurrent liabilities mature and become “fund liabilities.”**
Expenditure Recognition Options

- Interest on long-term debt maturing in following fiscal year may be accrued in current fiscal year if due “early” (not more than one month) in next year.

- Inventory expenditures may be recognized using either purchases method or consumption method.

- Prepayment expenditures [prepaid items or “prepayals”] may be allocated over benefited period or accounted for only in current period.
Intergovernmental: The “New” Expenditure Classification

- Frequently incurred in conjunction with state revenue-sharing, grant, and other financial assistance programs with local governments
- Classification indicates that expenditure was not for state-level operations
Timing of Expenditure Recognition

When Acquired

- Salaries and wages
- Contractual services
- Capital outlay
- Interest on fund liabilities
- Materials and supplies (Purchases Method)
- Insurance (Purchases Method)
- Rent (Purchases Method)
Timing of Expenditure Recognition

When Used

- Materials and supplies (Consumption Method)
- Insurance (Consumption Method)
- Rent (Consumption Method)
Timing of Expenditure Recognition

When Due

- Interest on GLTL
- GLTL principal retirement
- Claims and judgments
- Compensated absences
- Pensions
- Other Postemployment Benefits (OPEB)
Accounting for Personal Services

- Ensure that the persons is a bona fide employees
- Determine rates of pay
- Establish amounts earned by employees
- Record payments made to employees
- Charge expenditures to proper accounts
Pension Cost Expenditures

- Payments to pension plans, even self-administered ones, qualify as expenditures
- Most governments use either:
  - Defined contribution pension plan
  - Defined benefit contribution plan
Defined Contribution Plan

- Government obligation is limited to making contributions required by the plan.
- Retiree benefits dependent upon contributions made and investment performance of the plan.
- Government should recognize expenditure in year employees earned benefit – underpayment is not liability of fund but a noncurrent liability.
Defined Benefit Plan

- Government obligation is to pay certain amount to retirees each period
- Annual required contribution (ARC) based on many actuarial assumptions:
  - Years of service
  - Inflation and pay rates over time
  - Employee turnover
  - Retiree life spans & mortality rates
  - Plan funding, investment returns, & administrative costs
Accounting for Materials & Supplies

When accounting for materials & supplies inventory, it is good to keep two things mind:

- In the consumption method, the expenditures account reports the amount of supplies used – that is why changes in inventory level are charged to that account.

- In the purchases method, the expenditures account reports the amount of supplies purchased – that is why changes in inventory are charged to OFS (increases) and (OFU) decreases.
## Inventory Accounting Methods

### Consumption Method – Perpetual System

<table>
<thead>
<tr>
<th>Purchased</th>
<th>Inventory</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Vouchers Payable</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Issued</th>
<th>Expenditures</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Inventory</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year-end Over Short</th>
<th>Inventory</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Expenditures</td>
</tr>
</tbody>
</table>

|                     | Expenditures |
|                     | Inventory |


## Inventory Accounting Methods

### Consumption Method – Periodic System

<table>
<thead>
<tr>
<th>Purchased</th>
<th>Expenditures</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Vouchers Payable</td>
</tr>
</tbody>
</table>

| Issued           | No entry                |

<table>
<thead>
<tr>
<th>Year-end Increase</th>
<th>Inventory Expenditures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Decrease</td>
<td>Expenditures Inventory</td>
</tr>
</tbody>
</table>

## Inventory Accounting Methods

<table>
<thead>
<tr>
<th>Purchases Method</th>
<th></th>
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<td><strong>Purchased</strong></td>
<td>Expenditures</td>
</tr>
<tr>
<td></td>
<td>Vouchers Payable</td>
</tr>
<tr>
<td><strong>Issued</strong></td>
<td>No entry</td>
</tr>
<tr>
<td><strong>Year-end Increase</strong></td>
<td>Inventory</td>
</tr>
<tr>
<td></td>
<td>OFS – Inventory Increase</td>
</tr>
<tr>
<td><strong>Year-end Decrease</strong></td>
<td>OFU – Inventory Decrease</td>
</tr>
<tr>
<td></td>
<td>Inventory</td>
</tr>
</tbody>
</table>
Use of the Reserve account

- Fund Balance Reserved for Inventory **optional** for Consumption Method – may have no reserve, partial reserve, or fully reserve

- Fund Balance Reserved for Inventory **required** for Purchases Method – must be fully reserved
Why is a Reserve for Inventory account not always required?

- Consumption Method: supplies represent an expendable current financial resource – it can be used to finance future “expenditures” for supplies

- Purchases method: already charged to expenditures, so it does not represent a current financial resource
Accounting for Prepayments

- Known as prepaid expenses in the private sector or in Proprietary Funds
- Examples include:
  - Insurance
  - Rent
Accounting for Prepayments: Options

May use either consumption method or purchases method

- Under consumption method, balance in account reported as an asset
- Under purchases method, balance is not reported as an asset since amount has already been charged to expenditures
Capital Leases

GASB requirements have adapted private sector requirements for accounting for capital lease:

- Assets under capital lease are recorded in General Capital Assets with corresponding entry in General Long-term Liabilities

- Asset is recorded in appropriate fund as capital outlay expenditure with corresponding Other Financing Source for in-substance debt issued to acquire asset

- Use of Capital Projects Fund for acquisition or Debt Service Fund for paying principal and interest *not* required
# Review of Private Sector Entries

Also used in Proprietary Funds

## Inception of the Lease

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
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</thead>
<tbody>
<tr>
<td>Equipment Under Capital Lease</td>
<td>900</td>
</tr>
<tr>
<td>Obligations Under Capital Lease</td>
<td>860</td>
</tr>
<tr>
<td>Cash</td>
<td>40</td>
</tr>
</tbody>
</table>

## Annual Lease Obligation

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Obligations Under Capital Lease</td>
<td>13</td>
</tr>
<tr>
<td>Interest Expense</td>
<td>5</td>
</tr>
<tr>
<td>Cash</td>
<td>18</td>
</tr>
</tbody>
</table>
## Contrast with Governmental Fund

<table>
<thead>
<tr>
<th>Inception of the lease</th>
<th>General Fund (or other fund paying for capital lease)</th>
<th>General Capital Assets Accounts</th>
<th>General Long-Term Liabilities Accounts</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Expenditures recorded at present value of the future lease payments + cash disbursed.</td>
<td>Recorded at present value of the future lease payments.</td>
<td>Recorded at present value of the future lease payments.</td>
</tr>
<tr>
<td>Annual lease payment</td>
<td>Expenditures—Debt Service—Principal 13 Expenditures—Debt Service—Interest 5 Cash 18</td>
<td>None</td>
<td>Capital Leases Payable 13 Net Assets—Invested in Capital Assets 13</td>
</tr>
<tr>
<td></td>
<td>Principal and interest amounts determined using the effective interest rate method.</td>
<td>For principal amounts only.</td>
<td></td>
</tr>
</tbody>
</table>
Adjusting Entries

- Rules are not the same as revenue adjusting entries – availability criterion does not apply
- General rule
  - Record expenditure and related liability, unless the liability is noncurrent
  - Alternate view: if expenditure is normally paid from current financial resources, it should be recorded with related fund liability – applies primarily to accruals for debt service, claims and judgments, accrued vacation and sick leave, and pension plan contributions
Encumbrances

- Review outstanding encumbrances at year-end to determine if the order has been filled
- Failure to properly record expenditures could be
  - Unintentional – invoices and receiving reports not received in a timely manner at year-end
  - Intentional – department trying to avoid going over budget for the year
Long-Term Debt Service

- Debt service (principal and interest) normally not accrued at year-end

- Governments may accrue if two conditions are met:
  - Debt service payment occurs *early* (not more than 30 days) in the next fiscal year; *and*
  - Dedicated financial resources must have been provided in current fiscal year

- If accrual is made, it must be for full amount
Short-Term Debt Service

- Governmental funds may borrow on short-term basis using:
  - Tax anticipation notes (TANs)
  - Revenue anticipation notes (RANs)
  - Bond anticipation notes (BANs)
  - Other similar short-term notes

- Recorded as fund liabilities

- Accrue interest at year-end
Claims & Judgments

- Employment – workers compensation or unemployment claims
- Contractual actions – claims for delays or inadequate specifications
- Actions of governmental personnel – medical malpractice, damage caused by government-owned equipment, or improper police arrest
- Government properties – claims related to personal injuries & property damage
May be difficult to estimate ultimate liability

- Unreasonably high claims
- Time between occurrence and filing
- Time between filing and settlement and payment
GASB Standards

- Claims against the government are contingencies – rules of FASBS #5 have been adapted
- Liability is recorded if:
  - It is probable that an asset has been impaired or a liability has been incurred (as of date of financial statements)
  - Amount can be reasonably estimated
- If criteria not met, outstanding claims are disclosed in the notes
FASBS #5 Criteria Are Met

- Amount calculated reported as fund liability if amount is payable from expendable current financial resources – amount would include legal & other related costs and the settled or adjudicated amount, net of any insurance recoveries

- Any remaining liability would be recorded as a General Long-Term Liability
Insurance

- In governmental funds, insurance claims recorded as Other Financing Source (or, possibly as an extraordinary item).
- If insurance settlement is delayed, reservation of fund balance would be necessary to indicate that settlement receivable is not available for expenditure.
- If insurance settlement cannot be reasonably estimated, no receivable or OFS recognized until estimate can be made.
Self Insurance / No Insurance

- Governments self-insured because of escalating insurance rates – generally pay for all claims up to a certain amount.

- Alternative is no insurance – establish significant reserves to handle claims.

- Both choices may use umbrella policies to cover catastrophic losses.
Compensated Absences

- Vacation & similar compensated absences
- Sick leave & similar payments
Vacation Leave

Must accrue a liability when both conditions are met:

- Employees’ right to receive compensation for future absences are attributable to serviced already rendered; AND

- It is probable that the employer will compensate the employees through paid time off or with cash payments at termination or retirement
Sick Leave

- Expenditures of the year(s) in which the employees are ill
- Accrued only if it is probable that the employees will be paid upon retirement or termination
Compensated Absences Accrual Rules

- Liabilities are accrued at current salary levels.
- For vacation leave, accrual may be capped by the amount that may be carried forward at the end of the current year.
- Sick leave is capped by the amount that will be paid at retirement or termination.
- If not payable from current financial resources, the liability is in the General Long-Term Liability list.
Pension / OPEB Contributions

- GASBS #27 provides rules for determining contribution amounts – requires:
  - Use of acceptable actuarial methods in calculating contributions to defined benefit plan
  - Enforce contractual requirements for defined contribution plans

- GASB requires recognition of expenditures and liabilities in same matter as compensated absences and claims & judgments
  - Amount payable from current financial resources recorded as fund liability
  - Other amounts recorded in General Long-Term Liabilities
New Requirements for OPEB Accounting & Reporting

- Published under GASBS #43 and #45 in 2004
- Examples:
  - Healthcare insurance
  - Vision insurance
  - Life insurance
- Requirements are very similar to what is required for pensions
Expenditure Reporting: GAAP vs. Budgetary

- Level of required detail may be different in budgetary reporting than in GAAP reporting
- May report at different level of summarization – may use function for GAAP reporting but by department for local use
Change in Accounting Principles

- Expenditure not previously measurable may now be considered reasonably estimable
- Change from one acceptable alternative principle to another
- Change in method of applying a principle
- GASB issues new expenditure recognition criteria (new standard) that is different from policy currently in use
Error Correction:
Same Process as with Revenues

3 step process

1. Recognize the erroneous entry that was recorded
2. Determine what the correct entry should be
3. Fix the error by essentially combining steps 1 & 2
Error Correction Issues

- If error is caught in same year, fairly simple process to reverse it and record correction

- If error was made in a previous year, must consider if accounts affected have been closed – may result in a “Correction of Prior Year Error”
Classification of Expenditures

- Basic classification is by fund
- Other options include:
  - Function or program – Public Safety
  - Activity – Police Administration, Crime Control, Traffic Control, etc.
  - Organization unit – Police Department and Fire Department
  - Character – Operating, Capital Outlay, Debt Service
  - Object class – Personal Services, Supplies, Land, etc.