

Enterprise Funds

Chapter 10



Learning Objectives



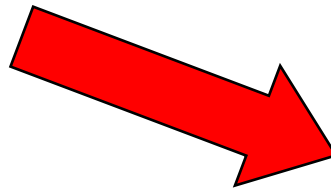
- Determine what activities should be reported using Enterprise Funds.
- Understand the Proprietary Fund accounting principles.
- Understand Proprietary Fund reporting for intergovernmental grant revenues and debt refundings.
- Review typical Proprietary Fund transactions.
- Understand the formats & classifications of Proprietary Fund financial statements.
- Understand and be able to compute the three components of Proprietary Fund Net Assets.
- Prepare the Proprietary Fund financial statements.

Transition Chapter



Leaving behind the new material:

Governmental Fund
Accounting & Reporting



Moving to material that
will look more familiar:

Proprietary Fund
Accounting & Reporting

Common Characteristics & Principles



- Accounting Equation
- Accounting Principles
- Financial Statements

Accounting Equation



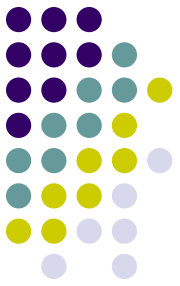
Traditional Balance Sheet Equation

$$\begin{array}{ccccccc} \text{Current} & & \text{Capital} & & \text{Other} & & \\ \text{Assets} & + & \text{Assets} & + & \text{Noncurrent} & = & \text{Current} \\ & & & & \text{Assets} & & \text{Liabilities} \\ & & & & & & + \\ & & & & & & \text{Long-Term} \\ & & & & & & \text{Liabilities} \\ & & & & & & + \\ & & & & & & \text{Net} \\ & & & & & & \text{Assets} \end{array}$$

OR

New Net Asset Equation

$$\left[\begin{array}{ccc} \text{Current} & + & \text{Capital} \\ \text{Assets} & & \text{Assets} \\ & + & \\ & & \text{Other} \\ & & \text{Noncurrent} \\ & & \text{Assets} \end{array} \right] - \left[\begin{array}{cc} \text{Current} & + \\ \text{Liabilities} & \\ & + \\ & \text{Long-Term} \\ & \text{Liabilities} \end{array} \right] = \text{Net Assets}$$



Accounting Principles

- Very similar to private sector counterparts
- Often use fixed budgets
 - May cause activity to be accounted for on budgetary basis during the year
 - Converted to GAAP basis at end of the year
- Legal or contractual reporting requirements that differ from GAAP met in CAFR or by issuing special purpose reports

Accounting Standards for Proprietary Funds



- All Proprietary Funds follow:
 - GASB Standards
 - CAP Bulletins, APB Opinions, and *FASB* Standards through #102, unless pronouncement conflicts with GASB Standards
- GASB #20 requires governments to either
 - Follow FASB Standards issued after #102, unless it conflicts with GASB Standards, **OR**
 - Not to apply subsequent standards [usual choice]



Financial Statements

- Statement of Fund Net Assets (or Balance Sheet)
- Statement of Revenues, Expenses, and Changes in Fund Net Assets (or Fund Equity)
- Statement of Cash Flows

Statement of Fund Net Assets



- Two formats allowed:
 - Traditional Balance Sheet format
 - New Net Asset format
- Either way, statement must be classified
- Statement presents current and noncurrent assets and current and noncurrent liabilities similar to private sector
- What is different is the equity section

Categories of Fund Net Assets



- Invested in Capital Assets, Net of Related Debt
- Restricted Net Assets
- Unrestricted Net Assets

Contributed Capital and Retained Earnings no longer used

Calculations of Net Asset Amounts



- Maintaining separate accounts during the year unnecessary – amounts do not articulate with other financial statements
- Transactions may cause reclassifications among amounts – entry to record unnecessary
- Amounts usually calculated at year-end

Invested in Capital Assets, Net of Related Debt



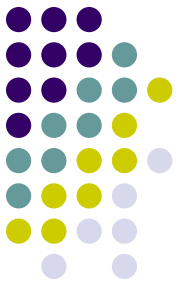
Historical cost of capital assets

– Accumulated Depreciation

= Net Book Value

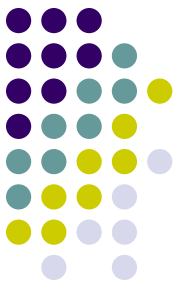
– Capital asset-related debt of the fund (adjusted for unspent proceeds)

= Invested in Capital Assets, Net of Related Debt



Restricted Net Assets

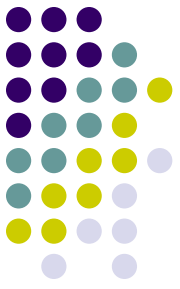
- Amount of restricted assets in excess of non-capital borrowing and other liabilities payable from restricted assets
- Constraints must be narrower than general limits of activity



Restrictions Imposed By:

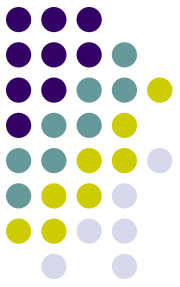
- Creditors, grantors, contributors, or laws and regulations of other governments
- Constitutional provisions
- Enabling legislations that
 - Authorizes government to assess, levy, charge or otherwise mandate payment of resources externally, AND
 - Places legally enforceable purpose restriction on those resources

Important Points about Restricted Net Assets



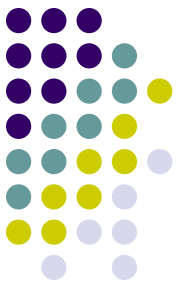
- Must be more limited than scope of activities accounted for in fund
- May not be reported as a negative amount – if liabilities exceed assets, amount is reported as zero and excess deducted from Unrestricted Net Assets
- If assets must be maintained in perpetuity, must classify Restricted Net Assets as expendable and nonexpendable (rare)
- Amount reported may be different than restricted assets less liabilities payable from restricted assets due to classification problems

Calculation of Restricted Net Assets



Assets restricted to a particular purpose

- Noncapital liabilities directly associated with and payable from restricted assets
 - Capital debt equal to unexpended proceeds of capital debt included in restricted assets
- = Restricted Net Assets



Unrestricted Net Assets

- Remainder of net assets not reported elsewhere (a “plug” number?)
- Designated by management
- Important points
 - Designations are internal and may be changed by management
 - Not the same as expendable available financial assets like in Governmental Funds
 - Not reported on face of statement
 - Very rare in practice

Calculation of Unrestricted Net Assets



- All other assets
- All other liabilities
- = Unrestricted Net Assets

OR

- Total Net Assets
- Invested in Capital Assets, Net of Related Debt
- Restricted Net Assets
- = Unrestricted Net Assets

Statement of Revenues, Expenses, & Changes in Fund Net Assets



	Operating Revenues (by source)
-	Operating Expenses (detailed)
<hr/>	
=	Operating Income (Loss)
±	Nonoperating Revenues and Expenses (detailed)
<hr/>	
=	Income (Loss) Before Other Revenues, Expenses, & Transfers
+	Capital Contributions (grant, developer, & other)
+	Additions to Permanent and Term Endowments
±	Special Items (detailed)
±	Extraordinary Items (detailed)
±	Transfers
<hr/>	
=	Increase (Decrease) in Fund Net Assets
+	Net Assets (Fund Equity) [Total] – Beginning of Period
<hr/>	
=	Net Assets (Fund Equity) [Total] – End of Period
<hr/> <hr/>	

Key Difference from Private Sector



- All-inclusive approach
- Revenues reported net of uncollectible accounts and similar amounts
- Net income ***not*** reported in statement
- Special items and transfers unique to Proprietary Fund reporting

Statement of Cash Flows



- Based on GASB #9 – issued 2 years after FASB #95
- Several important differences
 - Sections (GASB has 4; FASB uses 3)
 - Direct method required (FASB allows either method)
 - Noncash transactions reported on face of statement (FASB #95 allows it to be reported in notes)

Sections of the SCF



GASB

- Operating Activities
- Noncapital Financing Activities
- Capital and Related Financing Activities
- Investing Activities

FASB

- Operating Activities
- Financing Activities
- Investing Activities

Cash Flows from Operating Activities



- Reflects only transactions affecting operating income (unlike FASB which includes all transactions affecting net income)
- Excludes interest revenue and expense
- Section is only one affected by requirement to use the direct method – reconciliation of operating income to cash flows from operating activities must still be presented

Cash Flows from Noncapital Financing Activities



- Debt issued to finance operations, including related interest reported in this section
- Transfers not related to capital acquisitions reported here

Cash Flows from Capital & Related Financing Activities



- Issuance and repayment of debt, including interest, issued to acquire capital assets
- Acquisition and sale of capital assets
(reported in FASB #95 investing section)

Cash Flows from Investing Activities



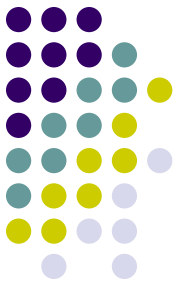
- Acquisition and subsequent sale of investments in debt and equity instruments
- Interest and dividends received from such investments
- Making and collecting most loans (except for operating loans which are reported in Operating Activities section)



Noncash Transactions

- Transactions not involving the actual flow of cash
- Examples
 - Signing a capital lease
 - Capital assets (or other noncash items) donated to the Proprietary Fund
 - Issuing debt to acquire a capital asset
 - Unrealized gains and losses on investments

Enterprise Funds vs. Internal Service Funds



Enterprise Funds

- Used to account for activities that provide goods and services primarily to the public on a charge basis
- If primary customers are internal to government, should reclassify as Internal Service Funds

Internal Service Funds

- Used to account for activities that provide goods and services to other departments of the governmental unit
- If primary customers are external to the government, should reclassify as Enterprise Funds

When Use of Enterprise Fund Is *Required*



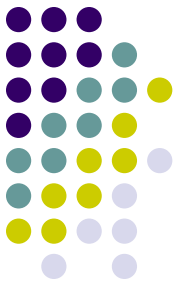
- Activity is financed with debt that is secured solely by a pledge of the net revenues from fees and charges of the activity
- Laws or regulations require that the activity's costs of providing services, including capital costs (such as depreciation or debt service), be recovered with fees and charges
- Pricing policies of the activity establish fees and charges designed to recover its costs, including capital costs

Common Examples of EFs



- Water & Sewer Departments
- Electric Utilities
- Gas Utilities
- Sanitary Sewer Operations
- Garbage and other waste collection & disposal services
- Off-street Parking Lots and Garages
- Solid Waste Landfills
- Airports

Governments may elect to use EFs even when not required



- Allows government to consistently use EF accounting even when requirements not always met
- Government seeks to report activity using full cost
- Government seeking to make reporting more comparable to other governments

Specific EF Topics

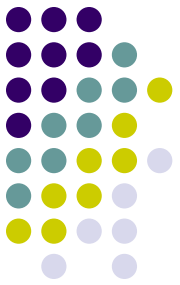


- Budgeting and appropriations practices
- Interfund activity
- Reporting grants
- Interest capitalization
- Debt refunding transactions

Budgeting and Appropriations



- Flexible budgets may be adopted to assist in control of operations
- Fixed budgets usually adopted because of legal requirements
- Many EFs operate on budgetary basis during the year and convert to GAAP at year-end



Interfund Activity

- Most transactions between EFs and Governmental Funds accounted for as interfund service transactions
- Billings to other departments recorded as operating revenues
- “Free” services provided to other funds recognized as Transfer to other fund with corresponding revenue
- Interfund transfers are last item on operating statement

Intergovernmental Grants



- Capital grants restricted to construction, acquisition, or improvement of capital assets
 - Reported on operating statement as first item after Income before other revenues, expenses, and transfers
 - Reported in SCF as Capital and Related Financing Activities
- Operating grants are all other grants
 - Reported on operating statement as nonoperating revenues
 - Reported on SCF as Noncapital Financing Activities



Interest Capitalization

- Interest cost on taxable debt follows guidance of private sector
- If tax-exempt debt is used:
 - Capitalization period starts when debt is issued
 - Must deduct interest earnings on temporary investments in calculating interest cost to be capitalized
- No interest is capitalized on assets financed by restricted gifts or grants

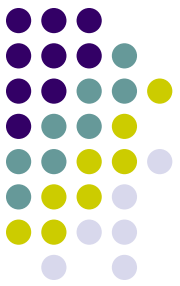
Long-Term Debt Refundings



- Governmental Fund refundings discussed in Chapter 8
- Private sector refundings discussed in Financial Accounting courses

EF Refundings a whole new ball game

Essence of the Refunding Differences



Old Debt	100,000	
<i>Where does difference go?</i>	10,000	
New Debt		110,000

Governmental Funds – no gain or loss recorded; difference absorbed into OFU or Expenditures, as appropriate.

Private Sector – extinguishment gain or loss (no longer extraordinary) in the period old debt is retired.

Enterprise Funds – depends on funding source

Own resources: extraordinary gain or loss

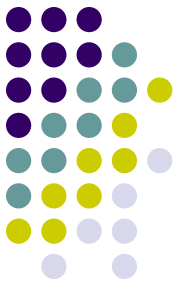
Refunding: gain or loss deferred and amortized

Situation #1 – No new debt [Page 402]



Bonds Payable	1,935,000	
Loss on Early Extinguishment of Debt	86,582	
Unamortized Discount on Bonds Payable		35,000
Unamortized Bond Issue Costs		1,582
Cash		1,985,000

Situation #1 – Refunding [Page 403]



New Debt:		
Cash	1,985,000	
Unamortized Refunding Bond Issue Costs	15,000	
Refunding Bonds Payable		2,000,000
Retirement:		
Bonds Payable (old debt)	1,935,000	
Deferred Interest Expense Adjustment	86,582	
Unamortized Discount on Bonds Payable		35,000
Unamortized Bond Issue Costs		1,582
Cash		1,985,000

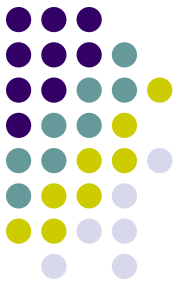
Deferred Interest Expense Adjustment



- Reported as deduction from (or addition to) Refunding Bonds
- Amortized over shorter life of refunded bonds (old debt) and refunding bonds
 - May use any rational systematic method
 - Most governments use straight-line method

Situation #1 – Interest effects

[Page 403–404]

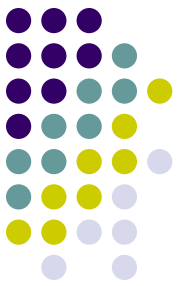


Interest Expense Cash	80,000	80,000
Interest Expense Deferred Interest Expense Adjustment – Refunding Bonds	17,316	17,316
Interest Expense Unamortized Refunding Bond Issue Costs	1,500	1,500

#1 EF established [Page 404]



Cash	400,000	
Transfer from GF		400,000



#2 Acquire existing plant [Page 405]

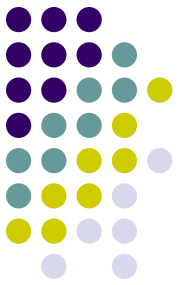
Land	50,000	
Buildings	90,000	
Improvements other than Buildings	480,000	
Machinery & Equipment	110,000	
Accounts Receivable	62,000	
Inventory of Materials and Supplies	10,000	
Allowance for Uncollectible Accounts		12,000
Bonds Payable		400,000
Compensated Absences Payable		100,000
Vouchers Payable		10,000
Due to ABC Electric Company		280,000

#3 Pay amount due [Page 405]



Due to ABC Electric Company	280,000	
Cash		280,000

#4 Close Transfer account [Page 405]



Transfer from GF Net Assets	400,000	400,000
--------------------------------	---------	---------

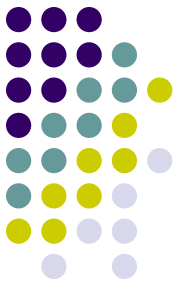
Note use of Net Assets account. Governments usually don't use separate Net Asset classifications. Aforementioned calculations are made at year-end.

#5 Ordering and receiving materials: Consumption method required [Page 405]



<u>Order materials</u> On a GAAP basis, no entry.		
<u>Receive materials</u> Inventory of Materials & Supplies	59,000	
Vouchers Payable		59,000

#6 Bill customers [Page 405]



Accounts Receivable	300,000	
Operating Revenues		300,000

#7 Purchase equipment on account [Page 405]



Machinery & Equipment	50,500	
Vouchers Payable		50,500

#8 Nonoperating Revenue:

Rent [Page 405]



Due from State Public Works Department Nonoperating Revenues – Equipment Rental	7,000	7,000
---	-------	-------

#9 Cash collections [Page 406]



Cash	291,000	
Accounts Receivable		290,000
Nonoperating Revenues – Interest		1,000

#10 Bill from ISF for services

[Page 406]



Operating Expenses Due to ISF	12,800	12,800
----------------------------------	--------	--------

#11–12 Cash payments [Page 406]



<u>#11 Bond principal and interest</u>	50,000	
Bonds Payable	20,000	
Nonoperating Expenses – Interest		70,000
Cash		
<u>#12 Operating expenses</u>		
Operating Expenses	139,200	
Vouchers Payable	70,000	
Cash		209,200

#13 Transfer to General Fund

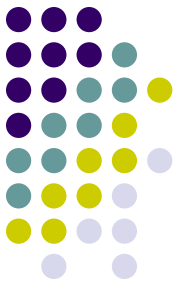
[Page 406]



<u>Enterprise Fund</u>		
Transfer to GF	10,000	
Cash		10,000
<u>General Fund</u>		
Cash	10,000	
OFS – Transfer from EF		10,000

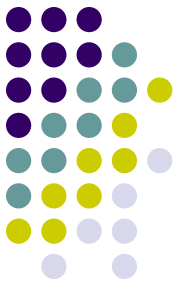
#14 Donation from a developer

[Page 406]



Improvements Other than Buildings	30,000	
Other Revenues – Capital Contributions		30,000

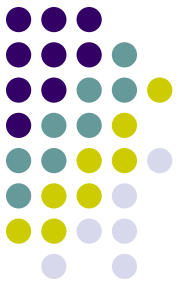
#15 Federal grant received [Page 406]



Cash	100,000	
Nonoperating Revenues – Intergovernmental Grants		100,000

#16a Adjusting Entries: Accruals

[Page 407]



Operating Expenses	13,500	
Nonoperating Expenses – Interest	2,000	
Accrued Salaries & Wages Payable		4,500
Accrued Interest Payable		2,000
Accrued Utilities Payable		7,500
Compensated Absences Payable		1,500

Other Adjusting Entries [Page 407]



<u>16b Unexpired Insurance</u>		
Prepaid Insurance	600	
Operating Expenses		600
<u>16c Change in supplies inventory</u>		
Operating Expenses	39,000	
Inventory of Materials & Supplies		39,000
<u>16d Bad Debts</u>		
Operating Revenues	1,500	
Allowance for Uncollectible Accounts		1,500

Other Adjusting Entries [Page 408]



<u>16e Depreciation</u>		
Operating Expenses	36,000	
Accumulated Depreciation – Buildings		5,000
Accumulated Depreciation – Improvements Other than Buildings		15,000
Accumulated Depreciation – Machinery & Equipment		16,000
<u>16f Unbilled revenues</u>		
Unbilled Accounts Receivable	21,000	
Accrued Interest Receivable	200	
Operating Revenues		21,000
Nonoperating Revenues – Interest		200

Accounting for Customer Deposits

[Page 409]



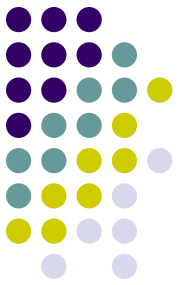
<u>#17 Receipt of deposits</u>		
Customer Deposits – Cash	11,000	
Customer Deposits – Deposits Payable		11,000
<u>#18 Invest deposits</u>		
Customer Deposits – Investments	10,000	
Customer Deposits – Cash		10,000
<u>#19 Accrue interest</u>		
Customer Deposits – Accrued Interest Receivable	200	
Nonoperating Revenues – Interest		200

Customer Deposits [Page 409] (continued)



<u>#20 Interest owed to customers</u>		
Nonoperating Expenses – Interest	150	
Customer Deposits – Accrued Interest Payable		150
<u>#21 Deposit forfeited for nonpayment of account</u>		
Customer Deposits – Deposits Payable	12	
Customer Deposits – Accrued Interest Payable	2	
Allowance for Uncollectible Accounts	8	
Accounts Receivable		22
Cash	14	
Customer Deposits Cash		14

Customer Deposits [Page 409] (continued)



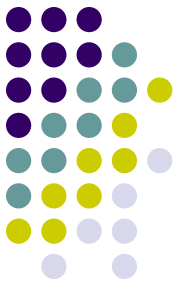
<u>#22 Customer discontinues account</u>		
Customer Deposits – Deposits Payable	15	
Customer Deposits – Accrued Interest Payable	3	
Accounts Receivable		10
Customer Deposits – Cash		8
Cash	10	
Customer Deposits – Cash		10

Customer Deposits [Page 410] (continued)



<u>#23 Change in fair value of investments</u>		
Customer Deposits – Investments	100	
Nonoperating Revenues – Net Increase (Decrease) in Fair Value of Investments		100
<u>#24 Adjust Net Assets</u>		
Net Assets	150	
Net Assets Restricted for Earnings on Customer Deposits		150

Capital Projects [Page 410]



<u>#25 Issue bonds to finance project</u>		
Construction – Cash	200,000	
Debt Service – Cash	2,000	
Unamortized Bond Premium		2,000
Bonds Payable		200,000
<u>#26 Sign contract for project</u>		
No entry required; may make memo entry		

Capital Projects [Page 411] (continued)



<u>#27 Materials for project</u>		
Construction – Work in Progress	41,000	
Construction – Vouchers Payable		41,000
<u>#28 Bill from contractor</u>		
Construction – Work in Progress	30,000	
Construction – Contracts Payable		30,000
<u>#29 Make payments</u>		
Construction – Vouchers Payable	41,000	
Construction – Contracts Payable	30,000	
Construction – Cash		71,000

Capital Projects [Page 411] (continued)



<u>#30 Other construction expenses</u>		
Construction – Work in Progress	56,000	
Construction – Cash		56,000
<u>#31 Contractor & project finished</u>		
Construction – Work in Progress	70,000	
Construction – Contracts Payable		70,000
Improvements Other than Buildings	197,000	
Construction – Work in Progress		197,000

Capital Projects [Page 411] (continued)



FINAL PAYMENTS		
Contractor		
Construction – Contracts Payable	70,000	
Construction – Cash		70,000
Dissolve “fund”		
Debt Service – Cash	3,000	
Construction – Cash		3,000

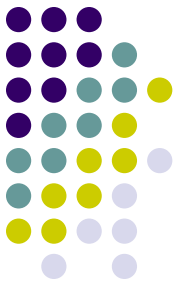


Debt Service Fund Types

- Term Bond Principal Sinking Fund
- Serial Bond Debt Service Fund
- Principal and Interest Reserve Fund
- Contingencies Fund

Debt Service Transactions

[Page 412]



<u>#33 Establish funds</u>		
Debt Service – Cash	25,000	
Principal and Interest Reserve – Cash	10,000	
Contingencies – Cash	10,000	
Cash		45,000
<u>#34 Pay interest on bonds</u>		
Nonoperating Expenses – Interest	15,000	
Debt Service – Cash		15,000

Debt Service Transactions

[Page 412] (continued)



<u>#35 Emergency repair from contingency fund</u>		
Operating Expenses	7,000	
Contingencies – Vouchers Payable		7,000
<u>#36 Investments made</u>		
Principal & Interest Reserve – Investments	9,000	
Principal & Interest Reserve – Cash		9,000
<u>#37 Interest earned and partial collection</u>		
Principal & Interest Reserve – Cash	300	
Principal & Interest Reserve – Accrued		
Interest Receivable	130	
Nonoperating Revenues – Interest		430

Debt Service Transactions

[Page 413] (continued)



<u>#38 Interest accrued and deferrals amortized</u>		
Nonoperating Expenses – Interest	5,700	
Unamortized Bond Premium	300	
Debt Service – Accrued Bond Interest Payable		6,000
<u>#39 Change in fair value of investments</u>		
Principal & Interest Reserve – Investments	20	
Nonoperating Revenues – Net Increase (Decrease) in Fair Value of Investments		20

Debt Service Transactions

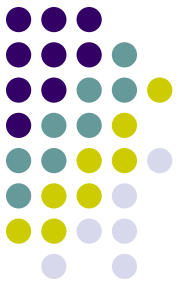
[Page 413] (continued)



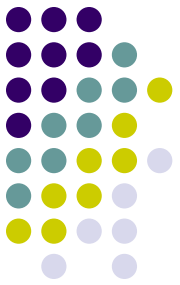
<u>#40 Adjust Net Asset accounts</u>		
Net Assets	22,450	
Net Assets Restricted for Bond Debt Service		9,000
Net Assets Restricted for Bond Principal & Interest Payments Guarantee		10,450
Net Assets Restricted for Contingencies		3,000

Extraordinary & Special Items

[Page 413]



<u>#41 Sold land that meets special item criteria</u>		
Cash	150,000	
Land		25,000
Special Item – Gain on Sale of Land		125,000



Unbilled Receivables

- Not your typical adjusting entry
- Represents revenues earned but not billed as part of the normal billing process – electricity sold, water used, etc.