

# **Principles of Accounting I**

## **Basic Accounting/Bookkeeping For Alabama Local School Personnel 2016**

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## PREFACE

The following materials have been designed for individuals with little or no prior formal education or training in accounting or bookkeeping. However, for those readers with an accounting or bookkeeping background, you should find these materials to be an excellent accounting "refresher."

### **Course Overview**

The participant will be introduced to basic accounting concepts, accounting terminology, the (accounting) balance sheet equation, the income statement equation, double-entry bookkeeping procedures, and basic financial statement reporting.

### **Classroom Activities**

Classroom activities will include lectures, bookkeeping and accounting examples, and class exercises. At the end of each chapter there are chapter exercises.

These end of chapter exercises are designed to:

1. Provide an immediate review of the material covered in that chapter.
2. Demonstrate, illustrate, and clarify the concepts, principles, and procedures discussed in the chapter by actively involving the students, and
3. Enable both student and instructor to evaluate the learning process, take necessary corrective action, and clarify any misunderstandings.

### **Course/Seminar Materials**

Why does the course manual for such a short course contain so much printed material? Part of the answer is contained in the question. This is a short course. Accordingly, effective utilization of time is critical. Time is not used effectively if the student is struggling to take notes, copy detail from power point slides or perform clerical tasks not essential to the learning process. Furthermore, subsequent review is frequently hampered or even made impossible, if the student must first organize and interpret sketchy notes. The course manual was designed to ease some of these problems by providing a systematic record of the material covered for your post-course references.

### **Seminar Evaluation**

An evaluation of materials and classroom instruction will be requested at the end of this Seminar to help in the continuous improvement and presentation of this seminar.

**CHAPTER 1**  
**ACCOUNTING AND BOOKKEEPING**

## ACCOUNTING AND COMMUNICATION

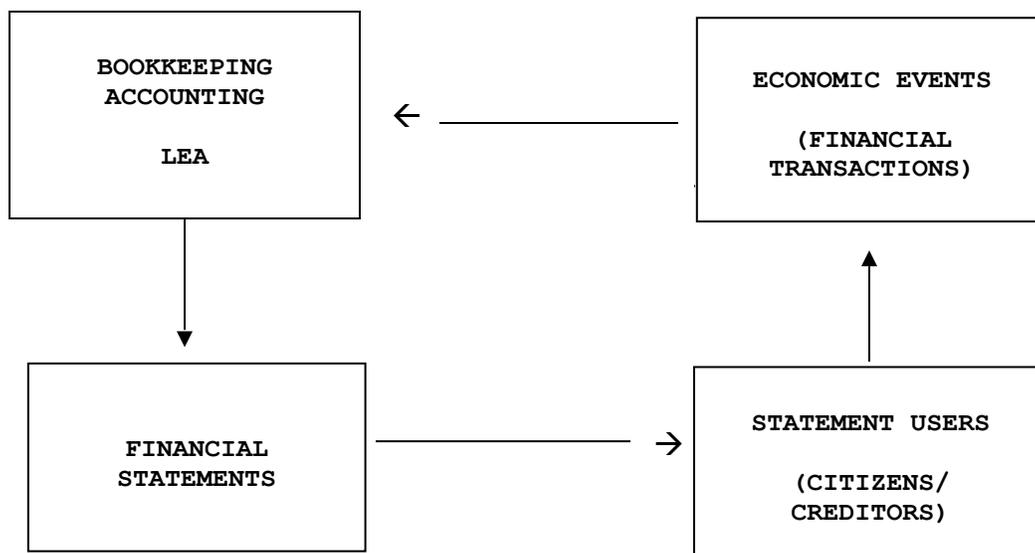
Whether you work in administration, personnel, or any service delivery, you will probably be required to make decisions regarding use of economic resources. Understanding accounting information can help you in making informed financial decisions.

Accounting can be considered a communication system because it provides the mechanism to send messages to interested parties. The accounting function includes:

- **recording** the results of economic events/financial transactions,
- **classifying** those transactions, and
- **presenting the information in reports** that will allow

internal managers and stakeholders, external investors/creditors, both current and prospective, to evaluate the entity for purposes of making economic resource allocation decisions. In addition, accounting reports provide citizens the economic information for making political decisions. The following diagram illustrates accounting as a communication system.

### Accounting As a Communication System



The following definitions and explanations are provided to clarify and frame the material presented in this text:

**Accounting -** Accounting is defined as the (art) process of identifying, analyzing, classifying, recording, summarizing, financial transactions of a governmental entity and then (presenting ) communicating that data. The definition also includes analysis and interpreting financial data.

**Bookkeeping -** Bookkeeping is the process of recording financial data. The processor/bookkeeper may, to varying degrees, identify, analyze and classify this financial information.

**Financial Data -** For accounting purposes, financial data is the product of an **economic event** taking place within an organization. This event is recorded, some say booked. The economic event is an inflow or outflow of assets.

**Financial Statements -** The starting point for the analysis of an organization by external users is their financial reports. Those reports are called the basic financial statements and include as a minimum, a **balance sheet** and an **operating statement**. These reports are prepared according to GAAP.

**Generally Accepted Accounting Principles -** (GAAP) uniform and minimum standards of and guidelines to financial accounting and reporting.

**Statement Users include but are not limited to:**

- Citizens
- Legislatures
- Boards/Commissions
- Creditors
- Other Governments
- Agency's<sup>(1)</sup> Chief Executive Officers (CEO)
- Stakeholders'

<sup>(1)</sup>Agency is used broadly to include department, division, section unit, commission, etc.

## **Role of Accounting and Bookkeeping in the Local School District**

In 1854, the Legislature of Alabama established the first provision for establishing public schools in Alabama. In 1901, the Alabama Legislature passed and the electorate ratified the Constitution of 1901 which states in Article XIV, Section 256:

The Legislature shall establish, organize, and maintain a liberal system of public schools throughout the state for the benefit of the children thereof between the ages of seven and 21 years.

Currently, there are 136 local school systems in Alabama that operate under local boards of education referred to as Local Education Agencies (LEA). Of the 136 systems, 67 are county boards of education, 68 are city boards of education, and one is a fine arts school in Birmingham.

The Education Trust Fund of Alabama, which funds all of the public education programs in Alabama administered by the 136 LEA boards, is currently the largest operating fund of the State of Alabama. Annual appropriations are made by the Legislature for this fund. For the fiscal year 2014, total appropriations for the Education Trust Fund were more than \$7 billion with approximately \$4.5 billion of that amount earmarked for the LEA boards. Revenues for the Education Trust Fund are received from the state individual and corporate income tax, sales tax, utility tax, use tax, beer tax and county licenses, hydroelectric company tax, insurance company licenses and premium tax, utility gross receipts tax and utility use service tax.

Alabama citizens and businesses commit a tremendous amount of its resources to fund the Alabama educational system and in return, rightfully, expect that the resources are managed efficiently and effectively. Accountability and stewardship of public funds is the responsibility of every LEA and its employees. Each school and district management leader must report, explain and justify their use of these funds. They must **“maintain an accounting system in accordance with generally accepted accounting principles and governmental accounting standards”** (SDE Administrative Code 290-2-5-.02(a)1. Financial accounting and bookkeeping assist management in fulfilling management’s stewardship responsibility by providing regular, complete, accurate, and detailed financial reports (on a monthly and annual basis) in an understandable and useful basis for the citizenry to assess how management allocated and used the resources.

The role of the accountant and bookkeeper is vital to achieving the above financial reporting goals. As such, the knowledge and skills to understand the basic accounting concepts is a necessary component to ensure the reliability and the accuracy of the financial database which supports the school financial reporting system.

## NEED FOR GAAP BASED FINANCIAL STATEMENTS

Governments should report their financial activity according to Generally Accepted Accounting Principles (GAAP).

### **Generally Accepted Accounting Principles (GAAP)**

GAAP are uniform minimum standards of and guidelines to financial accounting and reporting. Adherence to GAAP assures that financial reports of all state and local governments - regardless of jurisdictional legal provisions and customs - contain the same types of financial statements and disclosures, for the same categories and types of funds and account groups, based on the same measurement and classification criteria.

Who cares whether GAAP is followed? Bond rating companies do. The following was taken from Standards and Poor's (S&P) Policy Statement, written and disseminated November 26, 1980, and still applicable today.

All financial statements submitted to S&P, either in connection with a rating request for a bond sale or for a review is expected to be prepared in accordance with Generally Accepted Accounting Principles (GAAP). **Where legal requirements for recording transactions differ from GAAP, the accounting system employed should make provision for both, but in the preparation of general financial statements, GAAP must take precedent.**

**In the absence of financial reports prepared in accordance with the aforementioned guidelines, S&P will specifically reflect such absence in its rating process as a negative factor and where the report is not timely or is substantially deficient in terms of reporting, will not rate at all.\*** Each issuer is expected to immediately furnish to S&P any material changes in, or addition to, any information contained in the aforementioned documents.

\* Bold type did not appear in the original S&P policy, but was added here for emphasis.

Generally accepted accounting principles have developed initially from accounting practice. Attempts to formalize GAAP began in the 1930's through predecessor organizations of the American Institute of Certified Public Accountants (AICPA).

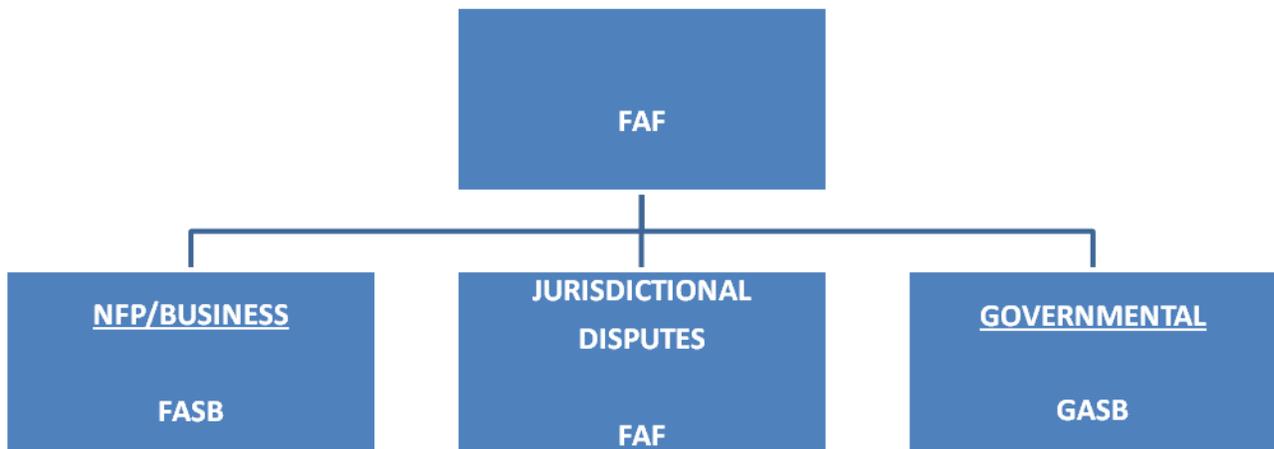
In 1973, a cooperative effort of the accounting profession established the Financial Accounting Foundation (FAF) which oversees the:

**Financial Accounting Standards Board (FASB)** as the standard setting body for business and not-for-profit (NFP) organizations, and

**Governmental Accounting Standards Board (GASB)** as the standard setting body for governmental organizations.

These independent organizations through a well-defined due process are responsible for GAAP in their respective areas.

### Authoritative Standard Setting Bodies



#### Acronyms:

**FAF:** Financial Accounting Foundation

**FASB:** Financial Accounting Standards Board

**GASB:** Governmental Accounting Standards Board

## GASB - Historical Perspective

### GRANDPARENT

NCMA (1934-49) National Committee on Municipal Accounting  
NCGA (1949-74) National Committee on Government Accounting

Pronouncement – GAAFR – Governmental Accounting, Auditing and Financial Reporting Principles (1968)



### PARENT

NCGA (1974-84)- National **Council** on Government Accounting

Pronouncements- Accepted (68) GAAFR and (74) AICPA Industry Audit Guide as amended by AICPA statements of position and FASB. Issued 7 NCGA statements, 11 NCGA interpretations and 1 concept statement New acronym GAFR - Eliminated the word auditing from previous NCGA pronouncement because of AICPA audit guide



### CHILD

GASB (1984) - Governmental Accounting Standards Board

Pronouncements - Statements of Accounting Standards, Interpretations, Technical Bulletins, Implementation Guides, and Concepts Statements.

## The GAAP Hierarchy for State and Local Governmental Entities

### **LEVEL 1 - GASB STANDARDS AND INTERPRETATIONS**

Certain AICPA and FASB pronouncements made applicable to SLGs by GASB Statements or Interpretations.

### **LEVEL 2 - GASB TECHNICAL BULLETINS**

AICPA Audit Guides and Statements of Position cleared by GASB

**LEVEL 3 –** Accounting Standards Executive Committee Practice Bulletins (AICPA) cleared by GASB  
Consensus Positions of GASB EITF (if established)

**LEVEL 4 - GASB QUESTIONS & ANSWERS (IMPLEMENTATION GUIDES)**  
Practice recognized in state and local governments

**LEVEL 5 -** Other Accounting Literature  
**GASB CONCEPT STATEMENTS**  
FASB Standards & Interpretations

## Exercises

1.1. **DEFINITIONS:** Explain the meaning of the following acronyms

LEA:

AICPA:

GASB:

FASB:

GAAP:

AASBO:

1.2. List three users of an LEA's financial statements and give reasons for their use.

## True/False

- \_\_\_\_\_ 1.3. An Alabama LEA must follow GAAP in preparing its financial reports/statements as proscribed by the Laws of the State of Alabama.
- \_\_\_\_\_ 1.4. An Alabama LEA must follow GAAP in preparing its financial statements for bond rating purposes.
- \_\_\_\_\_ 1.5. Interest expenditures on bonds will be higher/increased when non-GAAP financial statements are used for their issuance.
- \_\_\_\_\_ 1.6. Alabama citizen demands for accountability have remained unchanged for the past ten years.
- \_\_\_\_\_ 1.7. GASB is the highest authority for governmental GAAP.
- \_\_\_\_\_ 1.8. FAF and FASB are both foundations governing GASB.

## Short Answer

1.9. Define accounting.

1.10. Define bookkeeping.

1.11. GAAP is an acronym for:

## Multiple Choice

- 1.12. Which organization would be the most influential in establishing Governmental GAAP.
- a. GASB - Governmental Accounting Standards Board
  - b. FASB - Financial Accounting Standards Board
  - c. AICPA - American Institute for Certified Public Accountants
  - d. NCGA - National Council on Governmental Accounting
- 1.13. Which organization would be the most influential in establishing Business GAAP.
- a. GASB - Governmental Accounting Standards Board
  - b. FASB - Financial Accounting Standards Board
  - c. AICPA - American Institute for Certified Public Accountants
  - d. NCGA - National Council on Governmental Accounting
- 1.14. Which organization would be the most influential in establishing Not-For-Profit GAAP.
- a. GASB - Governmental Accounting Standards Board
  - b. FASB - Financial Accounting Standards Board
  - c. AICPA - American Institute for Certified Public Accountants
  - d. NCGA - National Council on Governmental Accounting

**CHAPTER 2**  
**THE ACCOUNTING EQUATION**

## THE BALANCE SHEET

A balance sheet is also known as a **Statement of financial condition**. It is a financial picture of the fund or the organization **at one point in time**. The balance sheet reports the organization's assets, liabilities, and equity. The accounting authorities define the elements of the balance sheet as follows:

**Assets** - are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events. (what the school/district owns)

**Liabilities** - are probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events. (what the school/district owes)

**Equity**- is the residual interest in the assets of an entity that remains after deducting its liabilities ( $A - L = E$ ). If the entity is a business, the term Owner's Equity is used. If the entity is a government fund, the term Fund Equity or Fund Balance is used.

### Elements of a Balance Sheet

**ASSETS** ----- A

**LIABILITIES** ----- L

**EQUITY** ----- E

## THE BALANCE SHEET AND ECONOMIC TRANSACTIONS

The organization balance sheet changes with each economic transaction. Therefore, the accounting system was designed to accommodate the recording of financial transactions that will maintain the equality of the balance sheet equation or model:

$$A = L + E$$

This model serves as the basis for the double entry system of bookkeeping. As financial transactions occur, the elements within the balance sheet model will change but the equality of the equation (left side = right side) will be maintained.

There will be several types of economic events that will increase and decrease the assets and liabilities of the entity. Likewise, there will be several types of economic events that

will change the residual interest in the entity (equity). These economic events are referred to as accounting transactions or simply, transactions.

### Accounting Equation Illustration

Hope School is a high school in Hope, Alabama. The high school starts its school year in August. Consider the following economic transactions and their effect on the balance sheet equation for Hope High School.

#### Hope High School Transaction Worksheet

<u>Transaction</u>	<u>Assets</u>	=	<u>Liabilities</u>	+ <u>Equity</u>
1. Central office sent \$6200 to school for instructional purposes to the school.	+6200			+6200
2. Bought 40 boxes of wipe-off board Markers and 20 erasers for new year. Principal signed PO for \$240. Cut check.	-240			- 240
3. Bought cookies and cokes for orientation for parents and students. A purchase order was prepared and signed by principal. School secretary paid Publix \$300 and used tax-exempt code.	-300			-300
4. Parents gave funds to school for classroom supplies. \$800 was received by teachers and submitted to the office.	+800			+800

## Exercise 2-1

Indicate the effect on the Hope High School balance sheet equation for each of the following transactions that occurred during the first month of school.

Assets    =    Liabilities    +    Equity  
+Rev (Exp.)

5. Principal is asked by superintendent to attend state technology conference in September. Paid \$150 for registration for conference with check.
6. Assistant Principal purchased more supplies for classrooms at Office Depot using school account. Receipt totaled \$1150. Funds will be due by 10th of September.
7. Students brought funds in for lockers and parking. Locker revenues were \$245 and parking revenues were \$400.
8. Instructional software was ordered from Microsoft for school lab for \$1500. Order is expected by August 30 with payment due upon delivery.
9. Bought pre-game meal for football players and coaches – paid ChickFilA \$400 with check.
10. Ticket sales from football game totaled \$2300. Received cash and deposited in bank immediately.
11. Paid athletic referees \$225 for officiating Friday night football game.
12. Received instructional software. Cut check for purchase of \$1500.

## CLASSIFICATION OF ELEMENTS

The Balance Sheet or Statement of Net Assets presents summarized data for each of the statement elements at a specific date in time. All financial reports are clearly titled as to the name of the entity, the type of financial statement and the appropriate date for the statement. To make the data more useful for balance sheet presentation, it is usually classified as follows:

### **ASSETS:**

Current - cash and those assets that will provide cash and/or benefits within the year.

Investments and Funds - long-term assets, restricted for a specific purpose and unavailable for use in operations.

Property, Plant, & Equipment - long-term, tangible assets used for operating activities

Intangibles - long-term assets, without physical substance, that provides rights necessary to operating activities.

### **LIABILITIES:**

Current - those obligations that will come due within the year and will be paid from current assets.

Long Term - obligations not due within the year.

### **FUND EQUITY:**

Contributed Equity – amount of net assets contributed to the organization from the start of the organization to the current date.

Retained Earnings – amount of net assets accumulated and kept from operating activities from the start of the organization to the current date.

## Exercise 2-2

Review the previous transactions and their effects on the balance sheet equation for Hope High School. Record the additional transactions in the expanded transaction worksheet and total at bottom of worksheet. Maintain the equality of the balance sheet model and classify the transactions according to the elements of the financial statements.

Economic Event	Assets		=	Liabilities			+	Equity						
	Cash			Accounts Payable	Approp.	Donations	Dues & Fees	Admissions Revenue	Inst. Software	Inst. Supplies	Purchased Food	Purchased Services	Reg Fees	
Central office sent \$6200 to school for instructional purposes to the school.														
Bought 40 boxes of wipe-off board markers and 20 erasers for new year. Principal signed PO for \$240. Cut check.														
Bought cookies and cokes for orientation for parents and students. A purchase order was prepared and signed by principal. School secretary paid Publix \$300 and used tax-exempt code.														
Parents gave funds to school for classroom supplies. \$800 was received by teachers and submitted to the office.														
Principal is asked by superintendent to attend state technology conference in September. Paid \$150 for registration for conference with check.														
Assistant Principal purchased supplies for classrooms at Office Depot using school account. Receipt totaled \$1150. Funds will be due by 10th of September.														
Students brought funds in for lockers and parking. Locker revenues were \$245 and parking revenues were \$430.														
Instructional software was ordered from Microsoft for school lab for \$500. Order is expected by August 30 with payment due upon delivery.														
Bought pre-game meal for football players and coaches. Paid ChickFILA \$400 with check.														
Ticket sales from football game totaled \$2300. Received cash and deposited in bank immediately.														
Paid athletic referees \$225 for officiating Friday night football game.														
Received instructional software. Cut check for purchase of \$500.														

**Totals** =

### Exercise 2-3

Prepare a classified balance sheet at the end of August for the Hope High School based on the economic events that occurred in exercise 2-2.

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#### ASSETS

Current Assets:

Property, Plant & Equipment:

Total Assets

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#### LIABILITIES AND EQUITY

Current Liabilities:

Long-Term Liabilities:

Equity:

Total Liabilities and Equity

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### Exercise 2-4

The items listed below are relevant to an Alabama agency. Classify them as Asset (A), Liability (L), Equity (E), or None of these are applicable (NA).

- a. Petty Cash. \_\_\_\_\_
- b. A truck \_\_\_\_\_
- c. Amounts due to a contractor. \_\_\_\_\_
- d. Amounts due from a federal grant. \_\_\_\_\_
- e. Payment of rent. \_\_\_\_\_
- f. Employees' salaries and wages earned. \_\_\_\_\_
- g. Concession supplies on hand. \_\_\_\_\_
- h. The difference between total assets and the total amounts due outside creditors. \_\_\_\_\_

### Exercise 2-5

Use the balance sheet equation to find the missing amounts.

	ASSETS	=	LIABILITIES	+	EQUITY
a.	\$ 56,000	=	\$ 6,000	+	\$ 50,000
b.	_____	=	6,000		58,000
c.	59,000	=	52,000		_____
d.	89,900	=	_____		9,900
e.	780,000	=	_____		625,000
f.	1,475,000	=	_____		520,000
g.	137,500	=	6,000		_____
h.	_____	=	290,000		1,405,000
i.	825,000	=	_____		515,000
j.	825,000	=	_____		(515,000)

## Exercise 2-6

### FILL IN THE BLANKS

1. A \_\_\_\_\_, frequently referred to as a Balance Sheet, shows for a given entity at a specific date, the following: (a) its assets, and (b) claims against its assets.
2. What an organizational entity owns is called \_\_\_\_\_.
3. Residual interest in the organization's assets by the organization itself is called \_\_\_\_\_.
4. Claims against the organization's assets by creditors and other "outsiders" are called \_\_\_\_\_.
5. The Balance Sheet Equation is:  
\_\_\_\_\_ = \_\_\_\_\_ + \_\_\_\_\_

## Exercise 2-7

### BALANCE SHEET PREPARATION -

Complete the attached balance sheet of Hope County School District as of September 30, 2012 from the information listed below (the amounts below represent the ending total or balance of each Balance Sheet element).

- a. Cash on deposit in General Fund – Office of School Administration: \$29,000.
- b. Cash on deposit in General Fund – Drivers Education Fees: \$ 6,370.
- c. Amounts due to creditors: \$15,200.
- d. Amounts due to bus drivers for school trips: \$8,300.
- e. Truck is purchased on September 30, 2012 for \$14,000.
- f. Food inventory on hand for entire district is \$ 1,800.

Exercise 2-7  
Hope County School District  
Balance Sheet  
September 30, 2012

Assets

Current Assets

Funds on Deposit \_\_\_\_\_  
Inventories \_\_\_\_\_

Total Current Assets

Equipment \_\_\_\_\_

Total Assets                     

Liabilities and Fund Equity

Current Liabilities

Accounts Payable \_\_\_\_\_  
Wages Payable \_\_\_\_\_

Total Liabilities

Fund Balance \_\_\_\_\_

Total Liabilities and Fund Balance

## **CHAPTER 3**

### **The Income Statement // Operating Statement**

## **OBJECTIVES OF THE OPERATING STATEMENT**

Financial reporting should assist users in evaluating the operating results of the governmental entity for the year. (GASB Codification)

Financial reporting should provide information about the changes in economic resources from operating activities. Financial reporting should account for:

- All revenues by source and type,
- All expenses by function and purpose,
- The extent to which revenues met expenses,
- Material nonrecurring financial transactions, and

## **ELEMENTS - OPERATING STATEMENT**

The operating statement is called the Statement of Revenues, Expenses, and Changes in Fund Balance/Retained Earnings. The financial statement elements to be reported in the operating statement are defined (SFAC #3 and SGAS #1) as:

- REVENUES - Revenues are inflows or other enhancements of assets of an entity or settlements of its liabilities (or a combination of both) during a period from delivering or producing goods, rendering services, or other activities that constitute the entity's ongoing major or central operations.
- EXPENSES - Expenses are outflows or other using up of assets or incurrence of liabilities (or a combination of both) during a given time period. In addition, these expenses are incurred from delivering or producing goods, rendering services, or carrying out other activities that constitute the entity's ongoing major or central operations.

- GAINS** - Gains are increases in equity (net assets) from peripheral or incidental transactions of an entity and from all other transactions and other events and circumstances affecting the entity during a period except those that result from revenues or investments by owners.
- LOSSES** - Losses are decreases in equity (net assets) from peripheral or incidental transactions of an entity and from all other transactions and other events and circumstances affecting the entity during a period except those that result from expenses or distributions to owners.

### **CASH ACCOUNTING BASIS**

Entities often do their daily accounting on a cash basis. Under the cash basis of accounting, revenue is only recognized or recorded when cash is received. Expenses are only recorded when a cash payment is made. The cash basis of accounting is **not** a generally acceptable accounting principle (**GAAP**) for financial reporting.

### **ACCRUAL ACCOUNTING BASIS**

Organizations who follow GAAP, whether private sector, government or not-for-profit types, use the accrual basis of accounting to recognize the elements and the changes to those elements that are reported in the financial statements.

According to the accrual basis:

**Revenue Recognition** occurs when the services have been performed, are measurable, and no uncertainties exist.

Example: Sold merchandise on account. Record increases to accounts receivable and sales revenue.

**Expense Recognition** occurs when cost of supplies or services used to generate the revenues has been incurred.

Example: Incurred utility cost for may. Record increase to utility expense and accounts payable.

**Gain and Loss Recognition** occurs when the event that caused the gain or loss has occurred and the amount is measurable.

Example: Sold office file cabinet below cost. Record increase to cash, decrease to office equipment and increase to loss on sale of office equipment.

## INCOME STATEMENT CLASSIFICATION AND FORMAT

The income statement or operating statement is comprised of five distinct sections which display results from:

- (1) **Revenues** – are a result of primary purpose activities
- (2) **Expenses** – are a result of primary purpose activities
- (3) Operating Income (Loss)-
- (4) **Other Revenues (Expenses)** and Special Items  
- are not a result of primary purpose activities but are secondary, incidental or peripheral activities
- (5) Net Income(Loss) or Changes in Fund Balance

The operating statement may be displayed in several different ways. The following format is the one commonly used in practice and throughout this text. Only four statement sections are numbered below.

(1) + Revenues

(2) - Expenses

---

(3) = Operating Income (Loss)

(4) +/- Other Revenues/Expenses

---

(5) = Net Income (Loss) or Changes in Fund Balance

+ Equity/Retained Earnings or Fund Balance, Beginning of Period

---

= Equity/Retained Earnings or Fund Balance, End of Period

## THE EFFECT OF OPERATING ACTIVITIES ON EQUITY

The elements of the Income Statement are classifications of the changes in retained earnings. Using the transaction data from the Hope High School example for the month of August, the analyses of changes in equity is shown on the following table.

		Assets	=	Liabilities	+	Equity	±	-
	<u>Economic Event</u>						<u>Revenues</u>	<u>Expenditures</u>
1	Central office sent \$6200 to school for instructional supplies to the school.	+					+	
2	Bought 40 boxes of wipe-off board markers and 20 erasers for new year. Principal signed PO for \$240. Cut check.	-						-
3.	Bought cookies and cokes for orientation for parents and students. A purchase order was prepared and signed by principal. School secretary paid Publix \$300 and used tax-exempt code.	-						-
4	Parents gave funds to school for classroom supplies. \$800 was received by teachers and submitted to the office.	+					+	
5	Principal is asked by superintendent to attend state technology conference in September. Paid \$150 for registration for conference with check.	-						-
6	Assistant Principal purchased supplies for classrooms at Office Depot using school account. Receipt totaled \$1150. Funds will be due by 10th of September.			+				-
7	Students brought funds in for lockers and parking. Locker revenues were \$245 and parking revenues were \$430.	+					+	
8	Instructional software was ordered from Microsoft for school lab for \$500. Order is expected by August 30 with payment due upon delivery.			+				-
9	Bought pre-game meal for football players and coaches. Paid ChickFilA \$400 with check.	-						-
10	Ticket sales from football game totaled \$2300. Received cash and deposited in bank immediately.	+					+	
11	Paid athletic referees \$225 for officiating Friday night football game.	-						-
12	Received instructional software. Cut check for purchase of \$500.	-		-				

## Review Exercises

- 3.1 An \_\_\_\_\_ reports the annual change in retained earnings from operating activities.
- 3.2 The Income Statement is a financial report for a specific time \_\_\_\_\_ which reports:
- (a) The \_\_\_\_\_ and applicable revenue deductions known as \_\_\_\_\_.
  - (b) Secondary or incidental revenues and expenses known as \_\_\_\_\_ revenues and expenses.
- 3.3 Financial Consulting Services (FCS) provides service to a large segment of the public. FCS's main source of resources for operation comes from fees charged clients. From the following data on the operations for FCS for the year ended June 30, 2012, complete the attached operating statement:

Personal Services Fees \$20,000;

Supplies consumed during year \$15,000;

Operating expenses \$12,000;

Corporate Service Fees \$4,500;

Community Grant \$10,000; and

Interest Expense \$7,200.

Exercise 3-3

FCS  
INCOME STATEMENT  
FOR THE YEAR ENDED JUNE 30, 2012

Revenues		\$
Expenses		
	_____	_____
Operating Income (Loss)		\$
Other Revenues/(Expenses)		
	_____	_____
Net Income (Loss)		<u>\$ 300</u>

## EXERCISE 3-4

### INCOME STATEMENT PREPARATION

Always Something Corporation has just completed operations for the year ended December 31, 2012. This is the third year of operations for the company and they have an ending balance in Retained Earnings of \$50,000 from the previous year's financials. Prepare the income statement for the year end given the following information:

Insurance Expense	\$4,000
Service Revenue	\$74,000
Supplies Expense	\$1,100
Rent Expense	\$13,000
Salary Expense	\$42,000

ALWAYS SOMETHING, INC.  
INCOME STATEMENT  
FOR THE PERIOD ENDED DECEMBER 31, 2012

3.5 Identify the following events for a local education agency as to the change in equity/fund balance classification.

R = Operating Revenue

E = Operating Expense

OR = Other Revenue

OE = Other Expense

- \_\_\_\_\_ a. Employee salaries
- \_\_\_\_\_ b. Payments to city for water usage
- \_\_\_\_\_ c. Federal revenue grants
- \_\_\_\_\_ d. Insurance premiums
- \_\_\_\_\_ e. Repairs to equipment
- \_\_\_\_\_ f. Billings to another school board for usage of school buses for state championship football game
- \_\_\_\_\_ g. Interest expense
- \_\_\_\_\_ h. Cost of materials used
- \_\_\_\_\_ i. Employee fringe benefits

**CHAPTER 4**  
**RECORDING FINANCIAL TRANSACTIONS**

## THE BOOKKEEPING PROCESS

### THE ACCOUNTING CYCLE

During the fiscal year, the entity follows established procedures to ensure the operation of the accounting system. These procedures, in sequential order are known as the accounting cycle:

1. Analyze the financial transactions to determine the economic events that change the entity.
2. Enter the transaction into the accounting system through journal entries and the postings to the ledger accounts.
3. Prepare a trial balance.
4. Prepare and enter (journalize and post) adjusting entries into the accounting system.
5. Prepare adjusted trial balance.
6. Prepare basic financial statements.
7. Journalize and post year end closing entries.
8. Prepare post closing trial balance.

The procedures in the accounting cycle were developed for a manual "pen and ink," accounting system. These manual procedures have been followed since the 16th century. Today, the computer is used to perform these procedures in a faster and more accurate way. Computer programs are written instructions (software programs) based on the manual procedures of the accounting cycle. Therefore, it is helpful to understand the manual accounting system prior to using a computerized accounting system. Sometimes files are not backed up properly and have to be reconstructed from the journals.

The events, processes or conditions which bring about changes +/- to an asset, liability, equity, revenue, expenditure or expense item is called a **financial transaction**. This "transaction" must be recorded by the accounting entity or fund. The cumulative result of these transactions is then used to prepare the financial statements. Up to this point, we have used the transaction worksheet (see Chapter 2, Exercise 2) to compile the transactions. The transaction worksheet is not a practical technique for even the smallest and simplest organization. Instead of using the transaction worksheet, the actual form used to record the transactions is the account. Accounts are created for each element within the entity's financial reporting system.

**The Account**

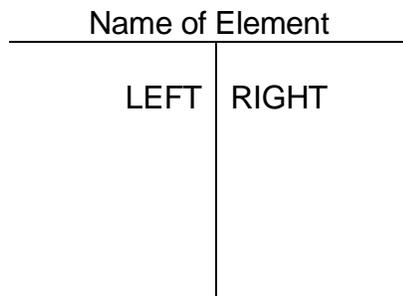
The business form that is used to maintain the changes in each financial statement element is called an account.

A Standard Account form looks like:

NAME OF ELEMENT      ACCOUNT NO. \_\_\_\_\_

Date	Explanation	Ref.	Right  IN or OUT +/-	left  OUT or IN +/-	Balance
------	-------------	------	-------------------------------------	------------------------------------	---------

T Accounts are used for illustrative purposes; the above account is reduced to a "T" .



The T account consists of two sides - left and right. There is a (T) account for each element in the financial statements. Changes to the accounts are based on the accounting equation.

$$A = L + E$$

The accounting equation is an algebraic model. As the financial transactions occur, the changes are recorded in the accounts in a manner that will maintain the equality of the equation. Therefore, for every financial transaction, two or more accounts will be affected so that the total right changes will equal the total left changes.

All ASSETS		=	All LIABILITIES		+	All EQUITY	
LEFT +	RIGHT -		LEFT -	RIGHT +		LEFT -	RIGHT +

The rules for determining change in an individual account are as follows:

**For accounts that sit to the left of the equation, increases are recorded on the left side of the account and decreases on the right side.**

**For accounts that sit to the right of the equation, increases are recorded on the right side of the account and decreases on the left side of the account.**

**Now we substitute the word debit for left and credit for right (a new language, peculiar to Accounting)\*.**

or

	<u>Increase</u>	<u>Decrease</u>
Assets	Debit (L)	Credit(R)
Liabilities	Credit(R)	Debit (L)
Equity	Credit(R)	Debit (L)

**Debit means left and Credit means right. What else do the words debit and credit mean? The answer - Absolutely nothing else!**

Managers need operating data on a regular basis. Therefore, it is necessary to classify the changes to equity as they occur. Second, the changes in equity are a result of operating activities and will be further classified by recording those changes in “temporary” accounts classified as:

REVENUES  
EXPENSES  
GAINS  
LOSSES

The complete account structure and relationship to the accounting equation can be presented as:

$$A = L + E$$

Assets		Liabilities		=	Equities			
DR +	cr -	dr -	CR +		dr -	CR +		
					Expenses		Revenues	
DR +	cr -	dr -	CR +		DR +	cr -	dr -	CR +
					Losses		Gains	
DR +	cr -	dr -	CR +		DR +	cr -	dr -	CR +

Revenues increase equity and expenses decrease equity. Hence the in/out (dr./cr) of these accounts represents the right and left side of the equity accounting. The rules for determining change in an individual account can now be stated as:

Permanent Balance Sheet Accounts

Assets  
Liabilities  
Fund Equity

Increase  
debit  
credit  
credit

Decrease  
credit  
debit  
debit

Temporary Equity Accounts

Revenues  
Expenses  
Gains  
Losses

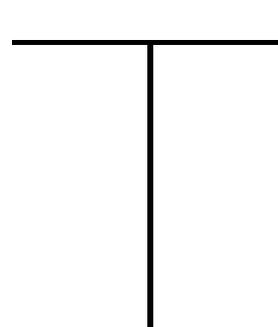
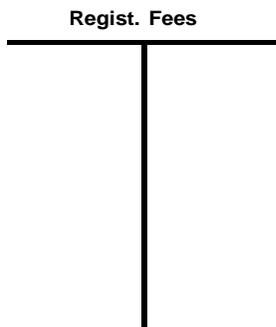
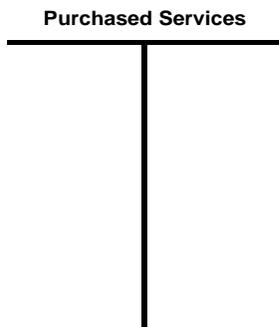
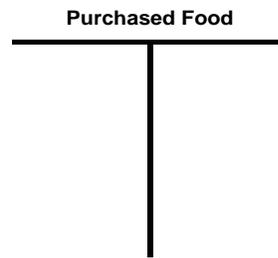
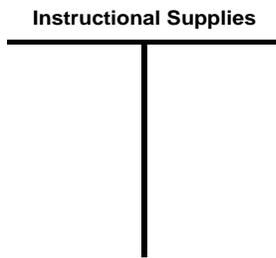
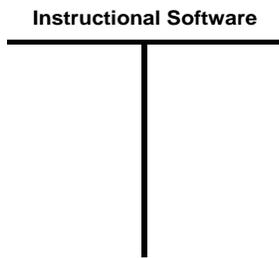
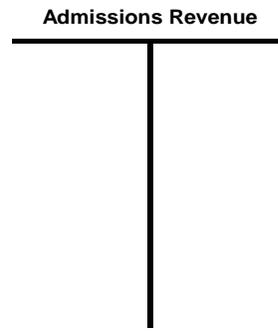
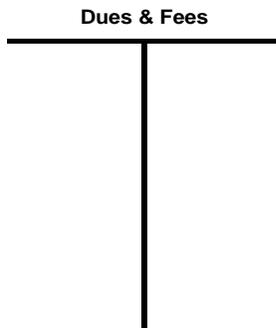
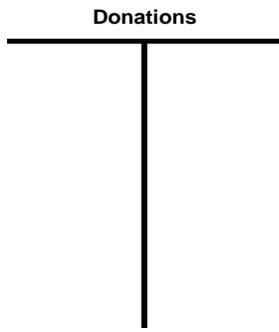
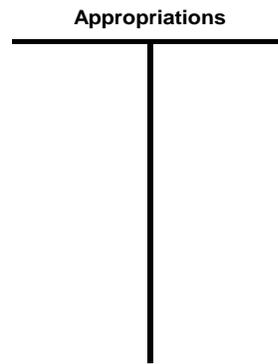
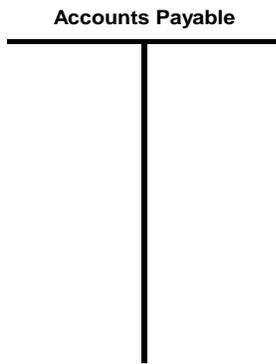
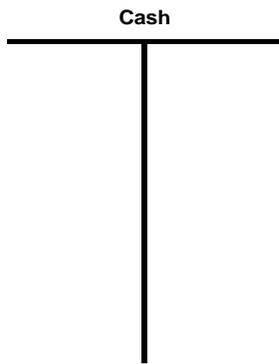
credit  
debit  
credit  
debit

debit  
credit  
debit  
credit

To demonstrate this process, we will use the transaction worksheet from exercise 2-2 presented on the following page to record the transactions into T accounts using the rules of debit and credit.

	<u>Assets</u>	=	<u>Liabilities</u>			+	<u>Equity</u>					
<u>Economic Event</u>	<u>Cash</u>		<u>Accounts Payable</u>	<u>Approp.</u>	<u>Donations</u>	<u>Dues &amp; Fees</u>	<u>Admissions Revenue</u>	<u>Inst. Software</u>	<u>Inst. Supplies</u>	<u>Purchased Food</u>	<u>Purchased Services</u>	<u>Reg Fees</u>
1. Central office sent \$6200 to school for instructional purposes to the school.	+6200			+6200								
2. Bought 40 boxes of wipe-off board markers and 20 erasers for new year. Principal signed PO for \$240. Cut check.	-240								-240			
3. Bought cookies and cokes for orientation for parents and students. A purchase order was prepared and signed by principal. School secretary paid Publix \$300 and used tax-exempt code.	-300									-300		
4. Parents gave funds to school for classroom supplies. \$800 was received by teachers and submitted to the office.	+800				+800							
5. Principal is asked by superintendent to attend state technology conference in September. Paid \$150 for registration for conference with check.	-150											-150
6. Assistant Principal purchased supplies for classrooms at Office Depot using school account. Receipt totaled \$1150. Funds will be due by 10th of September.			+1150						-1150			
7. Students brought funds in for lockers and parking. Locker revenues were \$245 and parking revenues were \$430.	+675					+675						
8. Instructional software was ordered and downloaded from Microsoft for school lab for \$500. Payment is expected by August 30 from school.			+500					-500				
9. Bought pre-game meal for football players and coaches. Paid ChickFilA \$400 with check.	-400									-400		
10. Ticket sales from football game totaled \$2300. Received cash and deposited in bank immediately.	+2300						+2300					
11. Paid athletic referees \$225 for officiating Friday night football game.	-225										-225	
12. Cut check for purchase of software for \$500.	-500		-500									
<b>Totals</b>	<b>\$8,160.00</b>	<b>=</b>	<b>\$1,150.00</b>	<b>\$6,200.00</b>	<b>\$800.00</b>	<b>\$675.00</b>	<b>\$2,300.00</b>	<b>(\$500.00)</b>	<b>(\$1,390.00)</b>	<b>(\$700.00)</b>	<b>(\$225.00)</b>	<b>(\$150.00)</b>

Let's record these transactions into T-accounts. Complete transactions 1 through 12 and then compute the balance of each account. The difference between the debits and credits in a single account is the account balance.



## Trial Balance

A list of the accounts and their current balance at a specific point in time is called a trial balance. Below is an example of a trial balance you would find in a for-profit entity – notice that the debits equal the credits. Trial balances for local schools are the same format, however, there are normally more equity accounts (revenues and expenses/expenditures) than assets and liabilities due to the nature of accounting found in local schools.

The trial balance checks to determine whether or not equality of the accounting equation has been maintained. If total debits equal total credits, the equality of the accounting equation has been maintained. A trial balance that is "in balance", however, does not necessarily assure correct balances. For example, Café King's prepaid insurance shows an asset value of \$480. This amount was the total premium paid on August 1 for a year's risk coverage. Some of that value is used up as of August 31. Therefore the accounts need to be "adjusted" to present correct balances for each account. These correcting or adjusting entries should be made prior to the preparation of financial statements.

### **CAFÉ KING TRIAL BALANCE August 31, 2012**

	DR	CR
Cash	\$155,575	
Supplies Inventory	14,500	
Prepaid Rent	120	
Prepaid Insurance	480	
Furniture & Equipment	58,000	
Building	250,000	
Accounts Payable		\$16,090
Notes Payable		2,000
Mortgage Payable		200,000
Equity		<u>260,585</u>
	<u>\$478,675</u>	<u>\$478,675</u>



## ANALYZING TRANSACTIONS

When a financial transaction occurs, an analysis is made of the event:

- STEP 1. Identify the financial statement elements that have been affected by the transaction.
- STEP 2. Indicate the change (increase/decrease) that occurred in each element.
- STEP 3. Locate (left or right) the element in the accounting equation.
- STEP 4. Apply the rules of debit and credit to the element.

**Example:** Hope High School collected \$1,000 from food sales at concessions.

### Analysis:

- STEP 1. Cash  
Concessions Revenues
- STEP 2. Cash increased by \$1,000  
Concessions Revenue increased by \$1,000
- STEP 3. Cash is an asset, sits to the left of the equation  
Concessions Revenue is an increase to retained earnings;  
it sits to the right of the equation
- STEP 4. Cash (asset) increases on the left - debit  
Concessions Revenue (revenue) increases on the right -  
credit

## JOURNALIZE

The accounting system begins with the analyzing and recording of financial transactions. This activity, however, does not begin in the accounts. Instead, it begins with recording the activity in a journal. The journal provides a record of the entire transaction in chronological order. When errors are found in the trial balance or with outside claims against the entity, it would be necessary to review the original transaction. That cannot be easily found in the individual accounts. The journal, which is also referred to as the book of original entry, provides a starting point for documentation and an easier source to locate errors and verify original transactions. For the journal is the only record with the economic event (dr./cr.) recorded in its entirety. The journal documents the transactions in chronological order.

### **EXERCISE 4-2**

Using the Hope High School economic events for the month of August, record the transactions in the general journal. You should not include posting references at the time that you are journalizing financial transactions. The posting reference column is used only during the posting process which is discussed later. Entry 1 has been provided as an example.

1. Central office sent \$6200 to school for instructional supplies to the school.
2. Bought 40 boxes of wipe-off board markers and 20 erasers for new year. Principal signed PO for \$240. Cut check.
3. Bought cookies and cokes for orientation for parents and students. A purchase order was prepared and signed by principal. School secretary paid Publix \$300 and used tax-exempt code.
4. Parents gave funds to school for classroom supplies. \$800 was received by teachers and submitted to the office.
5. Principal is asked by superintendent to attend state technology conference in September. Paid \$150 for registration for conference with check.
6. Assistant Principal purchased supplies for classrooms at Office Depot using school account. Receipt totaled \$1150. Funds will be due by 10<sup>th</sup> of September.
7. Students brought funds in for lockers and parking. Locker revenues were \$245 and parking revenues were \$430.
8. Instructional software was ordered from Microsoft for school lab for \$500. Order is expected by August 30 with payment due upon delivery.
9. Bought pre-game meal for football players and coaches. Paid ChickFilA \$400 with check.
10. Ticket sales from football game totaled \$2300. Received cash and deposited in bank immediately.
11. Paid athletic referees \$225 for officiating Friday night football game.
12. Received instructional software. Cut check for purchase of \$500.







## POSTING

After recording the financial transaction in its entirety, the information is transferred to the individual accounts. This process is referred to as posting. Both the journal and the accounts are cross referenced to assist tracing the information when needed.

The accounts are kept together in a ledger. There are two types of ledgers:

**General ledger** contains the summarized totals for each account which are the individual elements of the financial statements.

Example – Accounts Receivable

Balance \$10,000

**Subsidiary ledgers** contain the detailed breakdown of a control account in the general ledger.

Example - Subsidiary Ledger: Accounts Receivable

Due From Principal's Office	\$ 4,000	
Due From Boosters Club	\$ 5,500	
Due From ABC Company	<u>\$ 500</u>	
Balance		<u>\$10,000</u>

GENERAL LEDGER		SUBSIDIARY LEDGER : ACCOUNTS RECEIVABLE					
Control Account		Details for Control Account					
Accounts Receivable	=	Due From Principal's Office	+	Due From Boosters Club	+	Due From ABC Co.	
10,000		4,000		5,500		500	

The total of the subsidiary ledger accounts must equal the balance of the control account. This separation of detail from the summary account is one of the checks and balances within the accounting system. Periodically, the subsidiary ledger is reconciled to the control account to check the accuracy of the journalizing and posting.

The ledger accounts are organized and numbered according to type of element. This numbering system and rank order is called the chart of accounts. The chart of accounts is designed for each individual accounting entity.

## ADJUSTMENTS TO ACCOUNTS

Before preparation of financial statements, a trial balance is prepared from the posted accounts. The trial balance for Hope High School was prepared in Exercise 4-1. The trial balance column totals are checked for equality. Then, the individual accounts are scanned for normalcy of balance:

<u>debits</u>	<u>credits</u>
Assets	Liabilities
Expenses	Contributed Equity
Losses	Retained Earnings
	Revenues
	Gains

Other information is gathered to verify that all transactions have been recorded and all accounts are properly stated. There are usually some corrections needed at year-end or month-end to correct the accounts (bring up to date). These corrections or adjustments can be classified as:

- accrued revenues,
- accrued expenses,
- prepaid revenues,
- prepaid expenses, and
- valuation adjustments.

An **ACCRUED REVENUE** is revenue that has been earned but not recorded. For Hope High School, let's assume that the driver's ed teacher informs the bookkeeper that he has billed \$250 in fees and students will be turning those in after Labor Day weekend. The adjusting entry (A1) is:

Date	<b>General Journal</b>		<b>page</b>	
	Account	Post. Ref	Debit	Credit
A1	Accounts Receivable –Driver's Ed Fees		\$250	
	Driver's Ed Dues			\$250

An **ACCRUED EXPENSE** is an expense that has been incurred but not recorded. The bookkeeper underpaid for the pregame meal for the football game in August. ChickFILA asks that you pay the balance in September. An adjustment should be made to recognize the expense and the payable to ChickFILA.

Date	General Journal		Post. Ref	Debit	Credit
	Account	page			
A2	Prepared Food			\$100	
	Accounts Payable				\$100

A **PREPAID REVENUE** is revenue that has not yet been earned but has already been collected. Unearned revenue is a liability for the organization that will perform services or deliver products. The adjusting entry is made so that the revenue earned is recognized in the appropriate accounting period. For illustration purposes, assume that the band has been invited to attend the Macy's Day Parade. Students were asked to pay a balance of \$1500 by May of last year and the fees will not be considered earned for this year.

Date	General Journal		Post. Ref	Debit	Credit
	Account	page			
16.	Cash			\$1500	
	Unearned Fees - Fieldtrip				\$1500
A3	Unearned Fees – Fieldtrip			\$1500	
	Fees Revenue - Fieldtrip				\$1500

A **PREPAID EXPENSE** is an expense that has been paid for but has not been used. The organization making the payment should recognize an asset for the services or goods it will receive. The adjusting entry will allocate the amount used to expense and the amount of benefits still available to asset. Let's assume that Hope High School paid \$480 on August 1 for a one year insurance policy. As of August 31, one month ( $480 \div 12 = 40$ ) of the risk coverage has expired and should be recognized as an expense.

Date	General Journal		Post. Ref	Debit	Credit
	Account	page			
A4	Insurance Expense			\$40	
	Prepaid Insurance				\$40

## **Correction of an Error**

When bookkeepers and accountants are working with journal entries, it is normal to make errors, however, a review of the monthly entries is a good practice and helps maintain accountability in the school environment. Staff must make correcting entries when they find errors.

There are two ways to make correcting entries: reverse the incorrect entry and then use a second journal entry to record the transaction correctly, or make a single journal entry that, when combined with the original but incorrect entry, fixes the error. Normally, the second method is utilized, however, a t-account is a helpful tool if the entry/economic event is very involved and confusing.

For the purpose of illustration, assume that the bookkeeper incorrectly debited Purchased Food instead of Instructional Software when the Microsoft order was placed in August. The correcting entries (adjustment), using the 2<sup>nd</sup> method mentioned above, would be:

Date	General Journal		page	
	Account	Post. Ref	Debit	Credit
A5	Instructional Software		\$500	
	Purchased Food			\$500

### **NOTE –**

**The adjustments illustrated above, including the correcting entry adjustment, have NOT been added to the journal entries for Hope High School for August.**

## Exercise 4-3

### PART 1:

Record the following September transactions in the General Journal for Hope High School.

1. Received club dues for drama club (\$400); robotics club (\$250); and environmental club (\$150).
2. Bought 400 t-shirts and 200 hats for upcoming drug free week. Principal hopes to sell these to students as a pledge to “say no to drugs” campaign. Paid cash \$900 to local vendor same day.
3. Student turned in \$20 for lost textbook.
4. Paid Office Depot account from purchase of instructional supplies in August.
5. Sold 360 t-shirts for \$6 each and 120 hats for \$4 each.
6. Received \$400 from donations for Drug-Free week from parents to use towards instructional supplies.
7. Robotics club sponsor brought \$420 into office for 12 students to attend BEST competition district meeting in Birmingham on Thursday. Will be taking school bus and hiring driver for day to attend meeting.
8. Opened school concession store during 2<sup>nd</sup> week of September. Purchased food and drinks to sell to students during break. Paid Costco \$275 for entire amount with check.
9. Robotics club went to Birmingham – paid bus driver \$135 for trip.
10. Environmental club wants to purchase \$100 of instructional videos for club meetings. Will be using dues. Ordered and received videos in mail. Owe instructional vendor by 10<sup>th</sup> of next month.
11. At end of week, concessions deposit was \$720. Receipts showed \$730. Students had been supervised entire week by faculty, however, it appears there was a \$10 error in a register.
12. Bought pre-game meal for coaches and athletes from ChickFila. Paid \$380 with check.
13. Received \$1850 in gate receipts for game.
14. Paid officials \$225 for officiating game.
15. Drama club hired local carpenter to build set for \$200. Carpenter finished in one day and gave his bill to the school secretary. Cut check to carpenter.







### Exercise 4-3

#### PART 2:

Post the general journal entries to the general ledger (T-accounts) for Hope High School. The August 31 balances have been carried forward in the T-accounts. Additional t-accounts (if needed) are on the next page.

Cash	
8160	

Accounts Payable	
	1150

Appropriations	
	6200

Donations	
	800

Dues & Fees	
	675

Admissions Revenue	
	2300

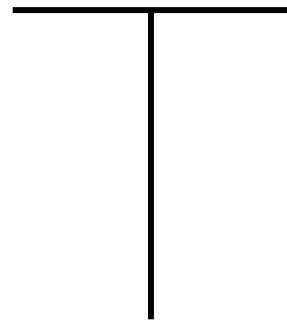
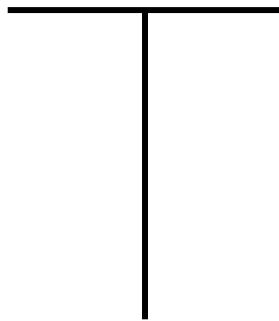
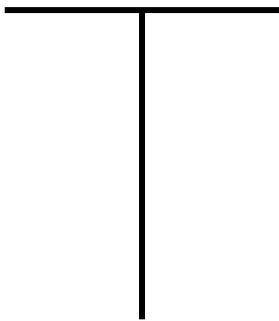
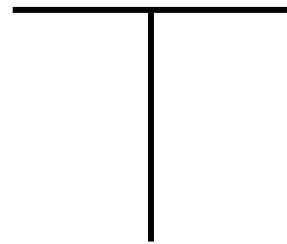
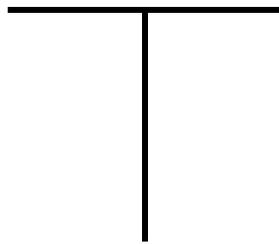
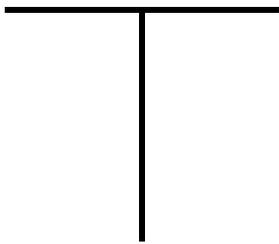
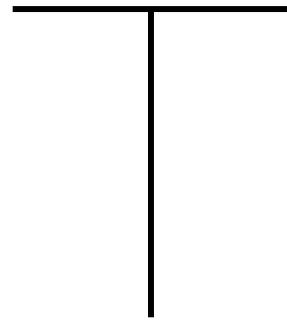
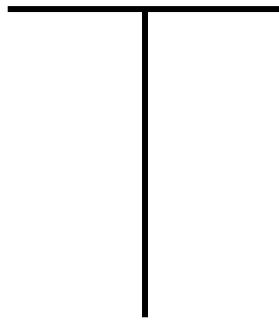
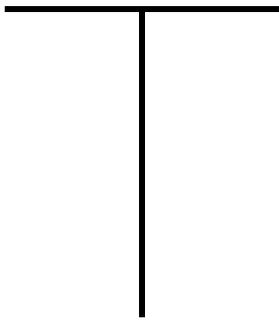
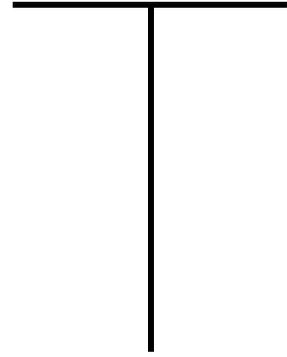
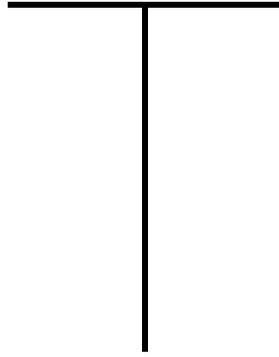
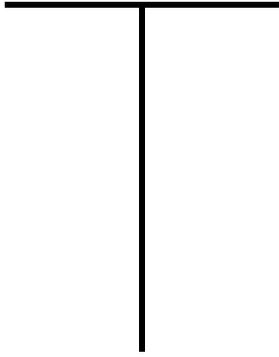
Instructional Software	
500	

Instructional Supplies	
1390	

Purchased Food	
	700

Purchased Services	
225	

Regist. Fees	
	150





## FINANCIAL STATEMENTS

After adjustments are made (if any) and the adjusted trial balance is completed, an organization can now prepare its basic financial statements. These statements are:

- Balance Sheet
- Income Statement

### **EXERCISE 4-3**

#### **PART 4:**

Using the trial balance from Exercise 4-3, Part 3, prepare the balance sheet and income statement for Hope High School as of September 30, 2012. The financial statements formats to prepare the Hope High School are provided below and on the next page.

### **HOPE HIGH SCHOOL BALANCE SHEET SEPTEMBER 30, 2012 ASSETS**

Current Assets:

Property Plant & Equipment:

**Total Assets**

=====

### **LIABILITIES**

Current Liabilities:

Total Liabilities

### **EQUITY**

Total Equity

**Total Liabilities and Equity**

=====

**HOPE HIGH SCHOOL  
INCOME STATEMENT  
For Partial Fiscal Year Beginning August 1, 2012, Ending September 30, 2012**

Revenues:

Total Revenues

Expenses/Expenditures:

Total Expenses/Expenditures

Income (Loss)

\_\_\_\_\_

\$ \_\_\_\_\_

### Year End Closing

At the end of the fiscal year, the balances in the temporary equity accounts and/or /fund balance accounts are transferred to the permanent equity/fund balance account. This process is called "closing the books." Closing is necessary so that the operating results and other changes to equity for the current year do not get commingled with operating results of the subsequent year. To close an account means to bring the balance to zero. The only accounts that will be closed for Hope High School are the revenue and expense accounts leaving a fund equity balance.

Prepare the closing entries for Hope High School as of September 30, 2012 in Exercise 4-3 Part 5.

### Exercise 4-3

#### Part 5: Closing Entries

Date	General Journal			page
	Account	Post. Ref	Debit	Credit
Sept 30 2012	Appropriations			
	Donations			
	Dues and Fees			
	Admissions Revenue			
	Concessions			
	Fines and Penalties			
	Sales			
	Unreserved Fund Balance			
	Instructional Software			
	Instructional Supplies			
	Purchased Food			
	Purchased Services			
	Registration Fees			
	Cash Short and Over			
	Items for Resale			
	Co-curricular Transportation			

## POST CLOSING TRIAL BALANCE

After all temporary accounts have been closed (brought to a zero balance), a final trial balance is prepared. This post closing trial balance is a final check to see if

- the ledger is in balance (debits = credits)
- the accounts are carrying normal balance, and
- no **temporary** equity accounts have been left open (carrying a balance forward) – these include the revenue and expense/expenditure accounts.

### Exercise 4-3

#### Part 6: Post-Closing Trial Balance

**Hope High School**  
**Post-Closing Trial Balance**  
**September 30, 2012**

Accounts	<u>Debits</u>	<u>Credits</u>
Cash		
Accounts Payable		
Unreserved Fund Balance		
Totals		

## CHAPTER 4

### REVIEW EXERCISES

#### TRUE/FALSE

- \_\_\_\_\_ 4.1 Debit means left and credit means right.
- \_\_\_\_\_ 4.2 A T account is used for explanation purposes and is not found in developed bookkeeping systems.
- \_\_\_\_\_ 4.3 To increase an asset account, you debit.
- \_\_\_\_\_ 4.4 To increase an expense account, you debit.
- \_\_\_\_\_ 4.5 Before you record a transaction, you should identify the transaction elements.

#### LIST/DISCUSS

- 4.6 List the steps in the accounting cycle.
- 4.7 What is the purpose of closing entries?

**CHAPTER 5**  
**LEA FINANCIAL STATEMENTS**

## **THE FINANCIAL STATEMENTS OF A LOCAL EDUCATION AGENCY**

The annual financial report issued by a local education agency (LEA) is the most consistent way in which the LEA can demonstrate its accountability to the citizens, the legislature, other resource providers, and its creditors. The financial statements are the heart of the annual report. These statements are prepared according to generally accepted accounting principles (GAAP) and conform to state guidelines for reporting assets, liabilities, net assets, revenues, and expenditures of the local education agency. The annual financial statements are audited by certified public accountants (CPA) or by the State Department of Examiners of Public Accounts. The auditor's report and the annual financial statements are submitted to the local school board and to the State Department of Education.

The annual financial reports provide the basis for evaluating the financial condition of the respective school system. This information facilitates the performance analysis of the school and/or district as conducted by the school board, the State Department of Education and other interested parties such as the citizenry, creditors, and bond rating agencies.

### **The Financial Statements – A brief overview**

The financial statement section of the annual report consists of five parts:

1. Management's discussion and analysis
2. The independent auditors' report
3. The basic financial statements
4. Required supplemental information
5. Other supplemental information.

Each component within the financial statement section is prepared according to specific guidelines issued by those regulatory bodies that have authority for financial reporting standards by state and local school districts – the Governmental Accounting Standards Board (GASB), and for auditing state and local school districts – the American Institute of CPAs (AICPA) and the Government Accountability Office (GAO). Let's take a closer look at a school board's basic financial statements: the district-wide financial statements and the fund financial statements.

### **District-Wide Financial Statements**

The district-wide financial statements are designed to provide financial statement readers with a broad overview of the Board's finances as a whole instead of on an individual school or activity (fund) basis in a manner similar to a private-sector business. The district-wide statements contain both long-term and short-term information about the Board's overall financial status. It is important to note that all of the activities of the Board reported in the district-wide financial statements are classified as governmental

activities. These governmental activities include, but are not limited to, student instruction, student transportation, school food services, facility maintenance, local school public funds, and interest and fiscal charges on long-term debt.

District-wide financial statements report capital assets and depreciation of all exhaustible capital assets as well as the outstanding balances of long-term debt and other obligations. These statements report all assets and liabilities perpetuated by these activities using the accrual basis of accounting. The accrual basis takes into account all of the Board's current year revenues and expenses regardless of when received or paid. This approach moves the financial reporting method for governmental entities closer to the financial reporting methods used in the private sector.

The following district-wide financial statements report on all of the governmental activities of the Board as a whole.

- The **Statement of Net Position** is most closely related to a business entity's balance sheet. It presents information on all of the Board's assets (what it owns) and liabilities (what it owes), with the difference between the two reported as net position. The net position reported in this statement represents the accumulated results of operating the school district. Thus, the amount of net position reported in this statement may serve as a useful indicator of whether the financial position of the school board is fiscally sound or is in financial trouble.
- The **Statement of Activities** is most closely related to a business entity's income statement. It presents information showing how the Board's net position changed during the current fiscal year as a result of district operations. All of the current year's revenues and expenses are reported in the statement of activities regardless of when cash is received or paid. This statement shows gross expenses and offsetting program revenues to arrive at net cost information for each major function or activity of the district. The change in net assets for the year allows the financial statement reader to determine whether the District's financial position has improved or deteriorated over the course of the current fiscal year.

Illustrations of the district-wide statements are provided on the next two pages.

## Illustrated District-Wide Statement of Net Assets

### CITY SCHOOL SYSTEM STATEMENT OF NET POSITION SEPTEMBER 30, XXXX

	Governmental Activities
<b>ASSETS</b>	
Current assets	
Cash and cash equivalents	\$ 19,653,119
Accounts receivable, net	40,586
Property tax receivable	5,401,793
Due from other governments	817,714
Inventories	121,361
Total current assets	<u>26,034,573</u>
Capital Assets not being depreciated	
Land and improvements	8,859,215
Construction in progress	657,516
Total capital assets not being depreciated	<u>9,516,731</u>
Capital Assets	
Land improvements	3,598,969
Buildings and improvements	104,540,193
Furniture, equipment and vehicles	12,546,078
Less accumulated depreciation	(34,092,923)
Total depreciable capital assets, net of depreciation	<u>86,592,317</u>
Total assets	<u>122,143,621</u>
<b>LIABILITIES</b>	
Accounts payable	921,985
Deferred revenues	5,715,276
Salaries and benefits payable	3,746,414
Obligations under capital leases - due in less than 1 year	672,252
Obligations under capital leases - due after 1 year	1,294,377
Total liabilities	<u>12,350,304</u>
<b>NET POSITION</b>	
Invested in capital assets, net of related debt	94,142,419
Restricted for	
Capital projects	891,588
Other projects	1,891,565
Unrestricted	12,867,745
Total net position	<u>\$ 109,793,317</u>

## Illustrated District-Wide Statement of Activities

### CITY SCHOOL SYSTEM STATEMENT OF ACTIVITIES SEPTEMBER 30, XXXX

Functions/Programs	Expenses	Program Revenues			Net (Expenses) Revenues and Changes in Net Position
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Total Governmental Activities
Governmental activities					
Instruction	\$ 41,907,026	\$ 1,141,985	\$ 24,433,670	\$ 501,124	\$ (15,830,247)
Instructional support	12,273,077	422,223	5,729,013	113,887	(6,007,954)
Operation and maintenance	5,484,664	115,222	1,138,907	774,098	(3,456,437)
Auxiliary services					
Student transportation services	3,294,864	143,501	2,072,036	306,871	(772,456)
Food services	3,515,856	2,776,150	154,754	-	(584,952)
General administrative services	2,762,156	4,696	438,238	-	(2,319,222)
Other	1,047,261	749,679	296,402	-	(1,180)
Interest and fiscal charges	27,363	-	-	-	(27,363)
Total governmental activities	\$ 70,312,267	\$ 5,353,456	\$ 34,263,020	\$ 1,695,980	(28,999,811)
General revenues					
Taxes					
Property taxes for general purposes					11,349,945
Local sales taxes					5,361,188
Alcohol beverage tax					523,749
Other taxes					55,015
Grants and contributions not restricted					2,080
City Council appropriations/payments					9,550,759
Investment earnings					127,803
Miscellaneous					423,701
Total general revenues					27,394,240
Change in net position					(1,605,571)
Net position, beginning of year					111,398,888
Net position, end of year					\$ 109,793,317

## **Fund Financial Statements**

The fund financial statements for the LEA are designed to provide financial statement readers with a more detailed report of the basic services provided by the school district during the current year. These statements have some of the same features as the district-wide statements but also have significant differences from the district-wide statements. The district-wide statements report aggregated data at the highest level providing an overall financial view of the LEA. The fund financial statements, on the other hand, provide some of the detail for the aggregated data reported in the district-wide financial statements.

The fund financial statements take a short term or current focus in reporting as compared to the district wide statements that provide both short term and long term information. Fund financial statements report current financial resources (short term) whereas the district-wide statements report all economic resources (current and long term). Fund financial statements recognize transactions that affect only financial resources ( when cash is received or paid) on a modified accrual accounting basis whereas the district-wide financial statements recognize transactions that affect all economic resources (regardless of when cash is received or paid) on an accrual accounting basis.

The following fund financial statements report on the basic government service activities of the district.

- The **Balance Sheet** is related to the district-wide statement of net assets. It reports only financial assets and liabilities to be paid from those financial assets in the fund balance sheet. The difference between the financial assets and the liabilities is reported as fund balance. The term fund balance implies the readily available financial resources to carry out that specific service activity. Fund balance is not the same as net assets as reported in the district-wide statement of net assets. Thus, the amount of fund balance reported in this statement may serve as a useful indicator of whether the financial resources of this fund are or are not sufficient to provide this particular service.
- The **Statement of Revenues, Expenditures, and Changes in Fund Balance** is related to the district-wide statement of activities. It presents information showing how the fund balance changed during the current fiscal year only. The current year's revenues and expenditures are reported in the statement of revenues, expenditures, and changes in fund balance based on when the financial resources were available (when cash is/would be received or paid) for the current year. This statement provides information to the financial statement reader to assess whether that general service (fund) was able to provide the planned services within the constraints of available resources to the district.

## Illustrated Fund Balance Sheet

### CITY SCHOOL SYSTEM BALANCE SHEET SEPTEMBER 30, XXXX

	General Fund	Capital Projects Fund	Other Governmental Funds	Total Governmental Funds
<b>ASSETS</b>				
Cash and cash equivalents	\$ 10,517,702	\$ 4,252,442	\$ 4,882,975	\$ 19,653,119
Accounts receivable, net	29,948	6,513	4,125	40,586
Due from other governments	622,599	30,677	164,438	817,714
Inventories	-	-	121,361	121,361
	<u>\$ 11,170,249</u>	<u>\$ 4,289,632</u>	<u>\$ 5,172,899</u>	<u>\$ 20,632,780</u>
<b>LIABILITIES AND FUND BALANCES</b>				
<b>Liabilities</b>				
Accounts payable	\$ 318,929	\$ 479,770	\$ 123,286	\$ 921,985
Deferred revenue	-	-	313,483	313,483
Salaries and benefits payable	3,459,381	-	287,033	3,746,414
Total liabilities	<u>3,778,310</u>	<u>479,770</u>	<u>723,802</u>	<u>4,981,882</u>
<b>Fund balances</b>				
Nonspendable	-	-	121,361	121,361
Restricted	-	891,588	1,770,204	2,661,792
Committed	-	-	2,701,509	2,701,509
Assigned	132,404	2,918,274	-	3,050,678
Unassigned	7,259,535	-	(143,977)	7,115,558
Total fund balances	<u>7,391,939</u>	<u>3,809,862</u>	<u>4,449,097</u>	<u>15,650,898</u>
Total liabilities and fund balances	<u>\$ 11,170,249</u>	<u>\$ 4,289,632</u>	<u>\$ 5,172,899</u>	<u>\$ 20,632,780</u>

**Illustrated Fund Statement of Revenues, Expenditures, and  
Changes in Fund Balance**

**CITY SCHOOL SYSTEM  
STATEMENT OF REVENUES, EXPENDITURES AND CHANGED IN FUND  
BALANCES – GOVERNMENTAL FUNDS  
SEPTEMBER 30, XXXX**

	<u>General Fund</u>	<u>Capital Projects Fund</u>	<u>Other Governmental Funds</u>	<u>Total Governmental Funds</u>
<b>REVENUES</b>				
State	\$ 31,099,426	\$ 1,690,671	\$ 1,000	\$ 32,791,097
Federal	73,688	-	4,344,583	4,418,271
Local	27,241,993	9,597	4,092,717	31,344,307
Other	176,482	-	157,557	334,039
Total revenues	<u>58,591,589</u>	<u>1,700,268</u>	<u>8,595,857</u>	<u>68,887,714</u>
<b>EXPENDITURES</b>				
<b>Current</b>				
Instruction	36,492,694	456,299	3,816,193	40,765,186
Instructional support	10,675,629	594,745	1,036,259	12,306,633
Operation and maintenance	4,665,100	658,495	126,720	5,450,315
Auxiliary services	3,336,550	306,871	3,946,910	7,590,331
General administrative services	2,546,672	14,979	258,426	2,820,077
Other	474,244	322	792,621	1,267,187
Capital outlay	-	5,477,068	-	5,477,068
<b>Debt services</b>				
Principal retirement	817,553	-	-	817,553
Interest	27,365	-	-	27,365
Total expenditures	<u>59,035,807</u>	<u>7,508,779</u>	<u>9,977,129</u>	<u>76,521,715</u>
Excess (deficiency) of revenues over expenditures	<u>(444,218)</u>	<u>(5,808,511)</u>	<u>(1,381,272)</u>	<u>(7,634,001)</u>
<b>OTHER FINANCING SOURCES (USES)</b>				
Transfers in	135,831	-	1,319,455	1,455,286
Proceeds from the sale of assets	13,084	-	2,165	15,249
Indirect cost	219,684	-	-	219,684
Other sources	35,533	-	1,425	36,958
Transfers out	(1,319,455)	-	(135,831)	(1,455,286)
Proceeds from the issuance of debt	1,904,630	-	-	1,904,630
Total other financing sources (uses)	<u>989,307</u>	<u>-</u>	<u>1,187,214</u>	<u>2,176,521</u>
Net changes in fund balances	545,089	(5,808,511)	(194,058)	(5,457,480)
Fund balances, beginning of year	<u>6,846,850</u>	<u>9,618,373</u>	<u>4,643,155</u>	<u>21,108,378</u>
Fund balances, end of year	<u>\$ 7,391,939</u>	<u>\$ 3,809,862</u>	<u>\$ 4,449,097</u>	<u>\$ 15,650,898</u>

## COMPARISON OF BASIC FINANCIAL STATEMENTS FOR BUSINESS TO STATE AND LOCAL GOVERNMENTS

### **Basic Financial Statements For Business**

- (1) The Balance Sheet
- (2) The Income Statement
- (3) The Statement of Cash Flows

### **State And Local Governments (Including School Boards)**

#### **GOVERNMENT-WIDE FINANCIAL STATEMENTS**

- (1) Statement of Net Position
- (2) Statement of Activities

#### **FUND FINANCIAL STATEMENTS**

##### **Governmental Fund Financial Statements**

- (3) Balance Sheet – Governmental Funds
- (4) Statement of Revenues, Expenditures and Changes in Fund Balances – Governmental Funds

##### **Proprietary Fund Financial Statements**

- (5) Statement of Net Assets – Proprietary Funds
- (6) Statement of Revenues, Expenses, and Changes in Net Assets – Proprietary Funds
- (7) Statement of Cash Flows – Proprietary Funds

##### **Fiduciary Fund Financial Statements**

- (8) Statement of Fiduciary Net Assets – Fiduciary Funds
- (9) Statement of Changes in Fiduciary Net Assets – Fiduciary Funds

#### **REQUIRED SUPPLEMENTARY INFORMATION**

- (10) Budgetary Comparison Schedule or Statement of Revenues, Expenditures and Changes in Fund Balances, Budget to Actual