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## Nonbusiness Organizations

# A Very Short Course in Reading a Municipal Balance Sheet

## How Much Surplus Cash Does the City Have?

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Editor: Yvonne C. Braune, City of Tacoma, Tacoma, WA

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By Mary Alice Seville

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The headlines reported that the city of Smithville<sup>1</sup> had a \$26 million cash surplus on June 30, 1985. Since the total expenditures for the city for that year were also approximately \$26 million, some citizens became concerned. The implication that the city had \$26 million in "unbudgeted, unappropriated funds" was discussed for days in newspaper articles and letters to the editor. A campaign to amend the city charter to limit "unbudgeted, unappropriated funds" to approximately \$360,000 was started. But did Smithville have a \$26 million surplus? If financial statements are useful, the balance sheet should help answer that question.

That financial statements are supposed to be useful was reaffirmed by the Governmental Accounting Standards Board (GASB) in a recent exposure draft on the objectives of governmental financial statements. The GASB defined the users of governmental statements as citizens, investors and lenders, and legislative and oversight bodies. Since governments are different from commercial enterprises, different information is needed by the users of government statements. Fund accounting and reporting are the accepted methods of providing that information. However, fund financial reports look complex, perhaps too complex for the typical citizen as

evidenced by the common complaint of local government finance officers that citizens do not use the financial statements.

This article looks at the recent balance sheet of Smithville and the use made of the balance sheet by the citizens in the recent controversy. Exhibit 1 reflects the Combined Balance Sheet of All Fund Types and Account Groups for the city of Smithville. We will look at what information about the "surplus" was provided by the balance sheet. First, the total cash and investments need to be determined. Luckily, Smithville uses the optional Totals (Memorandum Only) column, so the across funds adding is already done. All we have to do is find the lines listing Cash and Investments (a) and then add them. The numerous columns make it a little difficult to follow the lines, but when we do, we find that the city has \$18,074,000 plus \$8,180,000 in cash and investments for a total of just over \$26,250,000. So the city did have approximately \$26 million in cash and investments. But was it "unbudgeted, unappropriated" resources that Smithville could use for general purposes?

To answer that question, the easiest place to start is with the Restricted Cash and Investments (b). These assets, by definition, have restrictions placed on them by external parties and should not be considered available for general purposes. Thus, we can eliminate \$8 million.

The \$1.9 million in Trust and Agency (c) can easily be eliminated, too. The Trust and Agency Fund is used to account for resources received and held by the city in a fiduciary capacity, and expenditures from the fund can be made only in accordance with trust agreements. Thus, these assets are not generally available, and our unexplained balance is reduced to \$16.1 million.

Next, look at Special Revenue (d). Again by definition, this type of fund is used to account for the proceeds of specific revenue sources, often intergovernment grants that are legally restricted to expenditures for specified purposes. If they are not used for the specified purposes, they may have to be refunded to the grantor. So another \$.6 million is unavailable, leaving \$15.5 million. The \$2.9 million cash in Capital Projects (e) is bond proceeds to be used for capital construction as indicated by the Designation of Fund balance (f). This cash has been approved by the voters for certain uncompleted projects so should not be considered available for general purposes. Similarly, the Special Assessment (g) cash, \$3.9 million, is to be used for approved projects or to repay debt for previously constructed projects that benefit certain properties more than the general public. The debt incurred to construct the projects will be paid off by those property owners benefited, and any excess should be returned to them, not used for general purposes. Thus, we are down to a possible \$8.7 million available. The Debt Service (h) is used to accumulate resources to pay bonds as they come due. The accumulation might be required by the bond covenants or be at the discretion of the city. The designation (instead of reservation) of the fund balance indicates that in this case it may be discretionary. If we assume that the \$.8 million has to be held, we have approximately \$8 million that appears to be generally available.

An understanding of fund accounting would have led the financial statement reader to wonder about an \$8 million surplus. Since the total tax revenues of Smithville were somewhat less than \$8 million, it is a relatively major amount. However, not all of that \$8 million is generally available. In the Enterprise Fund (i), the unrestricted cash contains \$1.1

<sup>1</sup>Smithville is a fictional city, but its financial situation, including figures adapted for this paper, are taken from very real circumstances.

million of bond proceeds earmarked for construction projects and \$.6 million being held for bond repayment. The General Fund (j) contains about \$1.1 million contributed to the deferred compensation plan by city employees. Legally, the deferred compensation resources are available to the general creditors of the city, but morally they should not be considered generally available. Thus, the resources generally available are reduced to \$5.2 million.

However, Smithville was not just building up an unplanned cash reserve. The \$2.1 million in the Internal Service Fund (k) was set aside for maintenance and equipment replacement including a new computer mainframe. The \$1.3 million in the General Fund and the \$.2 million in the Internal Service Fund can be considered a cushion for operating expenses between July 1 and November 15, when the city starts receiving the next year's tax revenues. Thus, \$3.6 million was set aside for good management reasons. The final \$1.6 million is in the Enterprise Fund (i). The city recently reduced the

utility rates somewhat because of that operating surplus.

Among other municipal financial officers, the city of Smithville has a reputation for having strong financial management. In spite of this reputation, Smithville found itself defending its management of city revenues, probably for two reasons. One, the city had not done a good job explaining its financial management philosophy to its citizens. The newspaper discussion of the whole controversy highlighted the city's management philosophy and led to greater understanding. (The city has also taken other steps, such as neighborhood meetings, to get more information to the citizens.) Two, the citizens did not understand the information presented by the fund statements. This misunderstanding is not limited to this one city. Smithville used the standard footnotes explaining the funds and enlarged on that explanation in the Letter of Transmittal. The problem, in general, is that fund accounting and reporting are not understood by citizens. Educating citizens about city

financial management and municipal balance sheets needs to be done, or more confrontations, like the one in Smithville, can be expected. □



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**EXHIBIT 1**

**Smithville**  
**Combined Balance Sheet — All Fund Types and Account Groups**  
 Condensed  
**June 30, 1985**  
 (in 000's)

	Governmental Fund Types					Proprietary Fund Types		Fiduciary Fund Type	Account Groups		Totals (Memo Only) 1985
	General	Special Revenue	Debt Service	Capital Projects	Special Assessment	Enterprise	Internal Service	Trust and Agency	General Fixed Assets	General Long-Term Obligations	
<b>ASSETS</b>											
Cash and Investments (a)	\$ 2,405(j)	\$ 603(d)	\$ 759(h)	\$ 2,875(e)	\$ 3,923(g)	\$ 3,356(i)	\$ 2,282(k)	\$ 1,891(c)	\$ —	\$ —	\$ 18,074(a)
Receivables	2,234	2,189	292	108	11,160	1,172	41	35	—	—	17,231
Inventory	—	—	—	—	—	120	—	—	—	—	120
Other Assets	—	—	—	—	—	65	2	—	—	—	67
Restricted Assets:											
Cash and Investments(a)(b)	—	1,055	—	—	—	7,125	—	—	—	—	8,180(a)(b)
Receivables	—	435	—	—	—	825	—	—	—	—	1,260
Fixed Assets	—	—	—	—	—	28,025	440	—	10,098	—	38,563
Amount available for retirement of general long-term obligations	—	—	—	—	—	—	—	—	—	788	788
Amount to be provided for retirement of general long-term obligations	—	—	—	—	—	—	—	—	—	7,840	7,840
<b>TOTAL ASSETS</b>	<u>\$4,639</u>	<u>\$4,282</u>	<u>\$1,051</u>	<u>\$2,983</u>	<u>\$15,083</u>	<u>\$40,688</u>	<u>\$2,745</u>	<u>\$1,926</u>	<u>\$10,098</u>	<u>\$8,628</u>	<u>\$92,123</u>
<b>LIABILITIES AND FUND EQUITY (DEFICIT)</b>											
<b>TOTAL LIABILITIES</b>	\$ 2,479	\$ 2,388	\$ 263	\$ 2	\$ 23,169	\$ 13,527	\$ 111	\$ 23	\$ —	\$ 8,628	\$ 50,590
Fund equity (deficit)											
Contributed capital	—	—	—	—	—	8,269	—	—	—	—	8,269
Investment in general fixed assets	—	—	—	—	—	—	—	—	10,098	—	10,098
Retained earnings:											
Reserved for debt service and construction	—	—	—	—	—	6,942	—	—	—	—	6,942
Unreserved	—	—	—	—	—	11,950	2,634	—	—	—	14,584
Fund balance (deficit):											
Reserved	2	—	—	—	—	—	—	1,903	—	—	1,905
Unreserved:											
Designated for construction & debt service (f)	—	1,490	788	2,981	(8,086)	—	—	—	—	—	(2,827)
Undesignated	2,158	404	—	—	—	—	—	—	—	—	2,562
<b>TOTAL FUND EQUITY (DEFICIT)</b>	<u>2,160</u>	<u>1,894</u>	<u>788</u>	<u>2,981</u>	<u>(8,086)</u>	<u>27,161</u>	<u>2,634</u>	<u>1,903</u>	<u>10,098</u>	<u>—</u>	<u>41,533</u>
<b>TOTAL LIABILITIES AND FUND EQUITY</b>	<u>\$4,639</u>	<u>\$4,282</u>	<u>\$1,051</u>	<u>\$2,983</u>	<u>\$15,083</u>	<u>\$40,688</u>	<u>\$2,745</u>	<u>\$1,926</u>	<u>\$10,098</u>	<u>\$8,628</u>	<u>\$92,123</u>

See notes to combined financial statements.