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Fund Accounting:

Theoretical and Empirical Study

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ABSTRACT

The public sector operates in the context of increasing demand for transparency and accountability and better control of financial resources spending. Governmental organizations differ from business enterprises in their missions, ways of revenue acquisition and performance evaluation. At the same time, international discussion about how to develop and improve governmental accounting uses commercial accounting as the only accounting framework and do not provide an attention to other available accounting models, such as fund accounting and cameral accounting. The thesis aims to introduce fund accounting into this international debate. The study acquires knowledge about fund accounting as an accounting platform, which is used when carrying out an empirical study, analyzing the financial statements of the City of Wolverhampton, UK. The study discusses if fund accounting, or some of its elements, could be of interest to use as a part of the accounting framework in the public sector. The study finds that even though, municipal accounting uses some elements based on the original fund approach, the fundamental fund accounting concepts changed their meanings affected by the current accounting trends of business accounting standards adoption in the public sector. The study takes into consideration the advantages of fund accounting, such as focus on budgetary control and fiduciary stewardship and suggests its improvement and simplification in order to serve the public sector better, but not the replacement by the commercial (accrual) accounting.

Key words: fund accounting, governmental accounting, public sector, budgetary control, municipality, City of Wolverhampton, commercial accounting.

FOREWORD

This thesis is written as a part of the Master of Science program in Economics and Business Administration at NHH (Norwegian School of Economics). The course INB421 “International Business and Nonbusiness Accounting” provided me with an initial knowledge about the distinction between accounting in business, public sector and nonprofit organizations and introduced the great variety or accounting models and approaches.

I would like to thank my supervisor Norvald Monsen for inspiring me to study accounting for nonprofit organizations and the public sector and for his guidance, advice, valuable commentaries and support. This inspiration goes beyond work on this MSc thesis and I continue to study nonprofit accounting as a researcher.

Finally, I would like to thank my family for providing me with support and motivation.

Galina Goncharenko

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CONTENTS

LIST OF FIGURES

LIST OF TABLES

Chapter 1: INTRODUCTION

1.1. Motivation of study

All types of organizations must acquire revenues for financing their expenditures. However, different types of organizations acquire revenues in different ways. For example, business enterprises acquire revenues through market-exchange transactions in form of buying/producing and selling goods/services. On the other hand, governmental organizations primarily acquire revenues through one-way money transactions (like tax revenues from the tax payers) without giving a direct service in return (to the tax payers) (Danielsson, 1977, referred in Monsen, 2012). And due to this difference, historically different types of accounts have been prepared in the business and governmental sectors.

In the business sector, business (commercial) accounting has been – and still is – prepared, although the particular variant of commercial accounting has been developed over time (see e.g., Monsen, 2012). In the governmental sector, however, we can observe a greater variety with regard to the accounting models prepared. For example, on the governmental sector in continental European countries (Austria, Germany and Switzerland), cameral accounting has been – and still to some extent is – prepared (see e.g. Oettle, 1990; Monsen, 2012). Furthermore, in the governmental sector in Anglo-Saxon countries (especially, USA and UK), fund accounting has been, and still is, prepared.

In spite of this situation, the international discussion about how to develop and improve governmental accounting uses commercial accounting as the only accounting framework. It is true that a few attempts in recent years have been carried out, trying to introduce cameral accounting as a part of the international accounting framework for governmental accounting (see particularly Monsen, 2012). But no other researchers seem to have pursued this attempt. Similar attempts to introduce fund accounting into the international governmental accounting debate cannot, however, be observed, although fund accounting is explained and discussed in English-language text books (Vatter, 1947; Henke, 1983; Rutherford, 1983).

Given this situation, it would be of interest to try and introduce fund accounting into the international debate about how to develop and improve governmental accounting. Before it could be done, however, it would be necessary to acquire knowledge about fund accounting. Although fund accounting is presented in some English-language textbooks, this particular accounting model does not seem to be familiar to other persons than those who have attended a course on governmental accounting in Anglo-Saxon countries. Accordingly, knowledge about fund accounting is limited, especially in comparison with the knowledge about business accounting that is being taught all over the world.

1.2. Research purpose

There are three interrelated purposes for this study. First, the study will explain fund accounting in order to establish an accounting platform for use both in later parts of this study and in other research on governmental accounting. Second, this platform with knowledge about fund accounting will be used when carrying out an empirical study, analyzing the financial statements of a particular municipality (the City of Wolverhampton, UK). Finally, this study will discuss if fund accounting, or some of its ideas, could be of interest to use as a part of the accounting framework in the international discussion about how to develop and improve governmental accounting.

1.3. Structure

The thesis has the following structure. In the next chapter the methodological approach, perspectives and levels of analysis are presented. Chapter 3 consists of a brief analysis of the main accounting concepts, applied in governmental sector. Chapters 4, 5 and 6 include the literature study concerning different accounting theories (proprietary, entity and fund theory) and their comparison. Chapter 7 presents the concept of dollar accountability and modified basic accounting equations, applied in fund accounting followed by an extensive numerical example. In chapter 8, a review of experiences with fund accounting adoption by the governmental sector is given. In chapters 9 and 10, the case study of the City of Wolverhampton, UK is presented and analyzed. Finally, in chapter 11 the summarizing discussion of fund accounting implementation in the public sector is given, followed by concluding remarks in chapter 12.

Chapter 2: METHODOLOGY

The systematization of existing knowledge together with the empirical study and the theoretical discussion about fund accounting theory implementation in public sector is performed in this thesis by means of case study and descriptive method within different levels and perspectives of analysis.

2.1. Three perspectives

According to Monsen (1987), who refers to Arbnor & Bjerke (1977), there are three methodological perspectives, which could be applied in a research study: analytical, system and individual (actor) perspectives. The choice of the perspective affects the research findings.

The analytical perspective assumes that the reality can be viewed as a complex of the different components it consists of in an objective manner. The phenomenon is considered as a sum of its composing components. The knowledge achieved is explained by the observed phenomenon and different individuals are supposed to perceive a phenomenon in a similar way.

The system perspective suggests that the reality deviates from the sum of the components it consists of. The negative and positive (synergetic) effects of relationships between components affect the perceiving of the phenomenon. The components are considered within a system and their behaviour is explained by the properties of the system.

Both analytical and system perspectives assume that reality is objective.

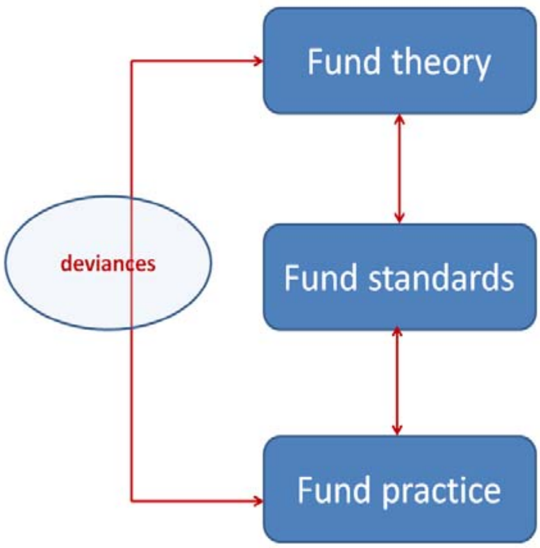
The individual (actor) perspective is mostly focused on the role of different individuals in specific processes. Reality is assumed to be constructed by different social processes. This perspective is not primarily interested in explaining the whole phenomenon, but when it takes place, the perceiving of the whole depends on the actors. The purpose of the individual perspective is identifying the meaning and the contents, which lay in actions of the different actors and the environment they are surrounded by.

The analytical perspective is chosen as a methodological framework for this thesis, since there are clear causality and effect linkages in accounting between different components (profit and equity, depreciation and residual value of fixed assets, etc.). Accounting can also be considered from the system and individual perspectives. In the first case, accounting could be viewed within a financial control system together with budgeting, etc. The individual prospective could create knowledge about accounting by collecting opinions of accountants, etc. However, the system and individual perspectives are beyond the scope of this thesis.

2.2. Levels of analysis

The existing accounting knowledge is distinguished between three broad levels: theoretical, normative (regulative) and practical (Monsen & Wallace, 1995). The relationship between these levels could be defined as complex. Accounting theories, norms and practices reside at continuous interactions; however, the causality of these relationships cannot be evaluated univocal. Figure 1 demonstrates these levels of analysis in fund accounting.

Figure 1: Different levels of analysis in fund accounting



Accounting theory can be developed by using several research methodologies:

"Among …commonly identified methodologies are: deductive approach, inductive approach, pragmatic approach, ethical approach and behavioral approach" (Schroeder et al., 2011, p. 113).

Nevertheless, the present time can be characterized by the dominant role of the pragmatic approach in accounting theory development:

"This approach asserts the sole test of truth, or soundness, lies in practical results. Another often used description of this method of selecting theory is good accounting is the accounting found useful by business" (Hylton, 1962, p. 24).

At the same time "financial accounting theory has had little substantive, direct impact on accounting practice or policy formulation" (Watts and Zimmerman, 1979, p. 273).

Therefore, it creates complexity (conflict) between different levels of analysis in accounting, in context of distinction between required and recommended practices. The research interest of this thesis focuses on fund theory study (theoretical level of analysis) with implication to governmental administrations (practical level of analysis) with the main attention to the deviances between fund theory and fund accounting practice.

2.3. Case study

The case study method is applied for acquiring knowledge about the accounting rules, regulations and practices adopted by a municipality, City of Wolverhampton, UK.

According to Yin (1984):

"A case study is an empirical inquiry that investigates a contemporary phenomenon within its real context; when the boundaries between phenomenon and context are not clearly evident; and in which multiple sources of evidence are used" (Yin, 1984, p. 23).

There is an increasing interest to the case study method application in accounting, even though, mostly in management accounting, therefore, the method has a significant unrealized potential in financial accounting field. Case studies help to understand the nature of accounting practice "both in terms of technologies, procedures, systems, etc. which are used and the way in which they are used" (Ryan et al, 2002, p. 143).

Case studies combine understanding with explanatory perspectives, theoretical explanation of studied phenomena, integrated theoretical interpretation and even a single case creates environment for theoretical generalization grounded on empirical evidence (Smith, 2011).

The thesis undertakes an exploratory and explanatory case study, as a non-laboratory social study method (see Yin, 1984). Based on the conceptual framework of analysed accounting theories and general accounting principles, the accounting reports and financial statements of the City of Wolverhampton, UK are evaluated with the main focus on the chosen levels of analysis.

2.4. Summary

Summarizing, in this thesis the case study approach is implemented from an analytical perspective with the focus on comparative analysis of theoretical and practical levels of fund accounting knowledge.

Chapter 3: GENERAL ACCOUNTING FRAMEWORK

In this chapter, basic accounting concepts, bookkeeping methods, different basis of accounting and accounting models are discussed in general and in relation to various types of organizations.

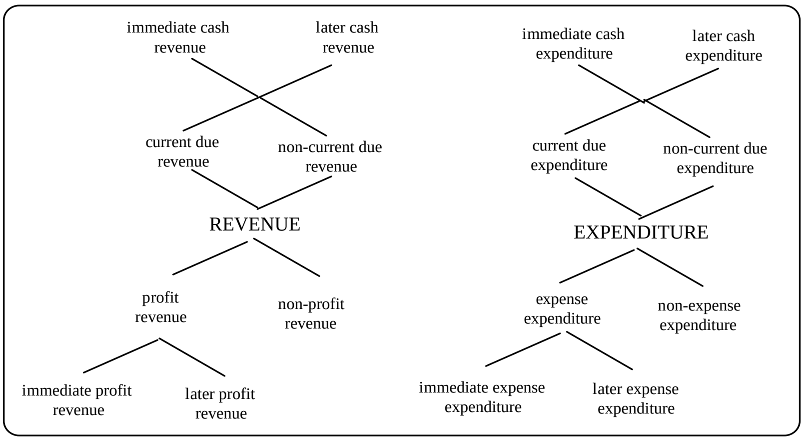
3.1. Revenues and expenditures

Main objectives of accounting – reporting of information for accountability (stewardship) and decision-making – are relevant for all types of organizations. Revenue acquisition is crucial for all organizations in order to cover expenditures and avoid bankruptcy. Therefore, revenues and expenditures could be considered as fundamental accounting concepts. Revenue could be defined as a claim on cash receipts; expenditure is an obligation for cash payments (Monsen, 2011).

"The revenues and expenditures always have money effects that influence the money deposit of an organization in the form of monetary assets minus liabilities. [In addition, they] may also have profit affects that influence the equity of the organization in the form of monetary and non-monetary assets minus liabilities" (Monsen, 2012, p. 1).

Incurred revenues and incurred expenditures can be accrued with respect to their money or profit effects (Figure 2). This leads to the existence of different accrual principles: money accrual principle and profit accrual principle.

Figure 2: The concepts of revenues and expenditures



Source: Monsen, 2012, Figure1.1, p. 1.

Monsen (2012) explains the **money accrual principle of accounting** in the following way:

"Those parts of the revenues and expenditures that have been authorized for cash receipt and cash payment are referred to as current due revenue and current due expenditure. The remaining parts of the revenues and expenditures that have not been instructed for cash receipt and cash payment are referred to as non-current due revenue and non-current due expenditure. The concepts of immediate cash revenue and immediate cash expenditure refer to those parts of the revenues and expenditures that have been received in cash and paid cash immediately (i.e., during the accounting period in question). The concepts of later cash revenue and later cash expenditure refer to those parts of the revenues and expenditures that are to be received in cash and paid cash later (i.e., during later accounting periods)" (p. 2).

In most of the European countries authorization of cash payments and cash receipts in the public sector are realized by the chief municipal administrative officer or other persons with authorization authority. Thereafter, another actor, for example, the municipal cashier, with the authority to receive and pay cash, may do so. However, it is possible that cash is received and paid by the municipal cashier or another person with execution authority, even though he has not received an authorization to receive or pay cash (Monsen, 2012).

Therefore, there are three alternatives for revenues and expenditures accruals in relation to their money effects:

"…the revenues and expenditures may be accrued with a view to whether they have been incurred, have been instructed for cash receipt and cash payment, or have been received in cash and paid cash. These three alternatives are reflected in the three concepts of the incurred principle, the current due principle and finally, the cash principle" (Monsen, 2012, p. 2).

In relation to **the profit accrual principle of accounting** revenues and expenditures which have profit effects need to be separated from those revenues and expenditures which do not have profit effects:

"Revenues with positive profit effects are referred to as profit revenue, while expenditures with negative profit effects are referred to as expense expenditure. Revenues and expenditures without profit effects are referred to as non-profit revenue and non-expense expenditure…The part of the revenues with a positive profit effect immediately (i.e., during the accounting period …) is referred to as immediate profit revenue, while the part of the expenditures with a negative profit effect during this period is referred to as immediate expense expenditure… Revenues and expenditures with profit effects later (i.e., during later accounting periods) are referred to as later profit revenue and later expense expenditure" (Monsen, 2012, p. 3).

Finally, it is important to notice here, that English accounting terminology, which is commonly used in accounting literature and, therefore, in this thesis as well, does not allow indicating a clear distinction between the revenues with profit effect during the period (immediate profit revenue) and the revenues with money effect in the form of claims on cash to be received. Monsen (2012) suggests that:

> "a more precise concept than revenue when referring to the profit effect of the revenues during the period…would be <u>immediate profit revenue</u>;…<u>immediate expense expenditure</u> would be a more precise concept than expense, when referring to the part of the expenditure with a negative profit effect…during the period" (p. 27).

Nevertheless, in further chapters of the thesis the concepts revenue and expense will be used with respect to Anglo-Saxon accounting literature traditions, even though in most of the cases these concepts will mean "immediate profit revenue" and "immediate expense expenditure" respectively. In this way, the English language becomes somewhat easier to read.

3.2. Bookkeeping methods

Different bookkeeping methods can be chosen; among the main are single-entry bookkeeping, systematic single-entry bookkeeping and double-entry bookkeeping.

Single-entry bookkeeping is the oldest method, which originally was used both in the governmental and business sectors. Later on, this method has been modified into systematic single-entry bookkeeping for business organizations.

> "Systematic single-entry bookkeeping is based upon use of the principle of single-entry. The single bookkeeping entries are, however, entered systematically into the accounts, by separating cash transactions with a performance result effect … from cash transactions without such an effect… Non-cash transactions with a performance result effect … are added, so that a performance result can be reported as the difference between revenues earned and expenses incurred" (Monsen, 2006, p. 362).

Under the double-entry bookkeeping principles, the value of each transaction is recorded twice: on the debit side and on the credit side and therefore, two different accounts are always used.

> "Use of the merchant's double-entry bookkeeping method allows the reporting of the performance result via both the payment side (the balance sheet) and the activity side (the income statement)" (Monsen, 2006, p. 362).

The merchant's double-entry bookkeeping method implements profit orientation and performance focus of business entities. At the present time, some governmental organizations use the principles of double-entry bookkeeping method as well (Jones & Pendlebury, 2000). However, an interpretation of this method in public sector accounting is significantly different due to the distinction of the fund theory (which created the original background of modern governmental accounting in Anglo-Saxon countries) from entity and proprietary theories.

"The equation underlying the double-entry mechanism, from the fund point of view, is "assets equal restrictions upon assets" (Monsen, 2012, p. 37).

More details are given in Chapters 4 and 5 of the thesis.

3.3. Different bases of accounting

The basis of accounting regulates when revenues and expenditures are accrued (recognized). Businesses and public organizations can use different basis of accounting for different purposes (Granof & Wardlow, 2003). Modern accounting literature differentiates mainly cash, accrual and modified bases of accounting.

"The **cash basis of accounting** recognizes resource flows…as the associated movements of cash take place" (Rutherford, 1983, p. 32).

The cash basis can be characterized by its simplicity, easiness to understand for nonaccountants, focus on fiduciary stewardship and financial burden. However, the cash basis has a significant disadvantage: in many cases, it does not present full and realistic information about the financial situation and underlying operations of the organization (Rutherford, 1983; Larkin & DiTomasso, 2008).

"If an entity adopts the full **accrual basis of accounting**, a transaction is realized when it has its substantive economic effect, irrespective of when cash is received or paid" (Granof & Wardlow, 2003, p. 23).

The accrual basis allows recognizing in accounting the substantial unpaid bills or uncollected income at the end of the accounting period, which could, otherwise, materially mislead the financial statements (Larkin & DiTomasso, 2008). Due to the significant differences between public sectors bodies from the private organizations, several research scholars argue against the application of accrual basis in the form of profit accrual basis in public sector accounting (Rutherford, 1983; Monsen, 2012). More details are given in Chapters 8 and 10 of the thesis.

The third alternative is to use **modified accrual (cash) basis of accounting**.

"Under the modified accrual basis… revenues and some expenditures are recognized on a cash or near-cash basis; other expenditures are recognized on a full accrual basis" (Granof & Wardlow, 2003, p. 23).

As it has been mentioned before, Monsen (2012; forthcoming) suggests the alternative classification of principles for revenues and expenditures accruals in relation to their money effects: incurred principle, the current due principle and finally, the cash principle.

"Use of the **incurred principle** implies that revenues and expenditures are entered on the accounts with money result effects when they are incurred ... Use of the **current due principle** implies that revenues and expenditures are entered on the accounts with money result effects when they are instructed for cash receipt and cash payment... Use of the **cash principle** implies that revenues and expenditures are entered on the accounts with money result effects when they are received in cash and paid cash" (Monsen, 2011, p. 115).

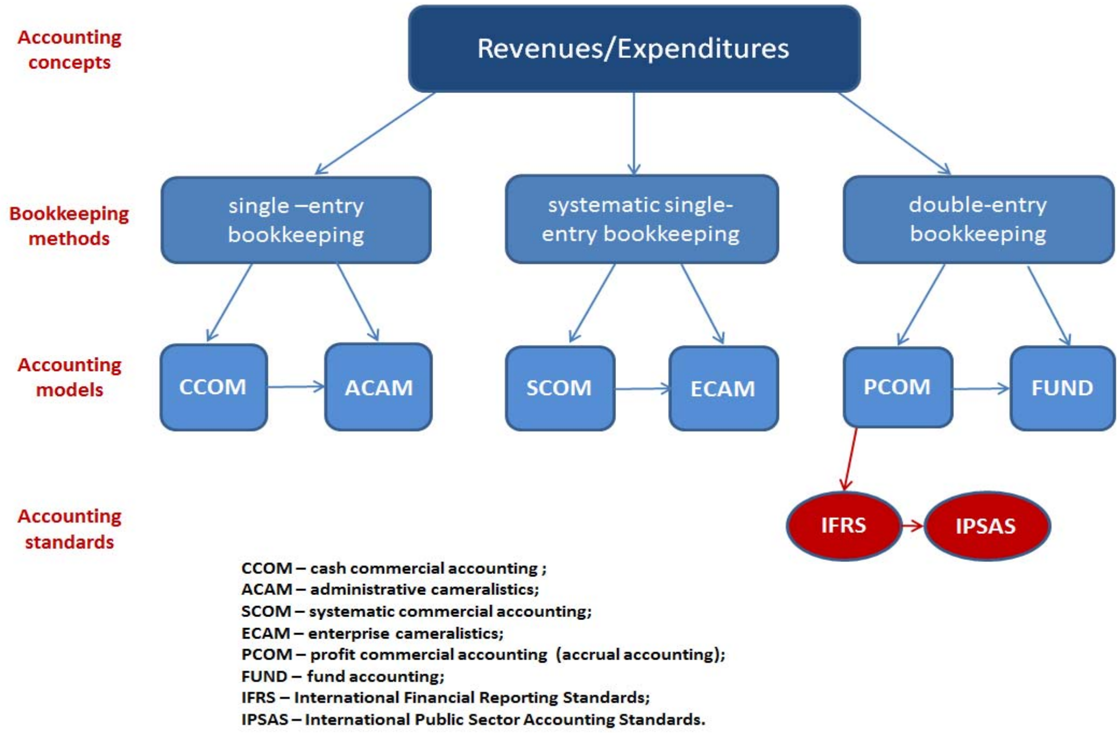
The implication of these two different classifications to public accounting practice is discussed in Chapter 10 of the thesis.

3.4. Different accounting models

Accounting has evolved through a historical process over thousands of years (Waymire & Basu, 2007), however, a universal theory of accounting has not been developed (Schroeder et al., 2011). The broad variety of existed bookkeeping methods (single-entry bookkeeping, systematic single-entry bookkeeping and double-entry bookkeeping) and theories (proprietary, entity, fund and cameral) creates at least six accounting models, which could potentially be implemented in public sector accounting (Figure 3).

Fund accounting and profit commercial accounting are both based on the double-entry bookkeeping method. However, only the profit commercial accounting (generally referred to as accrual accounting) model has been practically realized in accounting standards – International Financial Reporting Standards (IFRS). It creates the accounting framework in the public sector as well by establishment of the International Public Sector Accounting Standards (IPSAS). Nevertheless, it is not clear if for-profit accounting framework can satisfy all needs of governmental entities and providing users with adequate information.

Figure 3: Different accounting frameworks



Source: based on Monsen (2012), modified by author.

The comparative analysis of fund theory and public accounting practice within the current accounting framework is given in Chapter 10 of this thesis, based on the empirical study.

3.5. Summary

Summarizing this chapter, the fundamental distinction between profit-oriented companies and public sector organizations is realized through in different revenue/expenditure effects, ways of revenue acquisition, different interpretation of the double-entry bookkeeping method and the implementation of different bases of accounting and different accounting models. Different theoretical background is one of the factors which determines the realization of this distinction from an accounting perspective. The two forthcoming chapters systematize the existing knowledge about the main accounting theories appearing in Anglo-Saxon literature: proprietary, entity and fund theory.

Chapter 4: PROPRIETARY AND ENTITY THEORIES

At the present time, double-entry bookkeeping is the predominant accounting method in private and public sectors. According to Monsen (2012), who refers to Littleton (1933) and Kam (1990), this implication of double-entry bookkeeping method finds its substance in proprietary theory and later in entity theory of accounting. Both of these theories are presented in this chapter.

4.1. Proprietary theory

The **proprietary theory** is based on the principles that

“business or other organization being accounted for belongs to one or more persons thought of as proprietors or owners” (Lorig, 1964, p. 564).

“The assets of the firm belong to these owners, and any liabilities of the firm are also the owners’ liabilities” (Schroeder et al, 2011, p. 483).

A corporation is considered as a sole proprietorship for accounting purposes and a main accounting goal is to define the net income (i.e., profit result) of the proprietors and the changes in ownership (Lorig, 1964). The interests of owners are the crucial force in the preparation of financial statements.

For the proprietary theory the following balance sheet equation is applied:

Assets – Liabilities =Equity (Proprietorship)

Revenues, which the company receives, immediately increase the owner’s net interest in the company. All expenses, which are incurred by the company, immediately decrease the net proprietary interest in the company. All profit or losses immediately become the property of the owners (Schroeder et al, 2011).

Vatter (1966) explains this principle in the following way:

“The theory of double-entry is based on the idea that expense and revenue accounts have the same algebraic characteristic as “net worth”, i.e., accounts tending to increase net worth are increased by credits, accounts tending to decrease net worth are handled in reverse order” (in Monsen, 2012, p. 9).

Therefore, it means that “all changes in wealth should be accounted for, even … [when] no external transaction has taken place” (Monsen, 2012, p. 10).

According to Monsen (2011), who refers to Kam (1990), the proprietary theoretical concept was created in the eighteenth century as a principle of “accounting profit measurement, based on individualistic economic theories” (Merino, 1993, p. 164). Based on Mattessich’s (2003) historical evaluation, the proprietary theory was mainly represented in the scientific community by James W. Fulton, Frederick W. Cronhelm, Franz Hautschl, Georg Kurzbauer, G.D. Augspurg, Eduard Low, E. Thomas Jones, Charles E. Sprague, Henry R. Hatfield, etc.

The focus of the accounting framework under the proprietary theory is given to capital account and capital preservation, which became identified with the proprietor (Mattessich, 2003).

> “By developing a model that enabled the stockholder/owner to retain ultimate control and techniques that made good watered stock, thus restoring the integrity of capital, proprietary theorists appeared to reconcile passive ownership with traditional economic justifications of private property rights” (Merino, 1993, p. 169).

Economists approve the use of current value in accounting and the focus on proprietorship and the profit of the owner created a background for the double-entry bookkeeping (since there is no other reason “for wanting debits to equal credits, and double-entry bookkeeping becomes merely a set of rules” (Monsen, 2011, p. 19), and therefore, determined the direction towards twentieth-century accounting theory development (Mattessich, 2003).

However, at the time when the proprietary theory was developed the firms were mostly small and established in the forms of proprietorship or partnership (Monsen, 2011). When the forms of enterprises became more complicated with the separation of ownership and management, the proprietary theory became less adequate and authentic to economic reality (Schroeder et al, 2005).

4.2. Entity theory

> “The rise of the corporate form of organization … conveyed limited liability to the owners, and resulted in the legal definition of a corporation as though it were a person, encouraged the evaluation of new theories of ownership” (Schroeder et al, 2011, p. 484).

All of these factors created the sophisticated environment for the **entity theory** appearance, which made the firm (an entity) separated from the owners, the central point of accounting and financial reporting interests.

For the entity theory the following accounting equation is applied:

Assets=Equities

The assets and liabilities are appropriated to the firm and not to the owners. The income (profit) of a corporation is not income (profit) of the stockholders; it accrues to the stockholders only when dividends are declared.

> "All the items on the right hand side of the balance sheet, except retained earnings that belong to the firm, are viewed as claims against the assets of the firm, and individual items are distinguished by the nature of their claims" (Schroeder et al, 2011, p. 484).

The entity theory makes a clear distinction between annual income and capital (Mattessich, 2003), which always has a cost, even if it comes from equity investors (Anthony, 1987). However, there is no fundamental difference between liabilities (debt) and owner's equity (i.e. between creditors and proprietors), "both are considered sources of capital, and the operations of the firm are not affected by the amount of debt relative to equity"(Schroeder et al, 2011, p. 485).

Mattessich (2003) summarized, that the initial representatives of the entity theory were: Lodovico G. Crippa, J.G Courcelles-Seneuil, P. Child, E.G. Folsom, and later William A. Paton (one of the most well-known advocates and promoters of this theory), N. Brenkman, L. van Zanten, K. Bes, W. Kreukniet, Manfred Berliner. The entity theory entirely substituted the proprietary theory during the second half of the twentieth century (Mattessich, 2003).

Monsen (2011), referring to Kam (1990), claimed:

> "Although the entity theory is especially suitable for corporate accounting, supporters believe that it can be applied to proprietorships, partnerships, and even to non-profit organizations" (p. 21).

However, several critical arguments have been claimed against of the entity theory. Lorig (1964) summarized the main points of critique. According to his opinion:

> “A major criticism is that the creditor relationship between the accounting entity and the owners is unrealistic and hence an improper basis upon which to build a theoretical accounting structure” (p. 567).

With reference to Paton, Mattessich (2003) strengthened another problematic point of the entity theory. It relates to the requirement of the entity theory to consider interest on debt as distribution of income. In a practical aspect it is still a controversial point for several European countries where:

> “not only interest on debt but also on owners’ capital, as well as the owners’ salaries… is considered expenses and not distributions of income” (Mattessich, 2003, p. 134).

Another point of criticism Lorig (1964) found in a way of the entity theory to understand the nature of organization. He argued:

> “The individuals given the responsibilities of seeing that the governments’ functions are carried out often assume it has a separate existence. They tend to forget it is merely a useful device or servant of its creators and begin to regard it as having a will of its own with a right to determine its own functions and even to expect service of its citizens” (Lorig, 1964, p. 568).

4.3. Summary

Summarizing, proprietary and entity theories have made an attempt to create a conceptual accounting framework, which determine use of the double-entry bookkeeping, as an adequate response to the economic development (Mattessich, 2003; Monsen, 2012). The main difference between these two theories is related to the way of owner’s equity understanding (Bird et al, 1974). Further comparative analysis of the entity theory with the proprietary theory and the fund theory (which is presented in the following chapter) is given in Chapter 6 of the thesis.

Chapter 5: FUND THEORY

Fund accounting theory was established by the economist William Joseph Vatter in 1947 in his book "The Fund Theory of Accounting and Its Implications for Financial Reports" as an alternative to the proprietary and entity theories of accounting. Vatter argued that both the proprietary and entity theories use insufficient accounting approaches due to the focus of proprietary theory on the proprietor of assets and liabilities, which is not adequate to modern reporting system, and the focus of entity theory on the accountability of business itself as a separate entity.

"He saw no logical basis for viewing a corporation as a person in the legal sense, and he argued that the corporation is the people it represents" (Schroeder et al, 2011, p. 485).

Vatter (1947) proposed three areas with different levels of significance of accounting figures and reports: (1) management, (2) social control agencies (governmental units), and (3) over-all process of credit extension and investment. Since "the single-person" approach cannot satisfy needs of such different groups, a more fundamental and objective approach than the proprietary and entity theories is required (Vatter, 1947).

In addition, Vatter (1947) demonstrated that neither the proprietary, nor the entity theory can meet accounting challenges on the practical level. In his own theory he tried to avoid any entity's personification. In contrast to the existing theories, the main focus of the developed fund theory is given to a fund as "a unit of operations or a center of interests; and in a completely nonpersonal sense … the accounting entity" (Vatter, 1947, p. 12).

The fund theory allows eliminating any effect of personality and personal implications on the accounting procedures and quality of financial statements:

"A fund … cannot be identified with or related to a specific personality – there is no person for whom the fund accounts are kept or to whom the reports relate" (Vatter, 1947, p. 40).

5.1. Main concepts

"Fund" is a cornerstone concept of the fund theory. Fund is understood by Vatter (1947) as a collection of service potentials, provided by assets.

“In the sense of “fund” there are involved: (1) the segregation of assets for the given purpose and (2) a practical recognition of the set of separate operations which pertain to these assets” (Vatter, 1947, p. 12).

It determines the primary focus of fund accounting on the service potential of **assets** instead of their value in monetary terms:

“The basic notion in all accounting terminology is the concept of service potentials, and the asset notion is the simplest expression of this. Quite apart from the problem of measurement that is involved in stating the amounts of assets in dollar terms, the service concept is the basis of asset significance” (Vatter, 1947, p. 21).

This leads to the fact that the definition of assets, which Vatter presents in his book, is quite different in comparison with other accounting theories:

“Although assets are measured in monetary units, the nature of assets is not directly related to any monetary notion... Assets are economic in nature; they are embodiments of future want satisfaction in the form of service potentials that may be transformed, exchanged, or stored against future events. Whatever means or method is employed to measure assets (cost, price, appraisal, or arbitrary valuation), assets are service potentials, not physical things, legal rights, or money claims” (Vatter, 1947, p. 17).

According to the fund theory, assets are acquired in order to contribute to an increase of their service potentials and, therefore, “the bookkeeping of fixed assets is not considered from the point of view that the fixed assets are to be replaced at the end of their lifetimes, and it is also not a question about allocating the historical costs of the fixed assets over the life times of the assets” (Monsen, 2012, p. 35). Vatter criticizes the existing valuation methods, since it is impossible to eliminate the effect of the person, who performs valuation and chooses which method to use; which, finally, effects negatively on the objectivity of the accounting data (Monsen, 2012):

“... it is not the person or the owner or the manager of the business which affects the interpretation of service attributes; rather it is the operation (the fund activity) which determines the service significance of the asset…The acquisition, holding, conversion, and delivery of these services is the operation of the unit. Therefore, the services embodied in asset forms are the essence of asset definition” (Vatter, 1947, p. 18).

Assets are grouped to the funds based on the purpose of services they provide (administrative, entrepreneurial, social, etc.). Each fund has its assets restricted for concrete purposes and liabilities determine restrictions against those assets.

This principle forms the basic balance equation, which is applied within the fund theory:

Assets = Restrictions on assets

This equation determines the central accounting idea of the fund theory, which is underlined not only by Vatter, but by other scholars as well:

"Fund accounting arose as a procedure for separating unrestricted expendable resources from nonexpendable resources"(Ingram, 1986, p. 203).

This equation is based on the concept of **equity**, which is viewed as "restrictions [limitations] that apply to assets in the fund" (Vatter, 1947, p. 19) and it is the residual equity (fund equity) which determines the equality of assets and equities (Monsen, 2012):

"The recognition that assets are service potentials provides both operational content and homogeneity of substance for accounting terminology. Thus the concept of assets is related clearly to the expense stream and the corresponding flow of revenue. Equities are not claims or obligations, nor are they mere legal liabilities; rather they represent the restrictions that apply to the fund of assets. The equality of assets and equities rests on the fact of residual equity, not on the idea that property "belongs" to someone or that some fictitious person must account to owners for the assets intrusted to it" (Vatter, 1947, p. 38).

Grounded on the fund theory service perspective, Vatter specifies the basic accounting concepts, such as revenues and expenses.

"The service concept of expense as a release of service to the designated objectives of the fund applies not only to profit-seeking activities but also to service operations without any motivation for gain – indeed, it applies even when there is no hope of revenue" (Vatter, 1947, p. 22).

By using the joint-service phenomenon Vatter highlighted that **expenses** cannot be measured by the single transaction, since they are flowing through the service operation:

"The only feasible working concept of expense is a flow through time of services released to eventual ends from the fund of assets under consideration" (Vatter, 1947, p. 24).

Therefore, in the fund theory, the expense concept is not a transaction concept, as it is used to be in other accounting theories (Monsen, 2012):

"Although it is true that services are converted and released through the medium of transactions, many of these transactions are of such continuous and nonvisible nature and of such complex makeup that the transaction concept of expense must fail" (p. 38).

In the fund theory, **revenue** is perceived by an addition of new assets, which create greater service potential, but do not impose any restrictions.

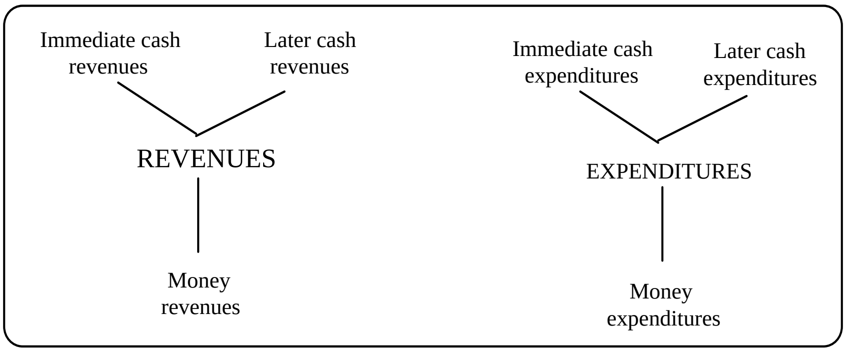
"Revenue differs from other asset-increasing transactions in that new assets are completely free of equity restrictions other than the residual equity of the fund itself" (Vatter, 1947, p. 25).

Since certain restrictions are always elaborated in financial transactions, they cannot establish revenues (Monsen, 2012):

"Thus are justified the two criteria that were proposed for the recognition of revenue: the existence of new service units and the absence of restrictions against them" (Vatter, 1947, p. 32).

By applying the Figure 2 (see above), which explains the concepts of revenues and expenditures in a general sense, Figure 4 demonstrates the meaning of the concepts of revenues and expenditures in terms of the fund theory[1].

Figure 4: The concepts of revenues and expenditures in terms of the fund theory



Source: Monsen, 2010, Figure 1, p. 1.

An intendancy to avoid any personality effect on the accounting data in the fund theory has impact on the understanding of the **income** concept:

"It is indeed unfortunate that "income" has a personal connotation; that is, that income is generally conceived of as accruing to the benefit of some person…"Entity income" is not a meaningful concept, for the income figure as calculated has relevance only to a personality that does not exist" (Vatter, 1947, p. 32-33).

[1] Please see the terminology comment in Chapter 3 of this thesis, which explains the reason of using term "expenditures" instead of term "expenses" in the Figure 4.

Therefore, fund theory pays much less attention to the income concept, then other accounting theories:

"We have rejected the notion of income because of the difficulties that arise from the personal associations and interpretations that are embodied in such a concept as can be evolved in operational terms" (Vatter, 1947, p. 38).

"…It is possible to avoid entirely the confusion associated with the notion of income by focusing attention upon the fund rather than the persons that are interested in it" (Vatter, 1947, p. 38).

Kam (1990) summarizes Vatter's view on the income concept in the following way:

"Vatter does not have much confidence in the income concept. He sees many problems in its determination and believes that accountants have overemphasized it. Income cannot fulfill all the important demands put on it, and the general-purpose income figure is limited in its usefulness. Instead of an income statement that ends with a bottom-line figure, Vatter proposes a statement where information is reported in a way that users, if they wish, can calculate an income figure that is meaningful for their own purposes. But the focus should be on the flow of funds rather than on income" (Kam, 1990 in Monsen, 2012, p. 33).

Finally, the fund theory offers flexibility in **reporting unit** determination (Jones and Pendlebury, 2000).

"The emphasis of establishing funds is upon the definition of areas of operation, not upon legal or other forms of personality" (Vatter, 1947, p. 39).

However, the double-entry bookkeeping approach needs to be applied to each unit separately. In the situations, when it is applied in consolidated way to all funds together, financial reports should still be separated for each fund (Vatter, 1947).

5.2. Fields of potential implementation

Vatter suggested that fund theory could be applied to various types of organizations and different activities. He considered an opportunity of fund accounting principles to be used for commercial organizations as an alternative to the proprietary and the entity theories. At the same time, he found fund theory applicable in the nonbusiness world (governmental organizations) as well.

"In these areas of accounting [government and eleemosynary institutions], funds of various kinds are established to separate those elements of administrative organization, particular activities, or special purposes that may be important… In governmental and institutional accounting the fund is the unit of accounting in the sense that it represents the field of attention covered by a given set of financial records and reports" (Vatter, 1947, p. 12).

"The view of a fund as an accounting unit is recognized even more explicitly in the government field" (Vatter, 1947, p. 40).

However, Vatter still sees the potential of applying the fund theory in the business sector. For commercial organizations he suggests:

"The notion of a fund as applied to commercial and industrial accounting is not really so far-fetched as it may seem. As we … see, there are many instances of its application even in extant practice. [An] application of the fund theory … assumes to consider business as one great fund" (Vatter, 1947, p. 13).

However, the fund theory presented by Vatter has not found an interest in business accounting practice (Monsen, 2012) and received significant amount of critics:

"Vatter's "statement of operations" is not an income statement but contains additional data, such as appear in a source and application of funds statement, and items usually relegated to footnotes, such as unrealized gains… [Therefore], the reader of the financial reports is expected to calculate net income according to his own concept of what that calculation should include" (Lorig, 1964, p. 569, with reference to Heath, unpublished).

Therefore, Lorig (1964) claimed that he did not know any adoption of the fund theory during the last fifteen years.

However, more recent research of Schroeder et al. (2011), Monsen (2012), etc. pointed out that, even though the fund theory has not received general acceptance in financial accounting, it has found a suitable place in the governmental accounting framework in Anglo-Saxon countries. They concluded that the fund theory is "a somewhat radical departure from current practices, and the added volume of bookkeeping it would require has inhibited its adoption" (Schroeder et al., 2011, p. 486). More details about the Anglo-Saxon debate of the fund theory implementation are presented in Chapter 11 of this thesis.

5.3. Summary

Driven by the idea of impersonality of accounting operations and the service potential of assets, Vatter develops the fund theory of accounting and within this framework defines the concepts of fund, assets, equity, revenues, expenses, income, etc.:

“We now have a few basic ideas with which to attack the problem of accounting theory: the notion of a fund, a service concept of assets, a restriction concept of equities, and recognition that expense and revenues are basic flows, not specific effects of individual transactions” (Vatter, 1947, p. 38).

Created as an alternative to the proprietary and the entity theories, the fund theory supposed to be applied in all types of organizations. Even though it has not been accepted in the business sector, it has made a significant effect on the development of the governmental accounting principles. The next chapter of the thesis consists of a brief comparison of the fund theory with the proprietary and the entity theories. The forthcoming Chapters 7 and 8 focus on the enhanced studying of the fund theory development and implementation in the governmental sector.

Chapter 6: COMPARISON OF DIFFERENT ACCOUNTING THEORIES

Based on the presentation of the proprietary, entity and fund theories, which is given in the previous chapters of this thesis and the research of Monsen (2012), Chapter 6 provides a comparison of the main accounting concepts and principles by these theories. Table 1 presents the main aspects of this comparison.

Table 1: Comparative analysis of the proprietary, entity and fund theories

	Proprietary theory	**Entity theory**	**Fund theory**
Focus	Proprietor	Entity	Fund
Accrual principle	profit accrual principle	profit accrual principle	money accrual principle (incurred principle)
Revenues/ expenditures effect	profit effect	profit effect	money effect
Assets	physical objects expressed in monetary amounts	physical objects expressed in monetary amounts	service potentials expressed in monetary amounts
Restrictions on resources	not restricted	not restricted	restricted according to the fund purpose
Balance equation	Assets-Liabilities =Proprietorship	Assets = Equities	Assets=Restrictions on Assets
Bookkeeping method	the merchant’s double-entry bookkeeping	the merchant’s double-entry bookkeeping	the double-entry bookkeeping of fund accounting
Equity	obligations of proprietor (liabilities) and ownership rights of proprietor (net worth)	claims against the assets	restrictions that apply to assets in the fund
Income	increase in the proprietor’s net worth which arises from the operations of his business	it belongs to the company, not to the owner	it is impossible to report one specific income figure that will satisfy all the requirements

It needs to be said that the proprietary and entity theories have received much more recognition in accounting literature than the fund theory, even though they are not always known as basic accounting concepts. However, it is difficult to conclude which theory could be more preferable to use.

Lorig (1964) argued:

> "The proprietary concept is adhered to by accountants in a large majority of their decisions, [and, therefore,] is the more realistic and theoretically accurate and practical" (p. 572).

From another side, the entity theory, which separates an entity's operations from the fund owners (Bird et al, 1974), could satisfy the needs of the modern corporations in a better way. Finally, the fund theory supposes to eliminate any personification in accounting and has an advantage for being applied in the public sector due to an approach of fund restrictions and separate accounting for each fund (Schroeder et al, 2011).

Summarizing, it is important to stress an attention on the questions, raised by Lorig in 1964:

> **"**Should one [accounting] concept suffice? ... Whether it is possible to have one basic concept apply to all accounting entities, or whether the different types of such entities naturally require different concepts. Do governments and other non-profit organizations have unique characteristics which call for a basic concept different from one suited to a profit-making enterprise?" (p. 563 - 564).

These questions are still actual and strongly debatable at the present time as well. An effort to find the answer to these questions is made in the next chapters of the thesis in terms of the fund theory principles implementation in the public sector.

Chapter 7: ACCOUNTING FOR NONPROFIT ORGANIZATIONS BY E.O. HENKE

7.1. Concept of dollar accountability

An American accounting scholar, Emerson O. Henke, contributed to the development of the fund theory by bringing the concept of dollar accountability and modifying the basic fund accounting equations in his book "Accounting for Nonprofit Organizations" (1983).

He claimed that the fiduciary nature of the governmental entities determines the advantages of the fund approach application, which splits the resources into the number of separate self-balancing funds. Furthermore, he claimed that fund accounting principles logically collaborate with the **dollar accountability concept** (which can be used as an equivalent of profit accountability in private entities):

"When we use the concept of dollar accountability … the balance sheet shows the spendable (appropriable) resources available to the organization, and the statement of revenues and expenditures shows the flows of spendable (appropriable) resources into and out of the organization… In this reporting philosophy, the emphasis shifts from accounting practices that emphasize the matching of costs and revenues towards techniques designed to account for the acquisitions and disposals of appropriate resources" (Henke, 1983, p. 6).

In addition, Henke classified the accounting entities of nonbusiness organizations into three categories: source and disposition funds, self-sustaining funds and account groups.

Source and disposition funds are fund entities, which are used for accounting for the resources allocated to finance the operations, capital improvements, and debt payments of the organization. They contain the receiving and using resources, therefore, the accounting transactions are supposed to disclose inflows and outflows of these resources.

Self-sustaining funds collect the resources "designated to be used in such a way that the fund entity sustains itself from its operations" (Henke, 1983, p. 7). These funds have a profit objective and, therefore, accounting rules follow the business accounting practice here.

The types of funds, which are most commonly used in governmental accounting, are discussed in subchapter 8.2 of this thesis.

Account groups are accounting entities, which do not enclose appropriable resources. They are used for accounting of general fixed assets and general long-term liabilities.

7.2. Accounting equations

Henke (1983) suggested the following modification of the basic fund accounting equation (Assets = Restrictions on Assets) for nonprofit organizations:

Assets + Interfund claims + Expenditures + Transfer to other funds = Liabilities + Fund balance + Interfund obligations + Revenues + Transfers from other funds

Accounts on the left side are increased by debits and decreased by credits; the opposite rule is applied to the right side accounts. Commercial accounting balance equation focuses on the performance result, but governmental accounting balance equation focuses on the financial result and transfers between different funds (Monsen, 2011).

In USA, where budgetary figures are incorporated into the accounting records of governmental entities (see subchapter 8.3 of this thesis), Henke's balance equation within fund accounting is looking in the following way:

Assets + Interfund claims + Expenditures + Transfer to other funds + Estimated revenue accounts = Liabilities + Fund balance + Interfund obligations + Revenues + Transfers from other funds + Appropriation accounts

Estimated revenue accounts are debited with the amount one expects to receive, and appropriation accounts are credited with appropriation amount. Any differences between these two amounts are entered on the account budgetary fund balance.

Herzlinger & Sherman (1980) claimed an importance of **encumbrance accounting** for governmental agencies. Encumbrance account contains the amount of resources for which there is a legal obligation to spend in the future and uses for expenditures control. Encumbrance accounting together with the recognition of budgeted resource inflows provides the measurement for the unencumbered resources. With respect to encumbrance accounts the following accounting equation is applied:

Assets + Interfund claims + Expenditures + Transfer to other funds + Estimated revenue accounts + Encumbrances = Liabilities + Fund balance + Interfund obligations + Revenues + Transfers from other funds + Appropriation accounts + Reserve for encumbrances

7.3. Numerical example

In his book Henke (1983) provides the examples of accounting transactions of Model City for fund accounting principles illustration. In order to understand the procedures and principles, advocated by Henke, his examples in relation to the General Fund and General Fixed Assets Account Group are followed in details in this thesis.

7.3.1. General Fund

This example is focused on the transactions in the General Fund. The General Fund accumulates the resources available for the general operating purposes. In order to show "the extent to which the actual acquisitions and disposals of resources coincide with the budget plan" (Henke, 1983, p. 45), the budgetary figures are recorded into accounts (for more details see subchapter 8.3 of this thesis). Table 2 demonstrates the General Fund balance sheet of the Model City at the beginning of the year.

Table 2: Numerical example: Model City. General Fund Balance Sheet

Assets		**Liabilities and Fund Balance**	
Cash	$20,000	Vouchers payable	$10,000
		Unreserved fund balance	10,000
	$20,000		$20,000

Source: Henke (1983), p. 25.

The following transactions took place during the year:

1. The City Council approves the budget for the next fiscal year:

Table 3: Numerical example: Model City. The Budget

Estimated Revenues by Sources	
Property taxes	$1,450,000
Sales taxes	300,000
Municipal court fines	50,000
Traffic fines	50,000
Retail store permits	100,000
Taxes for special services	25,000
Other revenues	25,000

Table 3 (continued)

Total estimated revenues	$2,000,000
Appropriations by Functional Classifications	
General government	$ 350,000
Police services	250,000
Street-maintenance services	400,000
Recreation services	200,000
Sanitation services	165,000
Transfer to debt service fund	50,000
School services	400,000
Transfer to special assessment fund	25,000
Transfer to municipal garage fund	85,000
Miscellaneous	25,000
Total applications	$1,950,000

Source: Henke (1983), p. 26.

According to the budget, during the period: Total revenues – Total appropriations = $ 50,000.

2. The property tax rate is equal to 4% and calculated by the ratio of "estimated revenue needed from the source" (Vatter, 1983, p. 26) ($1,450,000) and assessed valuation (assumed being equal to $36,250,000). After the certain adjustments tax bills in the total amount of $1,460,000 are send to the taxpayers. Taxes receivable from individual taxpayers are accumulated in a subsidiary ledger[2] and registered on the debit of the control account for taxes receivable. The revenue control account and the subsidiary ledger account for revenue from property taxes are credited.

3. Other revenues are received during the year:

Table 4: Numerical example: Model City. Other revenues by sources

Sales taxes	$ 320,000
Municipal court fines	60,000
Traffic fines	35,000
Retail store permits	90,000
Fees for special services	20,000
Other services	$ 545,000

Source: Henke (1983), p. 27.

[2] Each type of nominal account may describe a group of individual accounts found in the general fund ledger, or may serve as a control account in that ledger with appropriate supporting subsidiary records.

4. In fact, the total amount of collected property taxes is equal to $1,445,000. Individual accounts in the taxes receivable subsidiary ledger are credited as the entry is made to the control account.

5. In fact, during the year expenditures and transfers are made against the appropriations. Total amount of expenditures is equal to $1,739,000:

Table 5: Numerical example: Model City. Expenditures by functional classifications

General government	$ 348,000
Police services	249,000
Street-maintenance services	248,000
Recreation services	175,000
Sanitation services	160,000
Payment into debt service fund	50,000
School services	375,000
Payment toward special assessment project	25,000
Transfer to municipal garage fund	85,000
Miscellaneous expenditures	24,000
Total	$1,739,000

Source: Henke (1983), p. 27.

6. The city council intends to purchase the equipment: total estimated costs are equal to $200,000; contracts are signed:

Table 6: Numerical example: Model City. Encumbrances by functional category

Street-maintenance services	$ 150,000
Recreational services	25,000
School services	25,000
Total	$ 200,000

Source: Henke (1983), p. 27.

7. An actual cost of received street-maintenance equipment is equal to $150,000.

8. Vouchers and amounts due to other funds in the amount of $1,800,000 are paid during the year.

9. Old street-maintenance equipment originally costing $60,000 is sold as scrap for $5,000.

The example of Henke is followed by the journal entries in order to record the Model City General Fund transactions. In this thesis, the example moves straight to the posting of the journal entries to general fund accounts (Table 7). Number of posting is corresponded to the number of the economic operation, described above.

Table 7: Numerical example: "T" Accounts for Model City

Estimated Revenue

(1)	$2,000,000	(C-1)	$2,000,000

Appropriations

(C-1)	$1,950,000	(1)	$1,950,000

Revenues

(C-2)	$2,100,000	(2)	$1,460,000
		(3)	545,000
		(9)	5,000

Expenditures

(5)	$1,579,000	(C-2)	$1,724,000
(7a)	145,000		

Transfers to Debt Service Fund

(5)	$50,000	(C-2)	$50,000

Transfers to Special Assessment Fund

(5)	$25,000	(C-2)	$25,000

Budgetary Fund Balance

(C-1)	$50,000	(1)	$50,000

Transfers to Municipal Garage Fund

(5)	$85,000	(C-2)	$85,000

Unreserved Fund Balance

(C-4)	$50,000	Bal.	$ 10,000
		(C-2)	126,000

Encumbrances

(6)	$200,000	(7b)	$ 150,000
		(C-3)	50,000

Taxes Receivable

(2)	$1,460,000	(4)	$1,445,000

Reserve for Encumbrances

(7b)	$ 150,000	(6)	$ 200,000
(C-3)	50,000		

Cash

Bal.	$ 20,000	(8)	$1,800,000
(3)	545,000		
(4)	1,445,000		
(9)	5,000		

Vouchers Payable

(8)	$1,605,000	Bal.	$ 10,000
		(5)	1,544,000
		(7a)	145,000

Due to Special Assessment Fund

(8)	$25,000	(5)	$25,000

Due to Municipal Garage Fund

(8)	$120,000	(5)	$120,000

Fund Balance Reserved for Encumbrances

		(C-4)	$50,000

Due to Debt Service Fund

(8)	$50,000	(5)	$50,000

Source: Henke (1983), p. 32 – 33.

The entry (1) records the revenues, which Model City expected to accomplish and the amounts appropriated for the services, which the city intended to provide. The entry (2) presents the record of taxes, received from taxpayers according to their obligations. Revenues from other sources are registered by the entry (3). The entry (4) registers the total amount of collected property taxes, which have been recorded as receivables by the entry (2). The total amount of made expenditures within the accounting period is registered by the entry (5). The sum of amounts in due to debt service fund, due to municipal garage fund and due to special assessment fund ($50,000 + $120,000 + $25,000=$195,000) represents the interfund obligations, which were recognized by crediting these accounts. The balance ($1,544,000) is credited to vouchers payable. The entry (6) registers an encumbrance against appropriations for equipment purchases. The reserve for encumbrances is credited for the registration of the appropriable resources. The entry (7a) registers the actual cost of the purchased equipment; the entry (7b) shows the reserve of previously registered encumbrances. The entry (8) registers the payment of $1,605,000 in vouchers payable, amounts due to the debt service fund ($50,000), special assessment fund ($25,000), and municipal garage fund ($120,000). The entry (9) records revenue from the sailing of old street-cleaning equipment.

“C” entries, which have been mentioned in the “T” accounts above, are registering the closing of the nominal accounts of the general fund (Table 8).

Table 8: Numerical example: Model City. Closing entries

(C – 1)		
Dr. Appropriations	$ 1,950,000	
Dr. Budgetary fund balance	50,000	
Cr. Estimated revenue		$2,000,000
(C – 2)		
Dr. Revenues	$2,010,000	
Cr. Expenditures		$1,724,000
Cr. Transfers to debt service fund		50,000
Cr. Transfers to special assessment fund		25,000
Cr. Transfers to municipal garage fund		85,000
Cr. Unreserved fund balance		126,000
(C – 3)		
Dr. Reserve for encumbrances	$ 50,000	
Cr. Encumbrances		$ 50,000
(C – 4)		
Dr. Unreserved fund balance	$ 50,000	
Cr. Fund balance reserved for encumbrances		$ 50,000

Source: Henke (1983), p. 33 – 34.

Entry (C – 1) is closing the initial budgetary entry (1). Entry (C – 2) is closing the revenue and expenditure accounts to the unreserved fund balance account (together with all subsidiary records). Entry (C – 3) is registering reserves for encumbrances and encumbrances at the end of the fiscal period. Entry (C – 4) is recording the part of the unreserved fund balance reserved for encumbrances. Therefore, the budgetary plan contemplated an unreserved fund balance of $60,000 ($10,000 + $50,000 of budgeted increase). The unreserved fund balance is equal to $86,000 ($10,000[3] + $126,000[4] - $50,000[5]).

Henke assumed that governmental organizations should prepare separate financial statements for each fund. With respect to the concept of dollar accountability, Henke postulated that the financial statements for the general fund need to demonstrate:

"1. the sources and uses of funds; 2. the extent to which the budgetary plan has been achieved;3. the financial position of the fund at the end of the period with respect to appropriate resources" (Henke, 1983, p. 35).

First two of these objectives are achieved by the preparation of the Statement of Revenues, Expenditures and Changes in Fund Balances. Table 9 provides this statement for the General Fund of the Model City.

The statement provides a clear view on the relationships between budgeted and actual amounts.The statement shows that the actual revenues of Model City were $10,000 higher than budgeted. The statement discloses to which extent the actual expenditures correspond to the actual plan of the resource use.

[3] Beginning balance;
[4] (C – 2);
[5] (C – 4)

Table 9: Numerical example: Model City General Fund. Statement of Revenues, Expenditures and Changes in Fund Balances for Fiscal period

	Budget	**Actual**	**Variances Favorable/ (Unfavorable)**
Revenues			
Property taxes	$1,450,000	$1,460,000	$ 10,000
Sales taxes	300,000	320,000	20,000
Municipal court fines	50,000	60,000	10,000
Traffic fines	50,000	35,000	(15,000)
Retail store permits	10,000	90,000	(10,000)
Fees for special services	25,000	20,000	(5,000)
Revenue from water department	25,000	20,000	(5,000)
Revenue from sale of assets	0	5,000	5,000
Total	$2,000,000	$2,010,000	$ 10,000
Expenditures			
General government	$ 350,000	$ 348,000	$ 2,000
Police services	250,000	249,000	1,000
Sanitation services	165,000	160,000	5,000
Recreation services	200,000	175,000	25,000
Street-maintenance services	400,000	393,000	7,000
School services	400,000	375,000	25,000
Miscellaneous	25,000	24,000	1,000
Total	$1,790,000	$1,724,000	$ 66,000
Excess (deficiency) of revenues over expenditures	$ 210,000	$ 286,000	$ 76,000
Transfers			
To debt service fund	50,000	50,000	0
To special assessment fund	25,000	25,000	0
To municipal garage fund	85,000	85,000	0
Total	$ 160,000	$ 160,000	$ 0
Excess (deficiency) of revenues over expenditures and transfers	$ 50,000	$ 126,000	$ 76,000
Fund balances at beginning of period	$ 10,000	$ 10,000	$
Fund balances at end of period	$ 60,000	$ 136,000	$ 76,000
Fund balance reserved for encumbrances		$ 50,000	
Unreserved fund balance		$ 86,000	
Total fund balances		$ 136,000	

Source: Henke (1983), p. 37.

Henke strengthened the attention of the reader:

"[The statements of revenues and expenditures of governmental units] disclose information that is significantly different from that contained in the operating statements of profit enterprises. Those operating statements show periodic revenues and expenses offset against each other to determine net income for the period, whereas revenue and expenditure statements show inflows and outflows of appropriable resources for the period" (Henke, 1983, p. 38).

Table 10 presents the General Fund balance sheet at the end of accounting period.

Table 10: Numerical example: Model City. General Fund Balance Sheet, End of Fiscal Period

Assets		**Liabilities and Fund Balance**	
Cash	$ 215,000	Vouchers payable	$ 94,000
Tax receivable	15,000	Fund balance reserved	
		for encumbrances	50,000
		Unreserved fund balance	86,000
Total	$ 230,000	Total	$ 230,000

Source: Henke (1983), p. 38.

7.3.2. General Fixed Assets Account Group

The similar example is provided by Henke (1983) for the accounting transactions for the General Fixed Assets Account Group.

"This account group discloses the acquisition values of fixed assets of a governmental unit that are not accounted for in self-sustaining, or proprietary funds, and the sources of the resources that were used to acquire them. The account group is established as general fixed assets are acquired through use of resources from various source and disposition, or governmental funds" (Henke, 1983, p. 82).

Each transaction recorded in this group is a result of the entry in some fund. Table 11 provides the balance information at the beginning of the accounting period.

Table 11: Numerical example: Model City. General Fixed Assets Account Group. Beginning of Fiscal Period

	Dr.	Cr.
Equipment	$ 450,000	
Structures and improvements	650,000	
Investment in general fixed assets – from general fund		$ 750,000
Investment in general fixed assets – from capital project fund		350,000

Source: Henke (1983), p. 83.

The following transactions affect the fixed asset accounting group in the accounting period:

(FA-1) New street-maintenance equipment costing $145,000 is acquired – from general fund entry (7).

(FA-2) Old street-maintenance equipment originally costing $60,000 is sold for $5,000 – from general fund entry (9).

(FA-3) Street improvements amounting to $350,000 are completed – from capital projects fund entry.

These transactions are posted in the "T" accounts (Table 12).

Table 12: Numerical example: Model city. "T" Accounts for General Fixed Assets Account Group

Equipment

Bal.	$450,000	(FA-2)	$60,000
(FA-1)	145,000		

Investment in General Fixed Assets – from General Fund

(FA-2)	$ 60,000	Bal.	$ 750,000
		(FA-1)	145,000

Structures and Improvements

Bal.	$ 650,000		
(FA-3)	350,000		

Investment in General Fixed Assets – from Capital Projects Fund

		Bal.	$ 350,000
		(FA-3)	350,000

Source: Henke (1983), p. 84.

"The originating entries …are designed to show the original costs of general fixed assets owned by the city and the sources of the funds used to acquire them…When assets are retired, the entry originally made to reflect the acquisition is reversed…(FA-2)" (Henke, 1983, p. 84).

According to Henke (1983), due to the fact, that the general fixed assets group is a memo record, which does not elaborate the resource flows, it is not required to have a financial statement for this group. Anyhow, Henke (1983) provides the example of such a statement (Table 13).

Table 13: Numerical example: Model City. Statement of General Fixed Assets, End of Period

Assets Held		**Sources of Funds Used to Acquire Assets**	
Equipment	$ 535,000	Investment in general fixed assets From general fund	$ 835,000
Structures and improvements	1,000,000	From capital projects fund	700,000
Total	$ 1,535,000		$1,535,000

Source: Henke (1983), p. 85.

7.4. Summary

By introducing the dollar accountability concept and extending the basic balance equations, Henke (1983) developed the original fund theory with particular focus on its implementation in nonprofit (governmental) organizations. The numerical examples presented by Henke (1983) and analyzed in this chapter, provide an impression of fund accounting organization in public sector. This is compared with the current governmental accounting practice within the empirical study (Chapters 9 and 10 of this thesis). The forthcoming chapter analyzes the general trends of fund accounting adoption in the public sector.

Chapter 8: FUND ACCOUNTING IN PUBLIC SECTOR

8.1. Fund model in governmental accounting

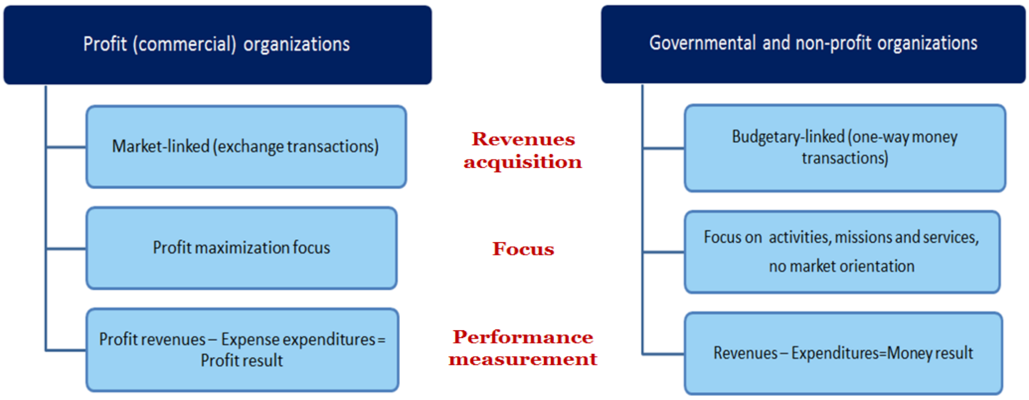
As it has been mentioned before, fund accounting receives its further development and implementation in the governmental sector, especially in Anglo-Saxon countries, such as USA and UK.

There are the following major items of revenues and expenditures in public sector (Rutherford, 1983):

The main revenue sources are:	The major expenditure items are:
1) taxes;	1) labor and raw materials;
2) charge some price for services;	2) capital expenditures on fixed assets;
3) borrowing.	3) grants and subsidies paid in cash;
	4) loans to individuals and corporations for socially beneficial purposes;
	5) interest on the state's outstanding debt.

In the public sector revenues are mainly driven by expenditures. First, governments calculate costs of services they intend to provide, and after that they establish the tax rates and fees for revenues generation. Revenues cannot rise without increasing of services the public sector provides and limited by the tax rates (Granof & Wardlow, 2003). External restrictions on fund resources generate significant accountability of public sector and strengthen the principle of democratic control over the funds use (Pallot, 1992). All these factors make governmental organizations slightly different from business enterprises and corporations, the profit maximization and the revenues acquisition through market-exchange transactions of whom are implemented in commercial (accrual) accounting (Figure 5).

Figure 5: Distinction between commercial and governmental organizations



Source: Monsen, 2011, modified by the author

Therefore, it is possible to conclude, that "service focus as opposed to income (profit) focus, restrictions on assets in the form of budgetary decisions, budgetary decisions in the form of flow of funds and dollar accountability" (Monsen, 2011, p. 45) determined advantages of the fund approach in governmental accounting.

8.2. Different types of funds

At the present time, in the governmental sector funds may be defined in the following way:

"Funds are separate fiscal and accounting entities, [which] include both cash and noncash resources – segregated according to the purposes or activities for which they are used – as well as related liabilities" (Freeman et al, 2006, p. 24).

According to Freeman et al (2006), two basic categories of funds can be defined:

- **expendable (governmental) funds**: to account for the current assets, related liabilities, changes in net assets and balances (for nonbusiness-type of governmental activities);

- **nonexpendable (proprietary) funds**: to account for the revenues, expenditures, assets, liabilities and equity (for business-type of governmental activities).

The fund structure of state and local governments (in terms of the American public sector) is presented in Table 14.

Table 14: Fund structure of state and local governments

Fund type	Purpose	Basis of accounting/ Measurement focus	Funds
Governmantal Funds	to account for governments' operating and financing activities finance predominantly through taxes and intergovernmental grants	modified accrual/current financial resources	**General fund –** to account for all resources not legally or contractually restricted or otherwise set aside for specific activities.
			Special revenue funds – to account for revenues restricted for a specific purpose other than debt service or capital projects.
			Debt service funds – to account for the payment of interest and principal on long-term debt of the general government.
			Capital projects funds – to account for revenues held for the acquisition or construction of major capital facilities.
			Permanent funds – to account for resources legally restricted in that only the earnings on investments, not the principal, may be used to support special government programs.
Proprietary Funds	to account for governments' activities that are similar to carried out in the private sector and financed though user charges	full accrual/ economic resources	**Enterprise funds** – to account for business-type activities that serve the public at large.
			Internal service funds – to account for goods and services provided to departments of the same government.
Fiduciary Funds	to account for resources held by governments as trustees or agents for another party.	full accrual/ economic resources	**Trust funds:** **Pension trusts** – to account for resources accumulated to pay pension, healthcare, and other benefits to the government's retired or disabled employees. **Investment trusts** – to account for investment pools in which other governments participate. **Private purpose trusts -** to account for resources held for external organizations.
			Agency funds – to account for resources held on a short-term basis on behalf of individuals, organizations, or other governments.

Source: Granof & Wardlow, 2003, p. 28.

The General Fund is established in order to account for all financial resources that are not restricted to specific purposes and available for general operating purposes.

Special Revenue funds are created to account for general government financial resources that are restricted to specific purposes.

Capital Project Funds are "established to account for financial resources that are to be used to consist or otherwise acquire major, long-lived general government capital facilities" (Freeman et al, 2006, p. 266).

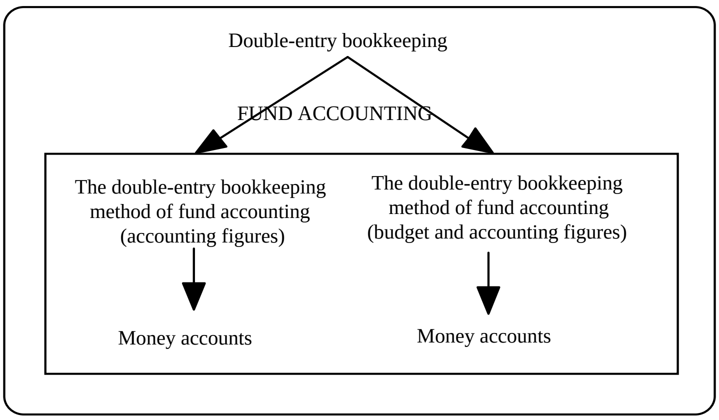
D**ebt service fund** is made in order to account for resources allocated for payment of interest and principal of general long-term debt.

Trust and agency funds are "used to account for resources received and held by the governments in the capacity of trustee, custodian or agent" (Freeman et al, 2006, p.475).

8.3. UK' and US' fund accounting approach

Accounting in the governmental sector is closely related to and correspond with budgeting (Monsen, 2011). With respect to different degrees of fund accounting assimilation with budgetary information, two different versions of fund accounting could be distinguished (Figure 6): fund accounting with incorporation of budgeting figures (US model) and fund accounting without adding of budgeting figures to accounting figures (UK model).

Figure 6: Different forms of fund accounting



Source: Monsen, 2012, Figure 4.1., p. 57.

With reference to Jones & Pendlebury (2000), Monsen (2011) defines the main strength of the US model in presenting the systematic and continuous comparison of budgeted amounts and actual spending:

> "The budgeted amounts of expenditure are credited to appropriation accounts and then as expenditure is incurred debits are set against these credits. The balance on these accounts therefore continuously represents the amount of the budget still unspent" (p. 49).

However, the disadvantage of the US model consists in increasing complexity of accounting procedures and reducing the understandability of financial statements.

8.4. Reporting alternatives (fund-to-fund vs. consolidated approach)

Another quite debatable issue in governmental accounting is the type of financial reporting. There are two main approaches: fund-to-fund report and consolidated report. Granof & Wardlow (2003) describe the distinction between these two approaches in the following way:

> "Governments may maintain hundreds of funds. A way is needed to summarize fund information for financial reporting so that the reports are of a manageable size but still provide useful information, including the restrictions on resources that funds represent. One possibility is simply to combine or aggregate the funds – add them together without adjusting for interfund activities and balances. Another is to consolidate the funds – add them together, but eliminate interfund activities and balances – and prepare financial statements for the government as a single economic entity" (p. 39).

Accounting is normally viewed through its basic objectives: accountability and decision making (Mellemvik et al, 1988) for the interested users. Therefore, in the discussion about the choice of appropriate reporting model the research scholars often refer to the information needs of the main users. Daniels & Daniels (1991) with reference to the Government Accounting Standards Board identifies three main groups of public accounting information users: citizens, investors (creditors), and legislative (oversight) officials. The authors concluded:

> "Citizens prefer information in easy-to-understand written form; investor/creditors want additional information (e.g., five-year trends); legislative/oversight officials favor additional information and the consolidated format" (Daniels & Daniels, 1991, p. 15).

Even though the researchers advocate the consolidated format of financial reporting in the public sector, some of them admit that financial data aggregation demands additional costs from creditors and interest costs on governments (Ingram, 1986).

8.5. Summary

The fund approach received its general acceptance in the public sector. The practical implementation lead to an existence of the funds variety, two types of accounting assimilation with the budgetary information (with and without budgeting figures incorporation) and two reporting alternatives (fund-to-fund and consolidated approach).

The forthcoming chapters of the thesis present the empirical study of applying fund accounting in the public sector of UK on a municipal level.

Chapter 9: EMPIRICAL STUDY:

A CASE STUDY OF THE CITY OF WOLVERHAMPTON

9.1. City of Wolverhampton

Wolverhampton is the 12th largest city in England outside London, one of the 4 local authorities in the Black Country sub-region, situated to the west of Birmingham (Census, 2013). Today, there are 249470 residents and 102177 households in the city; 27.5% of the city's population are ethnic minorities (Census, 2009). Wolverhampton has been initially developed as a centre of woollen trade (14^{th} - 15^{th} centuries) and rapidly grown in the 19^{th} century based on coal, manufacturing and engineering industries (Census, 2011).

According to Wolverhampton Economic Assessment Study (CHK Consulting, 2008), at the present time, there are few major industries in the city: engineering (including aerospace industry), construction, brewing industries, a small number of IT/software businesses and the growing service sector. The employment structure of Wolverhampton is dominated by non-manufacturing employment: public service and administration – 20.2% of total employment; wholesaling and retailing - 16.7%; health and education – 12.6%; finance and business services – 12.7%; construction – 11.8% (CHK Consulting, 2008). Estimated unemployment rate is 7.8% (Nomis Labour Market Profile, 2013). However, "the City remains bereft of a critical mass of high value added, export-oriented, revenue generating commercial activities" (CHK Consulting, 2008, p. i) with economic vulnerability and increasing polarization of the workforce.

9.2. Accounting for the City of Wolverhampton

9.2.1. Accounting standards

Wolverhampton City Council (WCC) prepares "Statement of Accounts" on the annual basis in accordance with CIPFA Code of Practice on Local Authority Accounting in the United Kingdom (CIPFA Code). In the introductory part of the statements, WCC specifies:

"For local authorities there are many types of transaction where the law, which takes precedence, requires a different treatment from the accounting rules. This effectively means that local authorities are trying to simultaneously fulfill two conflicting sets of rules when preparing their accounts. …It is the legal rules that must be used when calculating budget requirements, council tax and housing rents. As a result, all of the council's internal reporting and decision-making is based purely on accounts prepared under the legal rules, and the only time it prepares accounts that comply with the accounting rules is when it prepares this document. … In particular, it should be remembered that <u>figures which have been prepared under the accounting rules may have no practical meaning or use in the context of how the council actually manages its finances</u>" (WCC, Statement of Accounts, 2011/2012, p. 2).

It needs to be mentioned here, that CIPFA Code is not publicly available document outside of the UK; therefore, it is impossible to study CIPFA Code in details. In addition, according to the 2011/12 Code Update:

"[CIPFA Code] is based on International Financial Reporting Standards (IFRSs), and has been developed by the CIPFA/LASAAC Code Board under the oversight of the Financial Reporting Advisory Board" (p.2).

It means that, same as IFRS, CIPFA Code is based on the principles of commercial accrual accounting and, therefore, it is not relevant to a fund accounting theoretical context.

Finally, as it has been stated before, the purpose of this empirical study is to compare fund theory with fund accounting practice on the municipal level. Hence, the analysis of the CIPFA Code accounting standards is beyond the purposes of this study.

9.2.2. The structure of the Statement of Accounts

The purpose of WCC Statement of Accounts 2011/2012 is "to show the council's financial performance over the course of the year, and its financial position at the end of the year … [and to provide] some information about things that may affect the council's financial performance in the future" (WCC, Statement of Accounts, 2011/2012, p. 2).

The Statement of Accounts 2011/2012 consists of 204 pages and 11 sections. Table 15 presents the sections and the short description of their content.

Table 15: Structure of WCC Statement of Accounts 2011/2012

Section	Section's title	Page	Content
1	Introduction to the Statements	2	The note for the readers of accounts; the purpose and contents of the document.
2	Financial Performance 2011/2012	6	A summary of the council's financial performance for 2011/2012; a summary of changes to accounting policies and key items of interest in the accounts.
3	The Medium Term Financial Strategy	11	An outline of the council's medium term financial strategy, including its budget for 2012/2013 and forecasts through to 2016/2017.
4	Statement of Responsibilities	18	The statement of responsibilities (the roles and responsibilities of the authority and of the responsible (finance) officer in preparing the statement of accounts).
5	Independent Auditors' Report to the Members of WCC	20	The independent auditor's report.
6	The Financial Statements	26	The financial statements prepared in accordance with the CIPFA Code. They consist of four main statements and a series of notes (see the detailed description the Table 16).
7	The Housing Revenue Account Statements	118	A set of financial statements and associated notes relating to the Housing Revenue Account[6].
8	The Collection Fund Statement	128	Statements for the Collection Fund, which demonstrates how much council tax was raised during the year, and how it was allocated between the council, fire and police authorities.
9	West Midlands Pension Fund Statements	132	The financial statements of West Midlands Pension Fund[7].
10	Annual Governance Statement	182	The Council's Annual Governance Statement.
11	Glossary	190	Definitions of the used accounting terms.

Source: compiled from WCC, Statement of Accounts, 2011/2012, p. 1 – 5.

[6] "By law, the council has to account for its council housing service separately from other services, to ensure that rents only pay for housing (and likewise, that council tax does not subsidise housing)" (WCC, Statement of Accounts, 2011/2012, p.5).

[7] "These are completely separate from the council's accounts, but because the council is the administering body it has to include the Pension Fund's accounts alongside its own" (WCC, Statement of Accounts, 2011/2012, p.5).

Since the main focus of this empirical study is an analysis of WCC financial statements, Table 16 presents the detailed information about the content of the Section 6 “Financial Statements” of the Statement of Accounts 2011/2012.

Table 16: Structure of the Section 6 “Financial Statements” of
WCC Statement of Accounts 2011/2012

Financial Statement	Content
The Comprehensive Income and Expenditure Statement	Summarizing of all expenditure, income, gains and losses for the council during the year according to the accounting standards.
The Balance Sheet	Demonstration of all of the council’s assets, liabilities and reserves at the end of the financial year.
The Movement in Reserves Statement	Demonstration of the amounts in the council’s reserves, and how they have changed over the course of the year.
The Cash Flow Statement	Summarizing of all of the council’s payments and receipts over the course of the year. In contrast with the Comprehensive Income and Expenditure Statement, the Cash Flow Statement does not include adjustments to comply with the accounting concept of accruals.

Source: compiled from WCC, Statement of Accounts, 2011/2012, p. 3.

WCC Statement of Accounts 2011/2012 includes 11 notes (plus one Note on Group Accounts), which disclose the information presented in the main statements. WCC is obliged to disclose this information by law or by the Code. These notes consist of the information which is highly relevant for the empirical analysis, performed in this thesis, that’s why their detailed content is presented in Table 17.

Table 17: Structure of the notes of WCC Statement of Accounts 2011/2012

Note	Note's title	Content
1	Financial Performance for 2011/2012	Information on the council's financial performance for 2011/2012[8].
2	Income and Expenditure	Information about a number of specific areas of income and expenditure required by law or by the Code.
3	Current Debtors and Creditors	Information about how much money was owed to the council at the end of the year, and how much the council owed other people.
4	Provisions and Contingent Liabilities	Information about liabilities, when there is an uncertainty about one or more elements of the payment.
5	Non-Current Assets	Information about the council's non-current assets, i.e. assets that it uses for more than one year.
6	Employee Pensions	Information about employee pensions, including the net pension's liability at the end of the year.
7	Financial Instruments	Information about the council's financial instruments, which are assets or liabilities entered into under contracts.
8	Members of the WCC Group and Other Related Parties	Information about the financial relationships between WCC and other organizations.
9	Trust Funds	Information about the trust funds that the council manages on behalf of other people.
10	Reconciliation of the Financial Statements to the Statutory Accounts	Analysis of the differences between the financial statements and the legal accounts that the council uses for financial management.
11	Accounting Policies	Policies that have been used by the council to prepare these statements, changes in those since last year, and any significant judgments about applying the policies.
	Note on Group Accounts	Since WCC owns Wolverhampton Homes, it has to produce group accounts, which combine the accounts of these two organizations.

Source: compiled from WCC, Statement of Accounts, 2011/2012, p. 3 - 5.

[8] WCC stresses that this note "provides figures in the format … officers use when making decisions about the running of the council (<u>none of the four main statements … are ever used in decision-making because of the numerous discrepancies between them and the legal accounts</u>)" (WCC, Statement of Accounts, 2011/2012, p.3).

9.2.3. Accounting policy

The Statement of Accounts 2011/2012 of Wolverhampton City Council is prepared in accordance with WCC's accounting policy (Appendix 1).

"The council is required to prepare an annual Statement of Accounts by the Accounts and Audit Regulations 2011, which those regulations require to be prepared in accordance with proper accounting practices. These practices primarily comprise … [the CIPFA Code] and the Service Reporting Code of Practice 2011/12, supported by International Financial Reporting Standards (IFRS)" (WCC, Statement of Accounts, 2011/2012, p. 94).

The accounting policy describes the principles of accruals of income and expenditures, depreciation of assets, valuation of liabilities, recognition of government grants, contributions and investments, etc.

It seems that WCC applies accrual basis of accounting: "activity is accounted for in the year that it takes place, not simply when cash payments are made or received" (WCC, Statement of Accounts, 2011/2012, p. 94).

WCC depreciate property, plant and equipment assets and intangible assets on a straight-line basis over the estimated useful economic life of the asset. For the depreciation of council dwellings Major Repairs Allowance is used as a proxy. Investment properties and heritage assets are not depreciated. WCC valuates assets according to the CIPFA Code: infrastructure and assets under construction are valued at depreciated historical cost; other classes of asset are measured at fair value (the fair value of council dwellings is measured using existing use value) (WCC, Statement of Accounts, 2011/2012, p. 57).

At first glance, WCC applies a fund accounting approach. The council operates the number of restricted and unrestricted funds (reserves). The description of WCC funds (reserves) is provided in Note 10C (Appendix 2).

The analysis of the WCC financial statements and the information in the notes is presented in Chapter 10.

Chapter 10: ANALYSIS

This chapter presents the analysis of the Statement of Accounts 2011/2012 of Wolverhampton City Council with the main focus on its financial statements and the information disclosed in the notes. The purpose of this analysis is to discover how fund accounting is implemented in the public sector at the present time in terms of one British municipality and to compare how much this practice differs from the original fund theory of Vatter. The structure of this analysis is built on the theoretical platform presented in the previous chapters of this thesis. Firstly, the accounting basis and the bookkeeping methods, applied in WCC accounting, are analyzed. After that, the attention is given to the analysis of fund accounting and budgetary control organization in the municipality.

10.1. Basis of accounting

As it has been discussed in Chapter 3 of this thesis, the organization can apply cash, accrual and modified basis of accounting. The alternative classification, presented by Monsen (2012), is based on the money effects of revenues and expenditures and defines incurred principle, the current due principle and finally, the cash principle of accruals. Monsen (2011) suggests:

> "Within fund accounting, the revenues incurred and the expenditures incurred are accrued with a view to their respective money effects by use of the incurred principle… Accordingly, fund accounting may be referred to as ´money accounts in the form of incurred accounts´" (p. 105).

Later on, he is calling the principle, adopted by the fund accounting, the modified incurred principle, since some adjustments for the certain groups of revenues and expenditures can be made (Monsen, 2011).

In practice, as it has been mentioned in Chapter 9, WCC applies full accrual basis of accounting. In particular,

> "Revenue from the sale of goods is recognized when the council transfers the significant risks and rewards of ownership to the purchaser ... Revenue from the provision of services is recognized when the council can measure reliably the percentage of completion of the transaction and it is probable that economic benefits or service potential associated with the transaction will flow to the council. Supplies are recorded as expenditure when they are consumed ... Expenses in relation to services received … are recorded as expenditure when the services are received rather than when payments are made" (WCC, Statement of Accounts, 2011/2012, p. 94).

"Expenditure on the acquisition, creation or enhancement of Property, Plant and Equipment is capitalized on an accruals basis, provided that it is probable that the future economic benefits or service potential associated with the item will flow to the council and the cost of the item can be measured reliably" (WCC, Statement of Accounts, 2011/2012, p. 107).

"All investment management expenses are accounted for on an accruals basis" (WCC, Statement of Accounts, 2011/2012, p. 138).

The definition, presented in the glossary section of WCC Statement of Accounts 2011/2012, expresses the accrual principle as "accounting principle that [recognizes] income and expenditure … as they are earned or incurred, not as money is received or paid" (p. 190). This realizes the similarity between the accrual principle and the incurred principle, suggested by Monsen (2011), to some extent. However, the fundamental differences in these two principles lies into the fact that the accrual principle is based on the profit focus (effect) of accounting and the incurred principle is based on the money effects of revenues and expenditures, which is authentic to the Vatter's vision of the fund accounting. Accrual principle comes to the municipal accounting (in terms of WCC) directly from the commercial accounting with its profitability focus due to the adoption of the CIPFA Code, which is based on IFRS. Therefore, in this case the adoption of the accrual principle took place not based on rationality, practicability and authenticity to the public sector economic realities, but just due to the fact of the general adoption of the standards, guided by the current accounting policies and trends. This differs significantly from the principles the fund theory is based on.

10.2. Bookkeeping method

According to the Chapter 3, the organization can use single-entry bookkeeping, systematic single-entry bookkeeping or double-entry bookkeeping methods. Fund theory is originally based on the double-entry bookkeeping principle (Chapter 5).

It seems that WCC applies double-entry bookkeeping method as well. It is possible to suggest, that it happened due to the adoption of the CIPFA Code, which copies the double-entry bookkeeping method of commercial (accrual) accounting, which is supported by IFRS. However, from the Balance Sheet, presented within the financial statements of WCC Statement of Accounts 2011/2012 (Appendix 3), it is possible to conclude that WCC accounting follows the fundamental basic equation of the fund theory: the net assets are matched by reserves, i.e. the assets are equal to the restrictions on assets. Therefore, the double-entry bookkeeping applied by WCC intends to achieve the original control and accountability purposes in the governmental sector by providing link between budgeting and accounting.

It needs to be mentioned, that Vatter originally suggested that the double-entry bookkeeping method should be applied to each fund independently. However, since WCC does not provide the financial statements for each fund separately (see more details in subchapter 10.4 of this thesis), it is possible to suggest, that WCC applies the double-entry bookkeeping in a consolidated way as well (accept for the funds which legally required to be accounted separately).

10.3. Fund accounting

As it has been stressed in Chapter 5 of this thesis, Vatter built the fund theory based on an idea of impersonality of accounting operations and the service potential of assets and provided the new definitions for the fundamental accounting concepts such as fund, assets, revenue, expense, income, etc. within this framework.

In order to understand how the fund theory is applied in accounting of the concrete municipality, it seems to be interesting to find how the same concepts are understood in current practice and to compare them with the original theoretical concepts.

The meanings of the concepts on a practical level are extracted from WCC's Statement of Accounts 2011/2012 based on the information presented in Section11 – Glossary, Note 11 - Accounting Policies and by viewing the nature of WCC's accounting operations in the financial statements. Table 18 presents the comparison of the concepts of fund, assets, expense, revenue and income on the theoretical and practical levels.

Table 18: Comparison of the accounting concepts in the fund theory and practice

Concept	Fund theory	Fund accounting practice
Fund	a collection of service potentials, provided by assets; a unit of operations or a center of interests	Synonym for the concept “reserves”; a sum (account, amount of money) set aside for a specific purpose
Assets	service potentials (economic nature, but not physical objects) expressed in monetary amounts; any valuation choice effects objectivity of accounting; depreciation is recorded only in self-sustaining funds	physical objects which carrying service potentials; valued at historical costs or at fair value and depreciated on a straight-line basis over the estimated useful economic life
Expense	not a transaction concept, but a flow through time of services released to eventual ends from the fund of assets under consideration	spending of financial resources
Revenue	an addition of new assets, which create greater service potential, but do not impose any restrictions	acquisition of financial resources
Income	not a meaningful concept, since it is impossible to report one specific income figure that will satisfy all the requirements and to avoid personification	the concept is actively used and in fact replace the term “revenue” in some of the cases; determine the gain from the taxes, rents, charges for services, etc.

Source: compiled based on information from Chapter 5 of thesis and WCC, Statement of Accounts, 2011/2012

Based on this comparison it is possible to conclude, that most of the considered concepts changed their original meaning when the fund theory has been applied to practice. Some of the concepts, such as “income” and “assets”, obtained the meanings, which are more relevant to the proprietary and the entity theories, than to the fund theory. It is, in particular, determined by the fact, that the CIPFA Code, applied by WCC, adopted some elements of commercial (accrual) accounting (such as using income concept and presentation of the income statement, valuation and depreciation principles, etc.) from IFRS. In addition, the funds are used not for the money accounts, but for the profit accounts, which contradicts with original ideas of the fund theory as well.

Nevertheless, the funds (reserves) are the important elements of the WCC accounting. There are two categories of reserves, which are operated by WCC: usable and unusable reserves:

“Usable reserves are funds that the council has available to spend in the future, while unusable reserves are amounts that have come about purely from accounting adjustments and are not therefore available to spend” (WCC, Statement of Accounts, 2011/2012, p. 3).

Usable reserves are classified into the revenue group (General Fund, Housing Revenue Account, Earmarked Reserves) and capital (Major Repairs Reserve, Capital Receipts Reserve, Capital Grants Unapplied Account) group of funds. All capital funds are restricted:

“The Major Repairs Allowance … is restricted to being applied to new capital investment in … [Housing Revenue Account (HRA)] assets or the financing of historical capital expenditure by the HRA….The Capital Receipts Reserve …[is] restricted by statute from being used other than to fund new capital expenditure or to be set aside to finance historical capital expenditure…The Capital Grants Unapplied Account (Reserve) … is restricted by grant terms as to the capital expenditure against which it can be applied and/or the financial year in which this can take place” (WCC, Statement of Accounts, 2011/2012, p. 91).

It needs to be mentioned, that WCC Statement of Accounts can be characterized by the significant amount of complexity (especially for the external users’ understanding). It can be one of the reasons why the council claims that its councilors and officers do not use the information from the financial statements, prepared in accordance to the CIPFA Code for the decision-making purposes. In relation to this thesis, this complexity does not allow to deduce precisely WCC’s double-entry accounting method.

As about the reporting approach applied by WCC, it can be called “semi-consolidated”. From one side, some of the financial statements provide information in a consolidated way; however, another (such as the Movement in Reserves Statement) presents information with relation to each fund. In addition, by the law WCC is obliged to account and to report separately for the Housing Revenue Account; to present separate statements for the Collection Fund and the Pension Fund. Therefore, the full consolidation cannot be achieved.

10.4. Budgetary control

Budgeting followed by budgetary control is an important element of public sector accounting, which aims to demonstrate that the municipality is operated with respect to the decisions which have been made in relation to the public money spending.

The empirical study demonstrates that the budgetary figures are not incorporated into the financial statements of WCC (which seem to be a typical UK approach to the fund accounting implementation). It is important to remember here, that the council claims:

> "None of the four main statements … are ever used in decision-making because of the numerous discrepancies between them and the legal accounts" (WCC, Statement of Accounts, 2011/2012, p.3).

Therefore, it is necessary to look beyond the financial statements in order to get an impression about using the budgetary figures in WCC.

Budgetary figures are actively used in the notes, which provide specification of the financial statements, i.e. interested external users have the potential opportunity to compare WCC's budget with its original performance. This is an important component of the public control.

Furthermore, it is possible to conclude that the council is using budgetary figures on a daily basis for the decision-making purposes since Section 2 – Financial Performance 2011/2012 and Section 3 - The Medium Term Financial Strategy and Note 1 - Financial Performance 2011/2012 of WCC Statement of Accounts provide information based on the comparative analysis of the budgetary figures and the actual performance for the separate funds. The Council claims:

> "Crucially, [these sections and notes] provide figures in the format that councilors and senior officers use when making decisions about the running of the council" (WCC, Statement of Accounts, 2011/2012, p.3).

However, it can be questionable here to which extent the accounting figures, prepared based on the elements of the profit accrual principle, are comparable with the budgetary figures.

10.5. Summary

Summarizing, the analysis of the financial statements and information disclosed in the notes of the Statement of Accounts 2011/2012 of Wolverhampton City Council demonstrates that current accounting practice in UK public sector is quite different from the original fund theory. Even though municipal accounting is using different restricted and unrestricted funds as accounting entities and following the basic accounting equation of the fund theory, the concepts, such as assets, revenues, expenditures, etc. have the meanings, which differ from the original Vatter's concepts. The reason for it can be found in the current accounting trends which aim an adoption of business accounting standards and commercial (accrual) accounting in the public sector (CIPFA Code is grounded on the IFRS principles). In addition, it determines using the concepts which Vatter did not find appropriate for the fund theory (such as "income") and profit accrual principle of accounting. The next chapter continues to discuss the results of the empirical study together with the presentation of the research debate on fund accounting application in the public sector.

Chapter 11: DISCUSSION

In this chapter the application of the fund accounting in the public sector is discussed. In the first section the Anglo-Saxon research debate from 1980s is presented. The second section explores this debate based on other research and results of the empirical study, performed in this thesis.

11.1. Anglo-Saxon debate

A scientific debate about variety of accounting principles for profit and non-profit entities took place in 1980s. In this thesis the main attention is given to the part of that debate which related to the implementation of fund accounting principles in the public sector.

11.1.1. Anthony's (1980, 1989) claim

In 1980 Anthony evaluated the distinction between accounting for commercial and non-profit organizations through the different meanings of accounting concepts and information and the reasons of this variety existence. Nonbusiness world is characterized by an absence of profit motive, necessity of fiscal compliance and restrictions of resources.

Anthony (1980) pointed two **reasons of nonprofit accounting presence**: 1) nonbusiness organizations should not use business accounting principles, since they do not have a profitability focus; 2) nonbusiness accounting purpose is to guarantee compliance with the spending restrictions.

However, he claimed that these arguments are not significant for an existence of different accounting worlds. Anthony (1980) concluded that fund accounting implementation in the municipal world lead to the difference between business and non-business accounting. According to the scholar, nonprofit world presents fragmented data in separate statements for each part of organization. In addition, it creates **"new accounting language"** (p. 83), where the concepts which users of commercial accounting are familiar with, are implemented with the new (different from original) meanings. Financial reports based on fund accounting principles could be characterized by its complexity, "unnecessary" separate setting of special revenue funds from the general funds and misdirecting of the users by the conceptual deviations (in relation to liability and revenue concepts). This misdirecting leads to the situations when users cannot evaluate the financial condition of the municipality properly and predict financial problems.

Anthony (1980) pointed the following **weaknesses of the fund reporting system**: 1) fund report does not show the operational results; 2) operational reports are fragmented into funds; operational performance presented together reports of capital transactions; 3) numbers do not correspond to the economic reality.

Anthony (1980) argued that in the nonbusiness world there is **no financial measuring of performance** with the same level of reliability as revenue measure in the business world. The success of nonbusiness organizations could be measured by how much service they provide, but the quality of services is not taken into account in this context. Therefore, he claimed:

> "operating statement of a nonbusiness organization cannot have the same meaning as the operating statement of a business, … [since] in nonbusiness organizations, revenues do measure … the amount of resources provided for operations, … [which] may come from the sales of services, contributions for operating purposes, membership dues, taxation, government grants, or elsewhere" (p. 89).

Despite that, Anthony (1980) found the similarities in information which business and nonbusiness operating statements provide through an "idea of operating capital maintenance" (p. 87). He postulated that from accounting perspective the only one aspect which makes nonbusiness organizations significantly different from business enterprises, is the receiving the **contributed capital**. Anthony (1989) explains:

> "Although nonbusiness organizations do not have equity investors, they do receive equity capital from an external source. I shall use "contributed capital" as the name for this source. I define it broadly to include bequests for capital purposes; resources received in a capital campaign; capital appropriations made by a state to municipalities, universities, and other organizations for nonoperating purposes; and grants and contracts that specify payments for the acquisition of fixed assets".

Contributed capital must be separated from revenues earned in current period. According to Anthony this can be solved within the basic concept of revenue recognition. He suggested using separate balance sheets: one for operating capital and one for contributed capital, accompanied by funds flow statements which report sources and use of funds.

In relation to the restriction of assets which need to be controlled in nonbusiness organizations, Anthony recommended to use **appropriate accounting internal control** instead of fund accounting, as it is done in business sector.

Summarizing, Anthony (1980) proposed that nonbusiness organizations should use business accounting standards with some modifications. He concluded:

"There is little that is unique about accounting for nonbusiness organizations. …Although nonbusiness organizations must comply with certain restrictions on spending, they are not alone in this respect. Many businesses have restrictions on spending. These require appropriate internal controls but need not shape the format or content of the financial statements. With the exception of …capital contributions, nonbusiness accounting should be essentially the same as business accounting" (p. 92).

However, it is possible to say that Anthony did not take into account the difference in informational needs of users of business and governmental financial statements and the principle of public control.

11.1.2. Herzlinger & Sherman's (1980) argumentation

An article of Herzlinger & Sherman (1980) provided controversial point of view, where the position of Anthony is criticized for "urging … [nonprofit] organizations to conform to business accounting practices" (p. 94). The scholars argued that this leads to misdirection in the evaluation of financial management of nonprofits and strengthened the benefits of fund accounting model.

The position of Herzlinger & Sherman (1980) is based on **four main propositions**: 1) financial structures of business and nonbusiness organizations differ from each other significantly; 2) fundamental differences in objectives and missions could lead to misleading in evaluation of financial management of nonprofits in case if business accounting format would be used; 3) financial complexity of nonprofits determined mainly by problems in accounting control and not in nonprofit accounting principles; 4) professionals with experience in nonprofit sector are familiar with nonprofit financial structures and accounting practices and do not need knowledge about business accounting world.

Herzlinger & Sherman (1980) strongly supported using budgetary and fund accounting in nonprofit entities:

> “Nonprofit enterprises have a more basic need for … budgetary information. … The appropriate measure of their performance is the level of benefits achieved, not revenues. But the ability to measure that level is obviously quite limited …For nonprofit organizations … traditional corporate reporting is almost meaningless. The funds represent external restrictions on the use of resources, while the budget represents legislatively mandated restrictions on the distribution of monies” (p. 102).

Moreover, Herzlinger & Sherman (1980) reasoned against “simplification measures” in public accounting and claimed that the suggested by other scholars aggregation of funds and dismissing of budgetary and encumbrance accounting “would limit the disclosure of policies that reveal the financial management philosophy” (p. 101). The researchers claimed that complexity of financial statements of nonprofits could be eliminated by increasing the level of knowledge of nonprofit accounting users about the meaning of fund accounting concepts. They strengthened attention on the necessity of improving nomenclature and quality of information as well.

Herzlinger & Sherman (1980) summarized the following “insights” into financial management of nonprofit organizations provided by the fund accounting, which business accounting framework cannot offer:

> “Accounting for accruals and encumbrances is useful for tracking the availability of resources for specified purposes. Accounting for budgeted versus actual events offers a useful measure of how well management has carried out its plans. Segregation of fund balances into mandatory and discretionary components indicates the emphasis placed on various organizational objectives and on future versus current financial mobility. Separation of capital and operating transactions, coupled with disclosure of the funds available or required for plant addition or replacement and the amount of liquid assets at hand for this purpose, permits comparison of the available resources designated for capital additions with the expected demand for such resources” (p.104).

Therefore, Herzlinger & Sherman (1980) concluded, that fund accounting could satisfy information needs in the nonprofit sector in a better way, than business accounting framework.

11.1.3. Jones’s (1982) contribution

The position of Herzlinger & Sherman (1980) was supported by economists who adhere to Anglo-Saxon accounting traditions (see Jones, 1982; Rutherford, 1983; Henke, 1983; Gross et al., 1995).

In 1982 Jones suggested:

> "A way of thinking about financial reporting models [in nonprofit entities depends on the following parameters]: "(a) the fund, i.e. the reporting unit, (b) the unit of measurement, (c) the valuation model, and (d) the concept of capital maintenance" (p. 287).

According to Jones (1982) the debate about the financial reporting model for nonprofits is related to the issues which distinct nonbusiness organizations from business. He argued that the main reason, why the unification of accounting frameworks for all types of organizations is not achievable, is an existence of the profit motive in some of them:

> "Accountants in the business sector measure profit; profit does not exist in the nonbusiness sector: ergo accounting is different in the nonbusiness sector" (p. 289).

Jones (1982) suggested that the solution for the clarification of financial reporting, i.e. which debits and credits to report in the balance sheet and which in the operating statement, both in nonbusiness and business accounting is placed in capital maintenance approach.

11.1.4. Rutherford's (1983) contribution

In the book "Financial Reporting in the Public Sector" (1983) Rutherford supported the idea that public organizations and business organizations need different accounting systems:

> "There is no reason to presume, that the same accounting methods will be appropriate for both [private and public] sectors; …the argument that [some] information should be provided [by public organizations] because private bodies provide it is erroneous" (p. 44).

Rutherford (1983) provided several important characteristics of funds in governmental accounting: classification, qualities, functions, etc. In addition, Rutherford (1983) claimed that there are two main objectives of fund accounting in the public sector: accountability and fiduciary stewardship. Therefore, funds have **two essential qualities (functions)**: to be independent accounting entity (separately independent group of accounts) and to provide explicit regulatory framework. The separate accounting of resources provides an opportunity to demonstrate that they have been used according to the restrictions. Fund accounting provides a second level of control which accompanies the general internal control system.

Rutherford (1983) distinguished **pure (full) form of fund accounting from the partial (practical) form**:

“Pure or full fund accounting provides a strict “physical” control over financial resources; unspent balances are held in separate cash and investment accounts segregated from the resources of other funds maintained by the organization and borrowing and lending between funds are prohibited…A weaker, partial form of fund accounting is often employed in practice. Under this method some accounts are common for more than one fund…Alternatively, a full set of independent fund accounts may be maintained but lending between funds permitted. Physical control over resources is reduced but because each fund is accounted for separately in the organization’s financial statements it is possible for readers to trace what has happened to the resources of each fund and this may well provide managers with a powerful disincentive to engage in irregular spending” (p. 47).

Finally, Rutherford (1983) strengthened attention to the problem that operations of several funds increase complexity of financial reports of organizations. It makes difficult for readers to understand and to evaluate the performance of organizations. In addition, reporting of transactions between interrelated funds within organization increases the risk of double-counting. Therefore, Rutherford (1983) suggested that the solution of these problems can be in minimizing the number of funds and producing consolidated financial statements.

11.1.5. Summary

Summarizing, Anthony (1980, 1989), Herzlinger & Sherman (1980), Jones (1982) and Rutherford (1983) among other Anglo-Saxon research scholars made a significant contribution for understanding the features of accounting in nonbusiness (public) sector, its differences and similarities with accounting in business sector and the role of fund accounting approach in nonbusiness (public) sector. However, the duality in opinions of researchers and practitioners in relation to these issues exists up to the present day.

11.2. Empirical debate

As it has been shown by the empirical study, even though, the public sector accounting (including the municipal level) applies some elements of the original fund approach; it is strongly affected by the commercial accounting traditions. These findings supports the current trends when during the last decades international development of governmental accounting leads to the replacement of traditional governmental accounting models (like fund accounting) with variants of commercial accrual accounting within the framework of New Public Management.

Based on the theoretical and empirical studies above and the research of Granof & Wardlow (2003) and Monsen (2011) the comparison of commercial and fund accounting approaches is summarized in Table 19.

Table 19: Comparison of commercial and fund accounting models

	Commercial accounting	Fund accounting
Focus	information for profitable management of the owners' financial resources in business enterprises	information for money management of financial resources in a fund
Tasks	report the profit result via both the payment side (balance accounts) and the activity side (profit result accounts); report integrated complete balance accounts (assets, liability and equity)	budgetary control fiduciary stewardship
Accrual principle	profit accrual principle	money accrual principle (the incurred principle)
Revenue/ expenditure effect	profit effect	money effect
Causal effect, link revenues and expenditures	matching concept (expenditures must be paired with corresponding revenues)	revenues could be driven by expenditures, but they may not be directly related to expenditures
Restrictions on resources	assets are not restricted	assets are restricted for particular activities or purposes
Type of accounts	profit accounts	money accounts (incurred accounts)
Bookkeeping method	merchant's double-entry bookkeeping	double-entry bookkeeping of fund accounting

Source: Adopted from Monsen (2011), Granof & Wardlow (2003); modified by the author

Even though, like business enterprises, public organizations need to acquire revenues for covering expenditures (Monsen, 2011), various types of organizations have different objectives (Sommerfeld & Tucker, 2004; Abraham, 2007; Monsen, 2010) and focus on different effects of revenues and expenditures (Monsen, 2011). Governmental organizations, which focus on public services they provide, do not have market orientation and profit objective and acquire revenues though one-way money transactions. Therefore, the commercial accounting, which serves the needs of business enterprises, cannot satisfy the needs and measure the performance results of the municipality. Based on the concept of dollar accountability and original focus on money effects of revenues and expenditures, fund theory of accounting, when it applies to governmental organizations, focuses not on the results of operations, but on whether the financial resources have been spent in accordance with decisions made (budget decisions). Therefore, fund accounting and reporting approach creates the significant regulatory framework for fiduciary stewardship of the public sector (Rutherford, 1983).

Although this thesis advocates the fund approach, the main points of critics of fund accounting in the public sector need to be taken into account. Ingram (1986) summarized the main arguments of researchers and practitioners against fund approach in governmental accounting: failure in description of the operating results of the government, complexity in understanding by the external users, the main focus is given to the legal compliance and not to the efficiency evaluation, the performance results can be falsified and resources can be misappropriated. However, when Ingram (1986) evaluated these points of critique, he did not find support for this critical view. In contrast, he concluded:

> "Fund accounting model provides useful information for creditors. No evidence was identified in the study to support the argument that fund accounting is used by politicians to increase the ambiguity of financial reports. Instead, the results are consistent with the position that fund accounting provides control over government financial management and is viewed as being informative by creditors of the availability and use of debt resources" (p. 219).

Taking into consideration the advantages of fund accounting, such as focus on budgetary control and fiduciary stewardship and the results of empirical study, it is possible to claim that the fund accounting model needs its development and improvement in order to serve the public sector better, but not the full replacement by the commercial (accrual) accounting.

First of all, it is reasonable to suggest that the accounting framework for the public sector needs to be viewed though the main accounting objectives: accountability and decision making (Mellemvik et al, 1988) for the interested users. Wolverhampton City Council claims that its councilors and officers do not use the information from the financial statements, prepared in accordance to the CIPFA Code for the decision-making purposes, since it contradicts with the financial information prepared according to the legal rules. In addition, the external users also cannot benefit from this information due to the complexity and length of the statement of accounts (more than 200 pages) and public unavailability of the CIPFA Code. Therefore, the public funding is wasted for preparing the financial statements which nobody can benefit from. Work on the statements' improvement needs to be started from the careful research of the informational users' needs by interviewing the internal and external users. After that, the size of the statement of accounts can be reduced by decreasing the number of tables, extracting the main figures and prioritizing the quality of the financial information on its quantity.

In addition, the empirical study found that WCC accounting applies some elements of the original fund theory; however, the fundamental fund accounting concepts such as assets, revenues, expenditures, etc. changed their meanings affected by the business accounting standards adoption in the public sector. It signals that work on an improvement of clearance of the conceptual framework in the public accounting needs to be done with attention to the original meanings of the concepts. This work can be done within the synergy of efforts of the practitioners and researchers by introducing fund accounting as a possible conceptual framework for the governmental accounting improvement and its application in accounting research in Anglo-Saxon countries.

Chapter 12: CONCLUSION

12.1. Summary

This study aimed to acquire knowledge about fund accounting as an accounting platform, to use this knowledge when carrying out an empirical study and analyzing the financial statements of the City of Wolverhampton, UK and, on a more general level, to introduce fund accounting into the international debate about how to develop and improve governmental accounting. The study discusses if fund accounting, or some of its elements, could be of interest to use as a part of the accounting framework in the public sector. The empirical study has been undertaken by implementing the case study approach from an analytical perspective with the focus on comparative analysis of theoretical and practical levels of fund accounting knowledge. The empirical study provided valuable insights on the differences between the theoretical fund accounting approach created by Vatter (1947) and its implementation in the current municipal accounting practice in the British public sector. Therefore, it is possible to conclude that the study purposes have been generally achieved.

Wolverhampton City Council prepares its financial reports in accordance with the CIPFA Code grounded on the IFRS principles. The study found that WCC accounting contains some elements of the fund accounting approach, such as using restricted and unrestricted funds as accounting entities and following the basic accounting equation of the fund theory. However, the fundamental accounting concepts, such as assets, revenues, expenditures, etc. changed their meanings in comparison with the original concepts developed by Vatter (1947) for the fund theory. Moreover, WCC accounting uses the concepts which Vatter did not find appropriate for the fund theory (such as “income”) and profit accrual principle of accounting. This practice is determined by the current accounting trends to adopt business accounting standards and commercial (accrual) accounting in the public sector. The complexity and lack of clearness of WCC’s Statement of Accounts does not allow deducing precisely WCC’s double-entry accounting method and leads to the fact that the financial statements are not used by the council’s councilors and officers for the decision-making purposes. It is questionable as well if the external users can benefit from these financial statements.

With respect to the advantages of fund accounting, such as focus on money effects of revenues and expenditures, budgetary control and fiduciary stewardship, the study advocates using fund accounting in the public sector (in comparison with the commercial (accrual) accounting). However, the significant improvements need to be done for making fund accounting being able to serve the governmental sector in a better way.

12.2. Suggestions for further practice

In relation to the public accounting practice this study suggests the following improvements. The financial reports of the public authorities need to become more user's oriented with respect to both external and internal groups of users. Clarity and simplification of the public accounting (in particular, the used double-entry bookkeeping method) are the cornerstones of this improvement. The size of the statement of accounts needs to be reduced significantly by decreasing the number of tables and extracting the main figures.

In addition, it can be suggested to show the changes and dynamics in the financial years by presenting graphical development and some of the important financial ratios in order to improve demonstrativeness and visual expression. In this way wide groups of financial information users (such as investors, creditors, governmental officers, etc.) can rely on this information for the decision-making purposes.

As it has been strengthened in the previous chapters of this thesis, the conceptual framework of the public sector accounting demands clearance and improvement as well. The empirical study demonstrated that the municipality applies some concepts which belong to the fund accounting and other concepts which belong to the commercial accounting. Moreover, some of the concepts have unclear, deviated and mixed meanings. Since the clear conceptual framework is crucial for the understanding of the financial statements, the significant efforts need to be done for the harmonization of fund accounting theoretical framework and current accounting practices.

The author hopes that these suggestions can help to achieve the main purposes of the financial reporting in the public sector: to improve reliability, demonstrate transparency and accountability and openness for the public control.

12.3. Suggestions for further research

The results of the empirical study presented in this thesis can be considered as an example of conducting the case study research in the public accounting. However, the findings of this study are based only on analysis of the financial statements of one municipality. Therefore, the results have certain limitations, which determined mostly by the data specifics and methodological choice.

For example, the study analyses the accounting of the British municipality, which belongs to the British fund accounting traditions. As it has been mentioned above, the second type of the fund accounting traditions with incorporation of the budgetary figures into accounting process exists in the USA. It seems to be valuable suggestion for further research to perform the case study of the American municipality and to compare the results with the finding presented in this thesis. It can help to understand two different fund accounting practices and provide new ideas for the public accounting improvement and development.

In addition, deeper analysis of the municipal accounting can be suggested by combining the analysis of the financial statements with interviewing the external and internal users of the financial information. This will provide the opportunity to apply not only the analytical perspective of analysis, but the individual perspective as well. Moreover, the results of the study can be explored by performing the analysis of all three levels of accounting knowledge: theoretical, normative and practical. In order to achieve this purpose, CIPFA Code needs to be studied in details in order to compare the accounting norms with the fund theory and current accounting practice in the public sector. Furthermore, this thesis contains the elements of comparison of the fund accounting model with the commercial accounting model. The additional comparison of the fund model with the cameral accounting model could be valuable as well.

Finally, an introduction of fund accounting as possible conceptual framework for the governmental accounting and its application in the accounting research in the Anglo-Saxon countries, could rise the attention of researchers to studying the original fund theory and to work on an improvement of the conceptual framework of the public accounting in order to make it more authentic to the nature of public sector missions, activities and financial transactions.

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APPENDIXES

Appendix 1:

Note 11 – Accounting Policies (extraction)

Wolverhampton City Council Statement of Accounts 2011/2012

Note 11A – Accounting Policies Applying to these Statements

1. General Principles

The Statement of Accounts summarizes the council's transactions for the 2011/2012 financial year and its position at 31 March 2012. The council is required to prepare an annual Statement of Accounts by the Accounts and Audit Regulations 2011, which those regulations require to be prepared in accordance with proper accounting practices. These practices primarily comprise the Code of Practice on Local Authority Accounting in the United Kingdom 2011/12 and the Service Reporting Code of Practice 2011/12, supported by International Financial Reporting Standards (IFRS).

The accounting convention adopted in the Statement of Accounts is principally historical cost, modified by the revaluation of certain categories of non-current assets and financial instruments.

These accounting policies have been consistently applied, with the exception of the adoption of FRS 30 – Heritage Assets.

2. Accruals of Income and Expenditure

Activity is accounted for in the year that it takes place, not simply when cash payments are made or received. In particular:

Revenue from the sale of goods is recognised when the council transfers the significant risks and rewards of ownership to the purchaser and it is probable that economic benefits or service potential associated with the transaction will flow to the council.

Revenue from the provision of services is recognised when the council can measure reliably the percentage of completion of the transaction and it is probable that economic benefits or service potential associated with the transaction will flow to the council.

Supplies are recorded as expenditure when they are consumed - where there is a gap between the date supplies are received and their consumption, they are carried as inventories on the Balance Sheet.

Expenses in relation to services received (including services provided by employees) are recorded as expenditure when the services are received rather than when payments are made.

Interest receivable on investments and payable on borrowings is accounted for respectively as income and expenditure on the basis of the effective interest rate for the relevant financial instrument rather than necessarily the cash flows fixed or determined by the contract.

Where revenue and expenditure has been recognised but cash has not been received or paid, a debtor or creditor for the relevant amount is recorded in the Balance Sheet. Where debts may not be settled, the balance of debtors is written down and a charge made to revenue for the income that might not be collected.

3. Cash and Cash Equivalents

Cash is represented by cash in hand and deposits with financial institutions, repayable without penalty on notice of not more than 24 hours. Cash equivalents are investments that mature in three months or less from the date of acquisition and that are readily convertible to known amounts of cash with insignificant risk of change in value.

6. Charges to Revenue for Non-Current Assets

Services, support services and trading accounts are charged with the following amounts to record the cost of holding property, plant and equipment during the year:

Depreciation attributable to the assets used by the relevant service;

Revaluation and impairment losses on assets used by the service where there are no accumulated gains in the Revaluation Reserve against which the losses can be written off;

Amortisation of intangible assets attributable to the service.

The council is not required to raise council tax to fund depreciation, revaluation and impairment losses or amortisations. However, it is required to make an annual contribution from revenue towards the reduction in its overall borrowing requirement (calculated on a prudent basis determined by the council in accordance with statutory guidance). Depreciation, revaluation and impairment losses and amortisations are therefore replaced by the contribution in the General Fund Balance (known as Minimum Revenue Provision), by way of an adjusting transaction with the Capital Adjustment Account in the Movement in Reserves Statement for the difference between the two.

11. Government Grants and Contributions

Whether paid on account, by instalments or in arrears, government grants and third party contributions and donations are recognised as due to the council when there is reasonable assurance that the council will comply with the conditions attached to the payments, and the grants or contributions will be received.

Amounts recognised as due to the council are not credited to the Comprehensive Income and Expenditure Statement until conditions attached to the grant or contribution have been satisfied. Conditions are stipulations that specify that the future economic benefits or service potential embodied in the asset received in the form of the grant or contribution are required to be consumed by the recipient as specified, or future economic benefits or service potential must be returned to the grant issuing body.

Monies advanced as grants and contributions for which conditions have not been satisfied are carried in the Balance Sheet as creditors. When conditions are satisfied, the grant or contribution is credited to the relevant service line (attributable revenue grants and contributions) or Taxation and Non-Specific Grant Income (non-ring-fenced revenue grants and all capital grants) in the Comprehensive Income and Expenditure Statement.

Where capital grants are credited to the Comprehensive Income and Expenditure Statement, they are reversed out of the General Fund Balance in the Movement in Reserves Statement. Where the grant has yet to be used to finance capital expenditure, it is posted to the Capital Grants Unapplied Reserve. Where it has been applied, it is posted to the Capital Adjustment Account. Amounts in the Capital Grants Unapplied Reserve are transferred to the Capital Adjustment Account once they have been applied to fund capital expenditure.

12. Intangible Assets

Expenditure on non-monetary assets that do not have physical substance but are controlled by the council as a result of past events (e.g. software licences) is capitalised when it is expected that future economic benefits or service potential will flow from the intangible asset to the council. Expenditure on the development of websites would not be capitalised if the website were solely or primarily intended to promote or advertise the council's goods or services.

Intangible assets are measured initially at cost. Amounts are only revalued where the fair value of the assets held by the council can be determined by reference to an active market. The depreciable amount of an intangible asset is amortised over its useful life to the relevant service line(s) in the Comprehensive Income and Expenditure Statement. An asset is tested for impairment whenever there is an indication that the asset might be impaired - any losses recognised are posted to the relevant service line(s) in the Comprehensive Income and Expenditure Statement. Any gain or loss arising on the disposal or abandonment of an intangible asset is posted to the Other Operating Expenditure line in the Comprehensive Income and Expenditure Statement.

Where expenditure on intangible assets qualifies as capital expenditure for statutory purposes, amortisation, impairment losses and disposal gains and losses are not permitted to have an impact on the General Fund Balance. The gains and losses are therefore reversed out of the General Fund Balance in the Movement in Reverses Statement and posted to the Capital Adjustment Account and, for any sale proceeds greater than £10,000, the Capital Receipts Reserve.

14. Inventories

Inventories are included on the Balance Sheet at the lower of cost and net realisable value. The cost of inventories is assigned using the weighted average costing formula.

15. Investment Property

Investment properties are those that are used solely to earn rentals and/or for capital appreciation. The definition is not met if the property is used in any way to facilitate the delivery of services or production of goods, or is held for sale.

Investment properties are measured initially at cost and subsequently at fair value, based on the amount at which the asset could be exchanged between knowledgeable parties at arm's-length. Properties are not depreciated but are revalued according to market conditions at the year-end. Gains and losses on revaluation are posted to the Financing and Investment Income and Expenditure line in the Comprehensive Income and Expenditure Statement. The same treatment is applied to gains and losses on disposal.

Rentals received in relation to investment properties are credited to the Financing and Investment Income and Expenditure line and result in a gain for the General Fund Balance. However, revaluation and disposal gains and losses are not permitted by statutory arrangements to have an impact on the General Fund Balance. The gains and losses are therefore reversed out of the General Fund Balance in the Movement in Reserves Statement and posted to the Capital Adjustment Account and (for any sale proceeds greater than £10,000) the Capital Receipts Reserve.

19. Property, Plant and Equipment

Assets that have physical substance and are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes, and that are expected to be used during more than one financial year are classified as Property, Plant and Equipment.

Recognition - Expenditure on the acquisition, creation or enhancement of Property, Plant and Equipment is capitalised on an accruals basis, provided that it is probable that the future economic benefits or service potential associated with the item will flow to the council and the cost of the item can be measured reliably. Expenditure that maintains but does not add to an asset's potential to deliver future economic benefits or service potential (i.e. repairs and maintenance) is charged as an expense when it is incurred.

Measurement - Assets are initially measured at cost, comprising the purchase price and any costs attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. The council does not capitalise borrowing costs incurred whilst assets are under construction.

The cost of an asset acquired other than by purchase is deemed to be its fair value, unless the acquisition does not have commercial substance (i.e. it will not lead to a variation in the cash flows of the council). In the latter case, where an asset is acquired via an exchange, the cost of the acquisition is the carrying amount of the asset given up by the council.

Donated assets are measured initially at fair value. The difference between fair value and any consideration paid is credited to the Taxation and Non-Specific Grant Income line of the Comprehensive Income and Expenditure Statement, unless the donation has been made conditionally. Until conditions are satisfied, the gain is held in the Donated Assets Account. Where gains are credited to the Comprehensive Income and Expenditure Statement, they are reversed out of the General Fund Balance to the Capital Adjustment Account in the Movement in Reserves Statement.

Assets are then carried in the Balance Sheet using the following measurement bases:

Infrastructure, community assets and assets under construction - depreciated historical cost;

Dwellings - fair value, determined using the basis of existing use value for social housing (EUV-SH);

All other assets - fair value, determined as the amount that would be paid for the asset in its existing use (existing use value - EUV).

Where there is no market-based evidence of fair value because of the specialist nature of an asset, depreciated replacement cost (DRC) is used as an estimate of fair value. Where non-property assets have short useful lives or low values (or both), the depreciated historical cost basis is used as a proxy for fair value.

Assets included in the Balance Sheet at fair value are revalued sufficiently regularly to ensure that their carrying amount is not materially different from their fair value at the year end, but as a minimum every five years. Increases in valuations are matched by credits to the Revaluation Reserve to recognise unrealised gains.

Where decreases in value are identified, they are accounted for by:

Where there is a balance of revaluation gains for the asset in the Revaluation Reserve, the carrying amount of the asset is written down against that balance (up to the amount of the accumulated gains);

Where there is no balance in the Revaluation Reserve or an insufficient balance, the carrying amount of the asset is written down against the relevant service line(s) in the Comprehensive Income and Expenditure Statement.

The Revaluation Reserve contains revaluation gains recognised since 1 April 2007 only, the date of its formal implementation. Gains arising before that date have been consolidated into the Capital Adjustment Account.

Impairment - Assets are assessed at each year end as to whether there is any indication that an asset may be impaired. Where indications exist and any possible differences are estimated to be material, the recoverable amount of the asset is estimated and, where this is less than the carrying amount of the asset, an impairment loss is recognised for the shortfall.

Where impairment losses are identified, they are accounted for by:

Where there is a balance of revaluation gains for the asset in the Revaluation Reserve, the carrying amount of the asset is written down against that balance (up to the amount of the accumulated gains);

Where there is no balance in the Revaluation Reserve or an insufficient balance, the carrying amount of the asset is written down against the relevant service line(s) in the Comprehensive Income and Expenditure Statement.

Where an impairment loss is subsequently reversed, the reversal is credited to the relevant service line(s) in the Comprehensive Income and Expenditure Statement, up to the amount of the original loss, adjusted for depreciation that would have been charged if the loss had not been recognised.

Depreciation - Depreciation is provided for on all Property, Plant and Equipment assets by the systematic allocation of their depreciable amounts over their useful lives. An exception is made for assets without a determinable finite useful life (i.e. freehold land and certain Community Assets) and assets that are not yet available for use (i.e. assets under construction). Depreciation is charged on surplus assets.

Depreciation is calculated on the following bases:

Dwellings and other buildings - straight-line allocation over the useful life of the property as estimated by the valuer;

Vehicles, plant, furniture and equipment - straight-line allocation over the useful life of the asset;

Infrastructure - straight-line allocation over 50 years.

Where an item of Property, Plant and Equipment has major components whose cost is significant in relation to the total cost of the item, the components are depreciated separately. Revaluation gains are also depreciated, with an amount equal to the difference between current value depreciation charged on assets and the depreciation that would have been chargeable based on their historical cost being transferred each year from the Revaluation Reserve to the Capital Adjustment Account.

21. Provisions, Contingent Liabilities and Contingent Assets

Provisions - Provisions are made where an event has taken place that gives the council a legal or constructive obligation that probably requires settlement by a transfer of economic benefits or service potential, and a reliable estimate can be made of the amount of the obligation. For instance, the council may be involved in a court case that could eventually result in the making of a settlement or the payment of compensation.

Provisions are charged as an expense to the appropriate service line in the Comprehensive Income and Expenditure Statement in the year that the council becomes aware of the obligation, and are measured at the best estimate at the balance sheet date of the expenditure required to settle the obligation, taking into account relevant risks and uncertainties. When payments are eventually made, they are charged to the provision carried in the Balance Sheet. Estimated settlements are reviewed at the end of each financial year - where it becomes less than probable that a transfer of economic benefits will now be required (or a lower settlement than anticipated is made), the provision is reversed and credited back to the relevant service.

Where some or all of the payment required to settle a provision is expected to be recovered from another party (e.g. from an insurance claim), this is only recognised as income for the relevant service if it is virtually certain that reimbursement will be received if the council settles the obligation.

Contingent Liabilities - A contingent liability arises where an event has taken place that gives the council a possible obligation whose existence will only be confirmed by the occurrence or otherwise of uncertain future events not wholly within the control of the council. Contingent liabilities also arise in circumstances where a provision would otherwise be made but either it is not probable that an outflow of resources will be required or the amount of the obligation cannot be measured reliably. Contingent liabilities are not recognised in the Balance Sheet but disclosed in a note to the accounts.

22. Reserves

The council sets aside specific amounts as reserves for future policy purposes or to cover contingencies. Reserves are created by appropriating amounts out of the General Fund Balance in the Movement in Reserves Statement. When expenditure to be financed from a reserve is incurred, it is charged to the appropriate service in that year to score against the Surplus or Deficit on the Provision for Services in the Comprehensive Income and Expenditure Statement. The revenue is then appropriated back into the General Fund Balance in the Movement in Reserves Statement so that there is no net charge against council tax for the expenditure. Certain reserves are kept to manage the accounting processes for non-current assets, financial instruments, retirement and employee benefits and do not represent usable resources for the council – these reserves are explained in the relevant policies.

26. Heritage Assets

Heritage assets are recognised and measured (including the treatment of revaluation gains and losses) in accordance with the council's accounting policies on property, plant and equipment, with the following exceptions:

Where there is no market-based evidence of fair value, insurance valuation is used as an estimate of fair value;

There is no cyclical revaluation of heritage assets, which instead are kept under review for impairment on an annual basis;

The groupings used to classify property, plant and equipment assets are not used for heritage assets.

Appendix 2:

Note 10C – Description of Reserves

Wolverhampton City Council Statement of Accounts 2011/2012

Name of Reserve	Description
Usable Reserves	
Revenue	
General Fund Balance	The General Fund is the statutory fund into which all the receipts of an authority are required to be paid and out of which all liabilities of the authority are to be met, except to the extent that statutory rules might provide otherwise. These rules can also specify the financial year in which liabilities and payments should impact on the General Fund Balance, which is not necessarily in accordance with proper accounting practice. The General Fund Balance therefore summarises the resources that the council is statutorily empowered to spend on its services or on capital investment (or the deficit of resources that the council is required to recover) at the end of the financial year (however, the balance is not available to be applied to funding HRA services: see Housing Revenue Account Balance below).
Housing Revenue Account Balance	The Housing Revenue Account Balance reflects the statutory obligation to maintain a revenue account for local authority council housing provision in accordance with Part VI of the Local Government and Housing Act 1989. It contains the balance of income and expenditure as defined by the 1989 Act that is available to fund future expenditure in connection with the council's landlord function or (where in deficit) that is required to be recovered from tenants in future years.
Earmarked Reserves	Earmarked Reserves represent amounts that the council has chosen to set aside to fund specific items of expenditure in the future.
Capital	
Major Repairs Reserve	The authority is required to maintain the Major Repairs Reserve, which controls the application of the Major Repairs Allowance (MRA). The MRA is restricted to being applied to new capital investment in HRA assets or the financing of historical capital expenditure by the HRA. The balance shows the MRA that has yet to be applied at the year end.
Capital Receipts Reserve	The Capital Receipts Reserve holds the proceeds from the disposal of land or other assets, which are restricted by statute from being used other than to fund new capital expenditure or to be set aside to finance historical capital expenditure. The balance on the reserve shows the resources that have yet to be applied for these purposes at the year end.
Capital Grants Unapplied Account	The Capital Grants Unapplied Account (Reserve) holds the grants and contributions received towards capital projects for which the council has met the conditions that would otherwise require repayment of the monies but which have yet to be applied to meet expenditure. The balance is restricted by grant terms as to the capital expenditure against which it can be applied and/or the financial year in which this can take place.

Name of Reserve	Description
Unusable Reserves	
Revaluation Reserve	The Revaluation Reserve contains the gains made by the council arising from increases in the value of its Property, Plant and Equipment. The balance is reduced when assets with accumulated gains are reduced downwards or impaired and the gains are lost, used in the provision of services and the gains are consumed through depreciation, or disposed of and the gains are realised. The reserve only contains revaluation gains accumulated since 1 April 2007, the date that the reserve was created. Accumulated gains arising before that date are consolidated into the balance on the Capital Adjustment Account.
Available-for-Sale Financial Instruments Reserve	The Available-for-Sale Financial Instruments Reserve contains the gains made by the council arising from increases in the value of its investments that have quoted market prices or otherwise do not have fixed or determinable payments. The balance is reduced when investments with accumulated gains are revalued downwards or impaired and the gains are lost, or disposed of and the gains are realised.
Capital Adjustment Account	The Capital Adjustment Account absorbs the timing differences arising from the different arrangements for accounting for the consumption of non-current assets and for financing the acquisition, construction or enhancement of those assets under statutory provisions. The account is debited with the cost of acquisition, construction or enhancement as depreciation, impairment losses and amortisations are charged to the Comprehensive Income and Expenditure Statement (with reconciling postings from the Revaluation Reserve to convert fair value figures to a historical cost basis). The account is credited with the amounts set aside by the council as finance for the costs of acquisition, construction and enhancement. The account contains accumulated gains and losses on Investment Properties and gains recognised on donated assets that have yet to be consumed by the council. It also contains revaluation gains accumulated on Property, Plant and Equipment before 1 April 2007, the date that the Revaluation Reserve was created to hold such gains.
Financial Instruments Adjustment Account	The Financial Instruments Adjustment Account absorbs the timing differences arising from the different arrangements for accounting for income and expenses relating to certain financial instruments and for bearing losses or benefiting from gains per statutory provisions.
Pensions Reserve	The Pensions Reserve absorbs the timing differences arising from the different arrangements for accounting for post-employment benefits and for funding benefits in accordance with statutory provisions. The council accounts for post-employment benefits in the Comprehensive Income and Expenditure Statement as the benefits are earned by employees accruing years of service, updating the liabilities recognised to reflect inflation, changing assumptions and investment returns on any resources set aside to meet the costs. However, statutory arrangements require benefits earned to be financed as the council makes employer's contributions to pension funds or eventually pays any pensions for which it is directly responsible. The debit balance on the Pensions Reserve therefore shows a substantial shortfall in the benefits earned by past and current employees and the resources the council has set aside to meet them. The statutory arrangements will ensure that funding will have been set aside by the time the benefits come to be paid.

Name of Reserve	Description
Collection Fund Adjustment Account	The Collection Fund Adjustment Account manages the differences arising from the recognition of council tax income in the Comprehensive Income and Expenditure Statement as it falls due from council tax payers compared with the statutory arrangements for paying across amounts to the General Fund from the Collection Fund.
Accumulated Absences Account	The Accumulated Absences Account absorbs the differences that would otherwise arise on the General Fund Balance from accruing for compensated absences earned but not taken in the year, for example annual leave entitlement not yet used at 31 March. Statutory arrangements require that the impact on the General Fund Balance is neutralised by transfers to or from the account.

Appendix 3:

Section 6 – Financial Statements

Wolverhampton City Council Statement of Accounts 2011/2012

Comprehensive Income and Expenditure Statement (Council only)

2010/2011 Gross Expenditure £M	2010/2011 Gross Income £M	2010/2011 Net Expenditure £M		Note	2011/2012 Gross Expenditure £M	2011/2012 Gross Income £M	2011/2012 Net Expenditure £M
128.3	(53.3)	75.0	Adult Social Care		127.2	(53.9)	73.3
14.7	(3.6)	11.1	Central Services to the Public		19.1	(4.2)	14.9
342.1	(267.2)	74.9	Education and Children's Services		325.3	(240.7)	84.6
4.7	-	4.7	Corporate and Democratic Core		4.6	(0.1)	4.5
30.4	(10.7)	19.7	Cultural and Related Services		29.5	(9.8)	19.7
29.4	(7.5)	21.9	Environment and Regulatory Services		28.3	(7.0)	21.3
18.0	(7.0)	11.0	Planning Services		11.8	(3.8)	8.0
41.2	(5.0)	36.2	Highways and Transport Services		26.3	(4.9)	21.4
83.5	(79.9)	3.6	Housing Services		88.3	(90.5)	(2.2)
404.4	-	404.4	- Exceptional Item: Housing Revaluation	2H	-	-	-
-	-	-	- Exceptional Item: HRA Self-Financing Settlement	2H	12.1	(59.8)	(47.7)
161.9	(156.8)	5.1	Non-distributed Costs		172.6	(170.1)	2.5
			Other Exceptional Items				
6.0	-	6.0	- Contribution to Provision	2H	10.1	-	10.1
(63.8)	-	(63.8)	- Pensions Indexation	2H	-	-	-
1,200.8	**(591.0)**	**609.8**	**Net Cost of Services**		**855.2**	**(644.8)**	**210.4**
12.8	-	12.8	Levies		13.6	-	13.6
2.1	-	2.1	Payments to the Housing Capital Receipts Pool		2.4	-	2.4
-	(2.5)	(2.5)	(Gains)/Losses on the Disposal of Non-current Assets		17.6	(6.6)	11.0

Comprehensive Income and Expenditure Statement (Council only) (Continued)

2010/2011 Gross Expenditure £M	2010/2011 Gross Income £M	2010/2011 Net Expenditure £M		Note	2011/2012 Gross Expenditure £M	2011/2012 Gross Income £M	2011/2012 Net Expenditure £M
-	-	-	External Trading Organisations		0.3	(0.5)	(0.2)
28.5	-	28.5	Interest Payable		28.2	-	28.2
18.4	-	18.4	Pensions Interest Cost and Expected Return on Pensions Assets		56.5	(44.7)	11.8
-	(0.7)	(0.7)	Interest Receivable		-	(0.7)	(0.7)
-	(1.7)	(1.7)	Income and Expenditure in Relation to Investment Properties and Changes in their Fair Value		-	(0.1)	(0.1)
-	-	-	Other Investment Income		-	(0.6)	(0.6)
-	(93.5)	(93.5)	Council Tax		-	(93.1)	(93.1)
-	(125.9)	(125.9)	National Non-domestic Rates		-	(110.8)	(110.8)
-	(45.8)	(45.8)	Unringfenced Revenue Grants Receivable		-	(37.7)	(37.7)
-	(90.4)	(90.4)	Capital Grants Receivable		-	(60.2)	(60.2)
1,262.6	**(951.5)**	**311.1**	**(Surplus) or Deficit on the Provision of Services**		**973.8**	**(999.8)**	**(26.0)**
-	(0.7)	(0.7)	(Surplus) or Deficit on Revaluation of Non-current Assets		-	(9.2)	(9.2)
-	-	-	(Surplus) or Deficit on Revaluation of Available-for-sale Financial Assets		-	(1.7)	(1.7)
-	(50.0)	(50.0)	Actuarial (Gains) and Losses on Pension Assets and Liabilities		68.5	-	68.5
1,262.6	**(1,002.2)**	**260.4**	**Total Comprehensive Income and Expenditure**		**1,042.3**	**(1,010.7)**	**31.6**

Comprehensive Income and Expenditure Statement (Group)

2010/2011 Gross Expenditure £M	2010/2011 Gross Income £M	2010/2011 Net Expenditure £M		Note	2011/2012 Gross Expenditure £M	2011/2012 Gross Income £M	2011/2012 Net Expenditure £M
128.2	(53.3)	74.9	Adult Social Care		127.2	(53.9)	73.3
14.5	(2.4)	12.1	Central Services to the Public		19.1	(4.0)	15.1
342.0	(267.2)	74.8	Education and Children's Services		325.3	(240.7)	84.6
4.7	-	4.7	Corporate and Democratic Core		4.6	(0.1)	4.5
30.3	(10.6)	19.7	Cultural and Related Services		29.5	(9.8)	19.7
29.4	(7.5)	21.9	Environment and Regulatory Services		28.3	(7.0)	21.3
18.0	(7.0)	11.0	Planning Services		11.8	(3.8)	8.0
41.2	(3.8)	37.4	Highways and Transport Services		26.3	(4.8)	21.5
89.5	(89.3)	0.2	Housing Services		174.8	(180.4)	(5.6)
404.4	-	404.4	- Exceptional Item: Housing Revaluation	2H	-	-	-
-	-	-	- Exceptional Item: HRA Self-Financing Settlement	2H	12.1	(59.8)	(47.7)
162.3	(156.8)	5.5	Non-distributed Costs		172.6	(169.3)	3.3
			Exceptional Items				
6.0	-	6.0	- Contribution to Provision	2H	10.1	-	10.1
(70.0)	-	(70.0)	- Pensions Indexation	2H	-	-	-
1,200.5	**(597.9)**	**602.6**	**Net Cost of Services**		**941.7**	**(733.6)**	**208.1**
12.8	-	12.8	Levies		13.6	-	13.6
2.1	-	2.1	Payments to the Housing Capital Receipts Pool		2.4	-	2.4
-	(2.5)	(2.5)	(Gains)/Losses on the Disposal of Non-current Assets		17.6	(6.6)	11.0

Comprehensive Income and Expenditure Statement (Group) (Continued)

2010/2011 Gross Expenditure £M	2010/2011 Gross Income £M	2010/2011 Net Expenditure £M		Note	2011/2012 Gross Expenditure £M	2011/2012 Gross Income £M	2011/2012 Net Expenditure £M
-	-	-	External Trading Organisations		0.3	(0.5)	(0.2)
29.2	-	29.2	Interest Payable		28.2	-	28.2
18.4	-	18.4	Pensions Interest Cost and Expected Return on Pensions Assets		61.6	(50.0)	11.6
-	(0.8)	(0.8)	Interest Receivable		-	(0.7)	(0.7)
-	(1.7)	(1.7)	Income and Expenditure in Relation to Investment Properties and Changes in their Fair Value		-	(0.1)	(0.1)
-	-	-	Other Investment Income		-	(0.6)	(0.6)
-	(93.5)	(93.5)	Council Tax		-	(93.1)	(93.1)
-	(125.9)	(125.9)	National Non-domestic Rates		-	(110.8)	(110.8)
-	(45.8)	(45.8)	Unringfenced Revenue Grants Receivable		-	(37.7)	(37.7)
-	(90.4)	(90.4)	Capital Grants Receivable		-	(60.2)	(60.2)
1,263.0	**(958.5)**	**304.5**	**(Surplus) or Deficit on the Provision of Services**		**1,065.4**	**(1,093.9)**	**(28.5)**
-	(0.7)	(0.7)	(Surplus) or Deficit on Revaluation of Non-current Assets		-	(9.2)	(9.2)
-	-	-	(Surplus) or Deficit on Revaluation of Available-for-sale Financial Assets		-	(1.7)	(1.7)
-	(55.9)	(55.9)	Actuarial (Gains) and Losses on Pension Assets and Liabilities		72.0	-	72.0
1,263.0	**(1,015.1)**	**247.9**	**Total Comprehensive Income and Expenditure**		**1,137.4**	**(1,104.8)**	**32.6**

Balance Sheets

31 March 2011 Council £M	Group £M		Note	31 March 2012 Council £M	Group £M
1,595.9	*1,595.9*	Property, Plant and Equipment	5	1,631.2	*1,631.2*
17.7	*17.7*	Investment Property	5	16.3	*16.3*
0.9	*0.9*	Intangible Assets	5	1.4	*1.4*
11.5	*11.5*	Heritage Assets	5	11.5	*11.5*
16.8	*16.8*	Non-current Investments		18.6	*18.6*
0.1	*0.1*	Non-current Debtors		1.0	*1.0*
1,642.9	***1,642.9***	**Total Non-current Assets**		**1,680.0**	***1,680.0***
27.8	*27.8*	Current Investments		8.6	*8.6*
0.6	*0.6*	Inventories		0.5	*0.5*
64.6	*64.1*	Current Debtors	3	52.4	*50.7*
1.9	*8.5*	Cash and Cash Equivalents		2.6	*14.1*
94.9	***101.0***	**Total Current Assets**		**64.1**	***73.9***
(16.2)	*(16.2)*	Current Borrowing		(13.7)	*(13.7)*
(75.1)	*(78.4)*	Current Creditors	3	(87.1)	*(91.0)*
(26.3)	*(26.3)*	Current Provisions	4A	(34.2)	*(34.2)*
(117.6)	***(120.9)***	**Total Current Liabilities**		**(135.0)**	***(138.9)***
(530.4)	*(530.4)*	Non-current Borrowing		(481.0)	*(481.0)*
(367.8)	*(382.3)*	Net Pension Liability	6	(443.4)	*(461.9)*
(11.5)	*(11.5)*	Capital Grants Received in Advance		(8.5)	*(8.5)*
(45.3)	*(45.2)*	Other Non-current Liabilities		(42.6)	*(42.6)*
(955.0)	***(969.4)***	**Total Non-current Liabilities**		**(975.5)**	***(994.0)***
665.2	***653.6***	**Net Assets**		**633.6**	***621.0***

Balance Sheets (Continued)

31 March 2011 Council £M	Group £M		Note	31 March 2012 Council £M	Group £M
(39.5)	*(39.5)*	General Fund Balance	10B, 10C	(19.5)	*(19.5)*
(63.5)	*(63.5)*	General Fund Earmarked Reserves	10B, 10C	(83.6)	*(83.6)*
(5.1)	*(5.1)*	Housing Revenue Account Balance	10B, 10C	(10.5)	*(10.5)*
(4.6)	*(4.6)*	Major Repairs Reserve	10B, 10C	(5.2)	*(5.2)*
(1.8)	*(1.8)*	Capital Receipts Reserve	10B, 10C	(2.3)	*(2.3)*
(37.1)	*(37.1)*	Capital Grants Unapplied Account	10B, 10C	(36.1)	*(36.1)*
-	*11.6*	Reserves of Subsidiary	10B, 10C	-	*12.6*
(151.6)	***(140.0)***	**Total Usable Reserves**		**(157.2)**	***(144.6)***
5.3	*5.3*	Short-term Accumulating Compensated Absences Account	10B, 10C	6.2	*6.2*
(10.4)	*(10.4)*	Available-for-sale Financial Instruments Reserve	10B, 10C	(12.1)	*(12.1)*
(610.6)	*(610.6)*	Capital Adjustment Account	10B, 10C	(649.9)	*(649.9)*
(1.2)	*(1.2)*	Collection Fund Adjustment Account	10B, 10C	0.1	*0.1*
3.0	*3.0*	Financial Instruments Adjustment Account	10B, 10C	2.9	*2.9*
367.8	*367.8*	Pensions Reserve	10B, 10C	443.4	*443.4*
(267.5)	*(267.5)*	Revaluation Reserve	10B, 10C	(267.0)	*(267.0)*
(513.6)	***(513.6)***	**Total Unusable Reserves**		**(476.4)**	***(476.4)***
(665.2)	***(653.6)***	**Total Reserves**		**(633.6)**	***(621.0)***

Movement in Reserves Statement – 2011/2012

(For a detailed breakdown of the figures in this Statement, see Note 10B)

	General Fund Balance	General Fund Earmarked Reserves	HRA Balance	Major Repairs Reserve	Usable Capital Receipts Reserve	Capital Grants Unapplied Account	Total Usable Reserves	Unusable Reserves	TOTAL (Council)	*Reserves of Subsidiary*	*TOTAL (Group)*
	£M	£M	£M	£M	£M	£M	£M	£M	£M	*£M*	*£M*
Balance Brought Forward	(39.5)	(63.5)	(5.1)	(4.6)	(1.8)	(37.1)	(151.6)	(513.6)	(665.2)	*11.6*	*(653.6)*
Surplus or Deficit on Provision of Services	25.3	-	(51.3)	-	-	-	**(26.0)**	-	**(26.0)**	*(2.5)*	***(28.5)***
Other Comprehensive Income and Expenditure	-	-	-	-	-	-	**-**	57.6	**57.6**	*3.5*	***61.1***
Total Comprehensive Income and Expenditure	**25.3**	**-**	**(51.3)**	**-**	**-**	**-**	**(26.0)**	**57.6**	**31.6**	***1.0***	***32.6***
Adjustments between Accounting Basis & Funding Basis under Regulations	(25.6)	-	46.1	(0.6)	(0.5)	1.0	**20.4**	(20.4)	**-**	*-*	***-***
Net (Increase)/Decrease before Transfers & Other Movements	**(0.3)**	**-**	**(5.2)**	**(0.6)**	**(0.5)**	**1.0**	**(5.6)**	**37.2**	**31.6**	***1.0***	***32.6***
Transfers to/from other Reserves	20.3	(20.1)	(0.2)	-	-	-	**-**	-	**-**	*-*	***-***
(Increase)/Decrease for the Year	**20.0**	**(20.1)**	**(5.4)**	**(0.6)**	**(0.5)**	**1.0**	**(5.6)**	**37.2**	**31.6**	***1.0***	***32.6***
Balance Carried Forward	**(19.5)**	**(83.6)**	**(10.5)**	**(5.2)**	**(2.3)**	**(36.1)**	**(157.2)**	**(476.4)**	**(633.6)**	***12.6***	***(621.0)***

Movement in Reserves Statement – 2010/2011

	General Fund Balance	General Fund Earmarked Reserves	HRA Balance	Major Repairs Reserve	Usable Capital Receipts Reserve	Capital Grants Unapplied Account	Total Usable Reserves	Unusable Reserves	TOTAL (Council)	*Reserves of Subsidiary*	*TOTAL (Group)*
	£M	£M	£M	£M	£M	£M	£M	£M	£M	*£M*	*£M*
Balance Brought Forward	(31.9)	(50.2)	(3.5)	-	(0.6)	(14.0)	(100.2)	(825.4)	(925.6)	*24.1*	*(901.5)*
Surplus or Deficit on Provision of Services	(96.9)	-	408.0	-	-	-	**311.1**	-	**311.1**	*(6.6)*	***304.5***
Other Comprehensive Income and Expenditure	-	-	-	-	-	-	**-**	(50.7)	**(50.7)**	*(5.9)*	***(56.6)***
Total Comprehensive Income and Expenditure	**(96.9)**	**-**	**408.0**	**-**	**-**	**-**	**311.1**	**(50.7)**	**260.4**	***(12.5)***	***247.9***
Adjustments between Accounting Basis & Funding Basis under Regulations	76.0	0.2	(409.8)	(4.6)	(1.2)	(23.1)	**(362.5)**	362.5	**-**	*-*	***-***
Net Increase/Decrease before Transfers & Other Movements	**(20.9)**	**0.2**	**(1.8)**	**(4.6)**	**(1.2)**	**(23.1)**	**(51.4)**	**311.8**	**260.4**	***(12.5)***	***247.9***
Transfers to/from other Reserves	13.3	(13.5)	0.2	-	-	-	**-**	-	**-**	*-*	***-***
(Increase)/Decrease for the Year	**(7.6)**	**(13.3)**	**(1.6)**	**(4.6)**	**(1.2)**	**(23.1)**	**(51.4)**	**311.8**	**260.4**	***(12.5)***	***247.9***
Balance Carried Forward	**(39.5)**	**(63.5)**	**(5.1)**	**(4.6)**	**(1.8)**	**(37.1)**	**(151.6)**	**(513.6)**	**(665.2)**	***11.6***	***(653.6)***

Cash Flow Statement

2010/2011 Council £M	2010/2011 *Group* *£M*		2011/2012 Council £M	2011/2012 *Group* *£M*
311.1	*304.5*	Net (surplus) or deficit on the provision of services	(26.0)	*(28.5)*
(418.3)	*(413.3)*	Adjust for non-cash movements	(136.7)	*(139.1)*
44.3	*44.3*	Adjust for items that are investing and financing activities	6.6	*6.6*
(62.9)	***(64.5)***	**Net cash flows from operating activities**	**(156.1)**	***(161.0)***
		Comprising:		
28.5	*28.5*	Interest paid	29.0	*29.0*
(0.7)	*(0.7)*	Interest received	(0.7)	*(0.7)*
-	-	Dividends received	(0.6)	*(0.6)*
(90.7)	*(92.3)*	Other operating activities	(183.8)	(188.7)
(62.9)	***(64.5)***	**Net cash flows from operating activities**	**(156.1)**	***(161.0)***
		Investing activities		
132.7	*132.7*	Purchase of property, plant and equipment, investment property and intangible assets	124.0	*124.0*
22.5	*22.5*	Purchase of short-term and long-term investments	627.0	*627.0*
32.7	*32.7*	Other payments for investing activities	0.4	*0.4*
(4.0)	*(4.0)*	Proceeds from the sale of property, plant and equipment, investment property and intangible assets	(6.6)	*(6.6)*
(85.5)	*(85.5)*	Other receipts from investing activities	(642.3)	*(642.3)*
98.4	***98.4***	**Net cash flows from total investing activities**	**102.5**	***102.5***

Cash Flow Statement (continued)

2010/2011 Council £M	2010/2011 *Group* *£M*		2011/2012 Council £M	2011/2012 *Group* *£M*
		Financing activities		
(60.0)	*(60.0)*	Cash receipts of short- and long-term borrowing	(1.6)	*(1.6)*
1.3	*1.3*	Cash payments for the reduction of the outstanding liability relating to finance leases and on-balance sheet PFI contracts	1.2	*1.2*
26.5	*26.5*	Repayments of short-and long-term borrowing	53.3	*53.3*
(1.1)	*(1.1)*	Other payments for financing activities	-	-
(33.3)	***(33.3)***	**Net cash flows from total financing activities**	**52.9**	***52.9***
2.2	***0.6***	**Net (increase) or decrease in cash and cash equivalents**	**(0.7)**	***(5.6)***
		Cash and cash equivalents at the start of the year:		
0.2	*0.2*	- Cash held by the council	0.2	*0.2*
3.9	*8.9*	- Bank current accounts	1.7	*8.3*
4.1	***9.1***		**1.9**	***8.5***
		Cash and cash equivalents at the end of the year:		
0.2	*0.2*	- Cash held by the council	0.2	*0.2*
1.7	*8.3*	- Bank current accounts	2.4	*13.9*
1.9	***8.5***		**2.6**	***14.1***