

Misclassification, misreporting, and public accountability: A government enterprise fund teaching case

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ABSTRACT

The Governmental Accounting Standards Board (GASB), the authoritative body responsible for establishing standards for accounting and financial reporting of state and local governments, believes financial reporting is essential to public accountability for government entities. The financial reporting of state and local governments provides stakeholders with the ability to assess many aspects of a government's operations including the allocation of resources and compliance with budgets and laws. The misclassifying and misreporting of fiscal activities can adversely impact public accountability due to stakeholders having to make important assessments and decisions using information impaired in decision-usefulness. This teaching case has been crafted to provide students with an experiential learning tool to help develop analytical and critical thinking skills while identifying and addressing issues involving the misclassifying and misreporting of fiscal activities of a local government enterprise fund. Demetrius Kingsley, a senior accounting major at a regional university, attends a city council meeting as part of the requirements of the governmental accounting course in which he's currently enrolled. During the meeting, the city manager presents the adopted Fiscal Year 2023 Operating Budget which contains pro forma financial statements. When a financial statement for the city's Water Utilities Fund is selected for emphasis during the presentation, Demetrius notices differences between some of the information presented and what he learned in his governmental accounting course about how such information should be classified and reported. This situation confounds Demetrius and leaves him questioning what he heard in the meeting and what he learned in class.

Keywords: enterprise fund, governmental accounting, public accountability

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FINANCIAL REPORTING ESSENTIAL TO PUBLIC ACCOUNTABILITY

Revenues from taxes derived from non-exchange transactions are the primary means by which governments acquire most of the financial resources needed to run their operations. Given the nature of such transactions with one party (e.g., citizens) giving up financial resources without receiving anything of direct equal value in return from the other party (i.e., government), public accountability becomes very important. The financial reporting function of governments becomes crucial to public accountability, as that function is the primary method by which governments communicate the results of their operations, financial condition, as well as other important aspects of its activities during a reporting period.

The assertion of financial reporting being essential to public accountability has been emphasized for decades by the Governmental Accounting Standards Board (GASB; Allen, 2002). GASB Concept Statement No. 1, which is part of the conceptual framework, emphasizes the governing body's belief that financial reporting is essential to public accountability (GASBCS, 1987). That belief is perennially embraced by the GASB as it periodically reaches out to stakeholders to get a better understanding of their needs as it pertains to assessing accountability and making decisions using information that is the result of financial reporting (GASB Chair Report, 2022). Given financial reporting's importance, accurate reporting provides stakeholders with the information necessary to effectively exercise public accountability. Misclassification and misreporting, however, impairs the ability to do so by impairing the decision-usefulness of the information.

THE CASE

Key Players

Demetrius Kingsley is a graduating senior accounting major at a local regional university in the fictitious city of Seaton, Georgia. He is enrolled in a governmental accounting course. Although he has accepted a full-time employment offer from a Big Four accounting firm, he has developed a keen interest in governmental accounting since being in the course. Additionally, he is performing exceptionally well in classroom activities and on graded assignments.

Chad Lufkin is the city manager and de facto finance director for the city of Seaton, Georgia, a city with a population of approximately 75,000. He has served in those roles for the last five years. As finance director, his office is responsible for financial reporting, and a chief financial officer serves him and aids him with that responsibility. Mr. Lufkin possesses a master's degree in public administration and a bachelor's degree in economics. He possesses no designation/credential in accounting or governmental financial management.

The Scenario

As part of the requirements of his governmental accounting course, Demetrius attends a city council meeting during the month of May. Prior to the meeting, Demetrius downloaded some of the meeting materials from the city's website to his iPad. Those materials included the comprehensive Fiscal Year 2023 Operating Budget for the fiscal year spanning September 1, 2022 through August 31, 2023. That comprehensive document includes pro forma financial statements. The meeting is well attended by stakeholders as evidenced by his barely being able

to find one of the few vacant seats remaining in the room which seats 200 individuals. During the meeting, Mr. Lufkin uses a Microsoft PowerPoint presentation to present the budget along with emphasis on select financial information contained therein. That select information includes the Water Utilities Fund, an enterprise fund that provides water to city residents and businesses. Demetrius uses the budget document downloaded to his tablet to follow along. Once Mr. Lufkin turns his attention to the Water Utilities Fund, Demetrius identifies differences between what he learned in his governmental accounting course regarding the classification and reporting of enterprise fund activities and what Mr. Lufkin is reporting for some of the activities. To be taught one thing in his governmental accounting class and to see something different practiced in the real world presents Demetrius with a dilemma regarding the accuracy of what he heard during the meeting.

Water Utilities Fund Presentation Dilemma

Upon arriving at the part of his PowerPoint presentation on the City of Seaton's proprietary funds, Mr. Lufkin begins with presenting and emphasizing financial information from the Water Utilities Fund which is used by the Water Department, the city's largest department as measured by revenues. First, he provides attendees with a presentation slide providing the definition of enterprise funds and a description of the Water Utilities Fund as presented in the Budget Summary section of the budget as indicated in Table 1 (Appendix). He then proceeds to a slide presenting a financial report entitled "WATER UTILITIES FUND, STATEMENT OF REVENUES, EXPENDITURES, CHANGES IN FUND BALANCE" as indicated in Table 2 (Appendix). As Mr. Lufkin continues with the presentation while providing emphasis on the activities of the Water Utilities Fund, Demetrius identifies a few differences in how some of the activities are classified and reported. Those differences he notices present a dilemma given how he was taught enterprise fund activities should be classified and reported.

Discussion Questions

1. Using Tables 1 and 2, identify at least three discrepancies Demetrius may have noticed of the face of financial statement presented in Table 2.
2. Explain why you believe those items in (1.) are discrepancies.
3. Identify two possible responses or actions Demetrius can take to address the issues.
4. Select the response or action you believe Demetrius should take and explain why.

REFERENCES

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APPENDIX

Table 1
<p>City of Seaton, Georgia Fiscal Year 2022 Operating Budget Budget Summary Excerpt from Fiscal Year 2023 Operating Budget</p>
<p>ENTERPRISE FUNDS</p> <p>Enterprise funds account for and report the business-like operational activities of the Water Utilities Fund and that of the Solid Waste Fund. The intent is for water services as well as sewer and garbage collection services provided to the general public be recouped through user charges.</p> <p>Water Utilities Fund</p> <p>The Water Department oversees the following: (1) the production and sale of potable water for consumption domestically, commercially, and by the fire department; (2) wastewater collection and treatment in defense of public health and the environment; and (3) construction and maintenance of water and sewer infrastructure.</p> <p>The Water Department, as measured by revenues and expenditures, is the largest department within the City’s organizational structure. The Fiscal Year 2022 Budget estimates \$51.4 million in revenues and \$52.2 million in expenditures.</p> <p>A 3% increase in water and sewer rates effective September 1, 2021 is recommended by the Administration.</p>

Table 2

WATER UTILITIES FUND
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE

	Actual FY 2021	Budget FY 2022	Estimated FY 2022	Budget FY 2023
REVENUES:				
Water sales	\$ 39,043,108	\$ 39,500,000	\$ 39,000,000	\$ 40,500,000
Sewer charges	8,657,667	8,700,000	8,000,000	8,900,000
Other	2,415,074	2,300,000	2,000,000	1,950,000
Transfers in	-	3,637,500	3,637,500	-
TOTAL REVENUES	<u>50,115,849</u>	<u>54,137,500</u>	<u>52,637,500</u>	<u>51,350,000</u>
EXPENDITURES:				
Wages	7,542,688	8,009,500	7,994,200	8,261,000
Benefits	4,187,843	4,321,500	4,397,200	4,283,700
Operating expenditures	1,341,228	1,584,500	1,704,800	1,636,500
Repair and maintenance	5,019,700	5,162,700	5,162,600	5,337,000
Utilities	1,768,435	2,138,500	2,126,500	2,209,500
Contract services	3,209,054	4,486,600	4,309,100	4,108,200
Equipment purchases	119,192	65,000	97,900	131,800
Capital Expenditures	1,040,568	2,123,300	1,770,700	1,951,500
Debt service	17,692,334	17,763,200	17,664,900	16,424,700
Payment in lieu of taxes	7,800,000	7,900,300	7,900,300	7,900,100
Transfers to other funds	240,000	1,849,500	1,849,300	-
TOTAL EXPENDITURES	<u>49,961,042</u>	<u>55,404,600</u>	<u>54,997,500</u>	<u>52,244,000</u>
EXCESS (DEFICIT) REVENUES OVER EXPENDITURES	<u>154,807</u>	<u>(1,267,100)</u>	<u>(2,360,000)</u>	<u>(894,000)</u>
BEGINNING FUND BALANCE	<u>14,900,000</u>	<u>14,950,000</u>	<u>15,250,000</u>	<u>12,950,000</u>
ENDING FUND BALANCE	<u>\$ 15,054,807</u>	<u>\$ 13,682,900</u>	<u>\$ 12,890,000</u>	<u>\$ 12,056,000</u>