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## Accounting Questions: Surplus Accountants in a Municipal Balance-Sheet

American Institute of Accountants. Bureau of Information

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## Accounting Questions

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### *SURPLUS ACCOUNTS IN A MUNICIPAL BALANCE-SHEET*

*Question:* Difference of opinion appears to exist as to the advisability of showing a total for the surplus accounts in the consolidated balance-sheet of a municipality. It is generally admitted that such a total does not represent any one definite thing, and some authorities feel that its inclusion in a statement may mislead a reader and cause him to think that the figure represents something which is in the nature of an available asset. This objection exists even in cases where a consolidated municipal balance-sheet is prepared in columnar form and shows the various items included in the total.

Is there any recognized procedure in such cases? Is it wise to take the position that such a balance-sheet is similar to the consolidated balance-sheet of a group of allied corporations and that the same rules of practice should govern? In such commercial statements such totals are universally shown but are readers necessarily misled thereby?

*Answer No. 1:* It appears to us that there is not any single recognized procedure. The dissimilarities between the balance-sheets of municipalities and of business corporations are as important as the likenesses. Any general statement in respect either to points of agreement or of difference may tend to be misleading. Accounting practice in respect to consolidated balance-sheets of commercial companies is pretty well defined and understood. It is, of course, possible for a person to be misled if he consults the consolidated balance-sheet only, without reference to the balance-sheets of subsidiaries, especially if for credit purposes or for the purchase of securities of one of the subsidiaries. This, however, seems not to be a fault of the accounting procedure for consolidated balance-sheets but is due rather to a lack of care or understanding on the part of the reader, who fails to realize or to take into account that an excellent consolidated statement may include some subsidiaries which, considered by themselves, are not in good position. It is generally understood that, despite the merit and usefulness of consolidated balance-sheets, they do not serve

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every purpose but are to be read and studied in conjunction with balance-sheets of the constituent companies.

Coming more definitely to the question as to the advisability of showing a total for the surplus accounts in the consolidated balance-sheet of a municipality, it is necessary to differentiate between kinds of balance-sheets. For example, some municipal statements of financial position carry the property accounts among the assets and the funded indebtedness among the liabilities. Some other statements do not include the valuation of city-owned land, buildings and improvements as part of the stated assets. Various types of balance-sheets are prepared. The standard form of municipal report for towns in the commonwealth of Massachusetts shows two sections of a balance-sheet, namely, current balance-sheet and capital balance-sheet. In the capital balance-sheet, properties are not shown, although the funded debt is. The consequence is there is a balancing amount on the debit side that represents a figure to be compared with the property accounts. If the property accounts exceed that figure, there is a capital surplus.

It would appear to be good procedure to prepare a general balance-sheet showing in respective columns various types of assets and liabilities—for example, assets and liabilities of public service enterprises, general municipal current accounts, general municipal capital accounts and special and trust accounts. Where such a balance-sheet is prepared we see no objection to showing a surplus classified into current and capital surplus, supported by annexed details. It may be, and probably is, somewhat objectionable to submit a consolidated balance-sheet showing a surplus amount without explanation or supporting details. Surplus accounts, as consolidated on the condensed balance-sheet, will include various classes of items, such as unappropriated balances of funds, appropriated balances, cash reserve funds, etc. It is desirable that the balance-sheet be supported by details showing, not only these classifications in summary form, but the balances of the various funds.

*Answer No. 2:* Personally I like to see in a condensed one-page statement a consolidation of the entire accounts of a municipality in summarized form. I do not, however, want to see in such a statement a mingling and consolidation of items which in their nature and application are so different that they can not be mingled without misrepresentation of conditions.

The word "surplus" means simply the excess of one thing over another, and as such its nature must depend on the things which are being compared. In corporate accounts the surplus in general represents the excess of asset accountability over the accountability for liabilities and capital stock. In general any such surplus is available for whatever uses the corporation may wish to make of it. Expenditures for fixed assets may be funded and the proceeds may become available for current expenditures, dividend payments, etc. There are conditions in corporate accounting which call for segregation of certain assets as applicable only to particular purposes so that their amount is not to be reflected in a general surplus. We also must recognize in corporate accounting that any statement of surplus must appropriately take into account provisions of law which would serve to define, classify or limit it.

For corporations we do make consolidated balance-sheets which ignore the separate corporation lines and consider the accounts as a whole, but this is on

the theory that because of affiliated control the assets are subject to considerable general transfer within the group and therefore the consolidated picture is desirable, but always with recognition that it is a consolidated statement of various corporations.

The affairs and accounts of a municipality in most of our states are governed by some quite definite provisions of law. Generally, we have one set of provisions which will govern the current revenue and expenditure accounts, and these provisions are quite different from those which govern the funded liability and capital expenditure accounts or the so-called "trust accounts" of the municipality.

Generally, any surplus of current revenue and expenditure accounts which exists at the end of the year is available or may be made available for the current expenditures of the subsequent year. Such a "surplus," therefore, has a meaning and position in municipal accounts which is quite different from that of a surplus of capital improvements over bonded liability, which would not be at all available for current expenditure accounts. Many of the so-called "trust accounts" carry specific liability for paying out their entire yield, so that they never can have any such surplus as would be available for general town purposes. In some cases there may be trust accounts which can yield a surplus which to some extent and under some conditions might be so applied.

If, then, we ask ourselves what would be the meaning of a consolidated surplus account balance, we would have to admit that it seemed a pretty meaningless figure. Yet it is a figure which might be readily misunderstood and to which a false meaning might readily be attached. This is the reason many object to any showing of consolidated surplus. In some of the states the state authorities in charge of municipal accounts forbid the showing of a consolidated surplus balance. This is the general position taken by the national committee on municipal accounting. (See *Municipal Funds and their Balance-sheets*—preliminary edition, June, 1935.)

Personally, I have no objection to showing a consolidation of surplus accounts so long as the surplus accounts are kindred in their nature and significance. For example, if there is a trust fund available for library purposes, with surplus income of one year which will be available in the next year to meet library expenditures which otherwise would be made from general funds, I see no objection to including this and other similar funds in a consolidated surplus total. This would likewise apply to surplus from the water department or from other operation of utilities, provided such funds were available for current expenditure. On the other hand, I doubt if a municipality, with regard to its capital expenditures, has any real amount which it can state as a "surplus." It will have an amount of total cost, replacement value or current value of its capital assets which are in excess of the amount of its capital liabilities. Yet such cost or values are not going to yield the amount required for payment of the bonded debt, to say nothing of yielding any surplus which may be used otherwise. These capital improvements usually can not be sold or disposed of in any way and usually are not revenue producing. It is true they may constitute wealth to the town and their present existence may avoid the necessity of supplying them out of future revenues. Yet there is nothing in all this which would entitle them to be considered in measuring a "surplus" according to the ordinary conception of the word.

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Accordingly, then, while I like to see a brief, consolidated, summary statement of the entire accounts of the municipality and in such statement or with it would like to see a consolidation of all those surplus accounts which are or might be made available for future current expenditures, I would not want to see in such a consolidated surplus statement a reflection of amounts of capital expenditures or of trust or other accounts which were not in the nature of a real surplus.

Of course, if we only consider as surplus those amounts which are available or are expected to become available for future expenditure, I would have no objection to a consolidated surplus account. If, however, we are going to class as surplus the amounts of capital accounts or of trust accounts which will never become available for any future expenditures, I think we should not mix such so-called surplus accounts with those surplus accounts which are of an entirely different nature.

*Answer No. 3:* It appears to be the accepted practice to prepare separate balance-sheets for the general fund, capital fund, sinking fund and trust funds. The surplus in each fund is therefore shown separately. The general fund surplus (called in New York: "general fund for the reduction of taxation") most nearly resembles the general surplus account of private corporations.

In case all the balance-sheets of a municipality are presented on a single columnar sheet, the amount of surplus applicable to each fund should be readily apparent.

It is poor practice (particularly in view of the careful distinction which must be observed between revenue and capital funds) to present the financial condition of a municipality in a consolidated balance-sheet, without setting forth separately the surplus account applicable to each fund.