PRINCIPLES OF PUBLIC FINANCE

What is the meaning of finance?

- In General
  - Finance is the management of money and other valuables which can easily be converted into cash
- According to experts
  - Finance is a simple task of providing necessary funds (money) required by the business of entities like companies, firms, individuals, and others on the terms that are most favorable to achieve their economic objectives.
- According to Entrepreneurs
  - Finance is concerned with cash. It is so since every business transaction involves cash directly or indirectly.
- According to Academicians
  - Finance is the procurement of funds and effective utilization of funds. It deals with profits that adequately compensate for the cost and risks in result of the business.

What are the types of finance?

- Private Finance
- Personal Finance
- Corporate Finance
- Public Finance

What is public finance?

Public Finance is the study of the income and expenditures of a governmental entity. It deals solely with the finances of the government.

Scope of Public Finance consists in the study of the collection of funds and their allocation between various branches of government activities which are regarded as essential duties or function of that particular government.

What are the different governmental entities?

- Federal Government
- General Purpose Political Subdivisions
  - States
  - Counties
  - Cities
  - Villages
  - Townships
- Special Purpose Subdivisions
  - School Districts
- Public Corporations
  - Toll roads and toll bridges
- Other statutorily created entities

What are some differences in public vs. private entities?

Public Entity	*Private Entity*
Motive to satisfy collective wants of the people	Motive to satisfy personal wants of owners
Income is adjusted to the public expenditure	Income is adjusted to gain an amount of income
Government can make drastic fluctuations in its budget	Deliberate changes in income or expenses in large amounts are not easy

What are some differences in public vs. private entities? (continued)

Public Entity	*Private Entity*
Consideration of future aspect that the entity will probably exist forever	More focused on the present benefits or near future needs
During times of war or depression the government will have a deficit budget	During times of war or depression the private entity can adjust expenses to predict a surplus
Uses of public funds are all public record	uses of private funds are kept by those individuals

What are some differences in public vs. private entities? (continued)

Public Entity	*Private Entity*
Enterprise operations are generally a monopoly	Customers have choices as to which business to purchase from
Managers are elected for a duration and for a particular service	Managers are hired and compensated for profit and performance
Follows standards set by GASB	Follows standards set by FASB

What are the 3 parts of public finance?

- Public Expenditures
- Public Revenues
- Public Debt

What are public expenditures?

The term ***Public Expenditure*** refers to the expenses incurred by the government for its own maintenance and also for the preservation and welfare of the society and economy as a whole. It refers to the expenses of the public authorities, for protecting the citizens and for promoting their economic and social welfare.

What are the 3 categories of federal expenditures?

1. **Discretionary Spending**
   - Congress uses their discretion to decide how much funding to apply to a type of spending. In theory these amounts could go up or down at any time, but there are many sub-categories of discretionary spending that have only continued to rise as the years have gone on.
   - Examples of discretionary spending include the military (accounts for 57% of discretionary spending), education, and Veteran benefits.

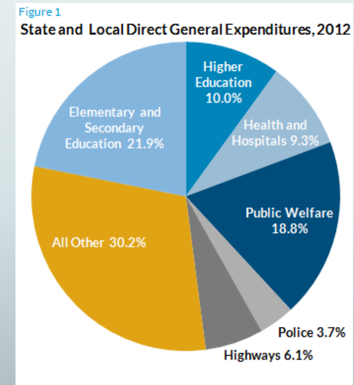
What are the 3 categories of federal expenditures?

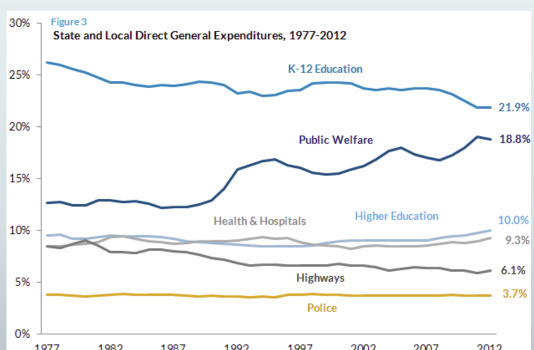
2. **Mandatory Spending**
   - These expenditures are expected to be paid being that they are earned by the individual.
   - Examples of this spending include Social Security (combined with unemployment benefits this makes up 51% of mandatory spending currently) as well as Medicare and other health programs.

What are the 3 categories of federal expenditures?

3. **Interest on Debt**
   - The biggest non-negotiable piece of spending the federal government has is that of interest payments on the debt we hold. Government debt is just like consumer or business debt. It has a principal balance and an interest rate. If you failed to make your credit card payments you would be held in default; the same holds true for the government.

What is the breakdown of state and local expenditures?





What are public revenues?

The term ***Public Revenue*** includes all income and receipts, regardless of source and nature, which the government obtains during any given period of time. This would include loans received by the entity, and all taxes, fees, fines, penalties, gifts, donations, etc..

The main source of public revenue is taxation.

What are the 9 canons of taxation in economics?

1. **Canon of Equality**
   - It implies that tax should be Levied on citizens on the basis of equality. The sacrifice of all citizens must be equal. In the words of Adam Smith "***The subjects of every state ought to contribute towards the support of the Government, as nearly as possible, in proportion to their respective abilities, that is, in proportion to their revenue which they respectively enjoy under the protection of the State***". In other words, this canon of taxation maintains that every person should pay to the State as tax according to Liability to pay. It implies taxing the people on the rate of taxation.

What are the 9 canons of taxation in economics?

2. **Canon of Certainty**
   - This canon of taxation suggests that the tax which an individual has to pay, should be certain and not arbitrary. It should be certain to the lax payer how much tax he has to pay, to whom and by what time the tax is to be paid. The place and other procedural information should also be clear. It would protect the tax payer from the exploitation of tax authorities in any way. It will enable the tax payer to manage his income and expenditure. The Government will also be benefited by this principle.

What are the 9 canons of taxation in economics?

3. **Canon of Convenience or Ease**
   - According to this canon of taxation, every tax should be levied in such a manner and at such a time that it affords to the maximum of convenience to the tax payer. According to Adam Smith, a good taxation policy must be convenient for the tax payer. The reason is that the tax payer for goes his purchasing power and makes a sacrifice at the time of payment of tax hence the Government should see that the tax payer suffers no inconvenience.
     For example, in an agricultural country, tax should be collected only after the harvesting has been done.

What are the 9 canons of taxation in economics?

4. **Canon of Economy**
   - This principle suggests that the cost of collecting tax should be the minimum so that a major part of collections may bring to the Government treasury. If the administration expenses in the collection of taxes consume a major portion of tax revenue collected; it cannot be said to be a good tax system.

In the words of Adam Smith-"Every tax ought to be contrived as both to take out and keep out of pockets of the people as little as possible over and above what it brings, into the public treasury of the State"

What are the 9 canons of taxation in economics?

5. **Canon of Productivity**
   - The theory was expounded by Prof. Bastable. According to this canon of taxation, the tax should be of such a nature as to yield sufficient income to the Government to run the administration efficiently and to work for the welfare of the people. Tax yield is important and every finance minister considers the yield before proposing any new tax. If a tax yields poor income, it cannot be said to be a good and productive tax. It is very often suggested that a few productive taxes are better than to go for a large number of unproductive taxes on the people.

What are the 9 canons of taxation in economics?

6. **Canon or Elasticity**
   - The tax system of the Government should be elastic so that tax burden may be increased or reduced from time to time as and when tile demand for revenue changes. The tax system should have a capacity to respond quickly to the changes in demand for revenue. If the tax system is inelastic, the Government cannot be able to meet various exigencies arise from time to time.

What are the 9 canons of taxation in economics?

7. **Canon of Simplicity**
   - According to this canon of taxation, the tax should not be complicated in its nature. It should be so simple that tax payer can understand its complications without the help of any expert. It would safeguard the tax payer against the exploitation of tax authorities and experts It would also reduce the chance of tax evasion. If the tax is complicated, it will harass the tax payer and instigate him to evade tax. It would also add to legal complications.

What are the 9 canons of taxation in economics?

8. **Canon of Diversity**
   - The cannon requires that there should be a number of taxes of different varieties so that every class of citizen may be called upon to pay something towards the national exchequer. The yield from a number of taxes is more dependable than from anyone. The reason being that a person can manipulate to avoid single tax. But, if the Government imposes a variety of taxes on Persons and commodities, it will be difficult for a people to evade them. Similarly, the tax burden of different types of tax should not centralize on one class of persons. Every person must be Obliged to pay, directly or indirectly, something to the national exchequer.

What are the 9 canons of taxation in economics?

9. **Canon of Desirability or Expediency**
   - A tax should be expedient or desirable so that the Government may defend itself against the public criticism, by advocating its expediency. A tax without any expedient cause will face severe criticism from the tax payers. An unjust tax will always face sharp unwillingness on the part of the tax payers to pay and they will try to evade them, Every new tax must have a justification to create a feeling of acceptance in the mind of the tax-payers. The- above cannons of taxation should be taken into consideration by the Government while considering the levy of. fax. But. the tax system in the world satisfies all the cannons discussed above. It is also not possible to devise a tax system that may satisfy all the cannons of taxation in an adequate measure. The Government should see that its taxation policy satisfies most of the canons of taxation.

What are the 3 types of taxes?

- Proportional Tax
  - as income increases, the percentage of income taxes stays the same
    - City Income Taxes
- Progressive Tax
  - as income increases, the percentage of income taxes increases
    - Federal Income Tax
- Regressive Tax
  - as income increases, the percentage of income taxes decrease
    - State Sales Tax

What is public debt?

The term ***Public Debt*** refers to any and all notes, bonds, or loans acquired by the governmental entity. Each of these notes, bonds, or loans will carry with it an obligation of repayment of the original borrowed amount with applicable interest to the individuals or business in which the funds were derived. This debt can be short term or long term at the discretion of the governmental entity.

When is public debt good?

In the short run, public debt is a good way for governmental entities to achieve a higher level of funding to invest in their economic growth. When used correctly, public debt improves the standard of living within the entity and could promote further boosting of economic growth from private businesses and individuals.

When is public debt bad?

- Governments tend to take on too much debt to spur economic growth and gains support of voters. This in turn drives up interest rates and could become more expensive for entities to refinance existing debt. In time, more funds are applied toward debt repayment and less toward government services.
- To avoid this burden, the entity must find a medium balance between debt and current available resources.

What is fund accounting?

Fund Accounting is an accounting system for recording resources whose use has been limited by the initial intent set forth when acquiring the funds.

Fund Accounting is more focused on accountability than profitability.

A ***fund*** consists of a self-balancing set of accounts and each are reported as either unrestricted, temporarily restricted or permanently restricted based on the provider-imposed restrictions.

An entity can have as many funds as needed.

What are the differences in fund accounting?

Separate Categories

- At its core, fund accounting serves to break down an organization into a series of separate funds. Each fund is examined on its own, so that it has its own balance sheet. This contrasts with traditional business accounting, which measures the finances of an entity as a whole. Generally Accepted Accounting Principles, which are a standard set of principles, guidelines and standards used in the United States, require that governments use fund accounting. This means that the finances of a municipal government, for instance, are broken into different funds and departments, such as public works, police and recreation.

What are the differences in fund accounting?

Tracking Restrictions

- Fund accounting allows groups to manage the diverse streams of revenue that they receive and to monitor the restrictions often attached to that revenue. By breaking up an entity's finances into appropriate funds, fund accounting enables organizations to keep the revenues that it receives in the proper categories and prevents those revenues from being spent on inappropriate expenses. For instance, tax revenues in a government typically can only can go toward funding certain services.

What are the differences in fund accounting?

Evaluation

- Fund accounting provides organizations with the tools to consider how well they are meeting their goals. In the case of a nonprofit charity, for instance, fund accounting provides a view of the organization's relative success providing the service that it was created to provide. It helps identify the sources of an organization's revenue, and it shows how efficiently the organization is transforming those resources into expenses that match the organization's aspirations. Fund accounting highlights areas of strength and weakness, and it documents an organization's assets and debts. As with business accounting, it provides transparency for external audiences, such as donors or taxpayers.

What are the differences in fund accounting?

Planning

- Fund accounting not only shows the organization's current financial standing for external audiences, but it also enables the organization's decision-makers to plan for the future. For one thing, it demonstrates if an organization has funds on hand that can be used moving forward. It also indicates the types and size of the revenues to be expected in a given year, informing the budget for the upcoming year, and it gives context to administrators and others who are planning how much they can accomplish in the given year.

What are the different fund types?

- Governmental Fund Types
  1. General Fund
  2. Special Revenue Fund
  3. Capital Projects Fund
  4. Debt Service Fund
  5. Permanent Fund
- Proprietary Fund Types
  1. Enterprise Fund
  2. Internal Service Fund
- Fiduciary Fund Types
  1. Pension Trust Fund
  2. Investment Trust Fund
  3. Private Purpose Trust Fund
  4. Agency Fund

What are Governmental Fund Types?

- Governmental Fund Types are used to account for tax-supported governmental activities.

- 5 fund types used to account for the government’s governmental activities include
  - General Fund
  - Special Revenue Fund
  - Debt Service Fund
  - Capital Projects Fund
  - Permanent Fund

What are the 5 governmental fund types?

1. **General Fund**
   - The general operating fund and the catch-all category for governmental funds. It includes all government functions that do not belong in some other fund. These general governmental activities normally receive their support from tax revenues. There is never more than 1 general fund.
2. **Special Revenue Funds**
   - The purpose of special revenue funds is to report money reserved for specific purposes. For example, governments sometime use this fund to report federal grants, road work or an emergency fund. This fund does not include trust funds, which come under the fiduciary fund.

What are the 5 governmental fund types?

3. **Debt-Service Funds**
   - Debt-Service Funds account for the accumulation of resources for and the repayment of, general long-term debt principal and interest payments on notes, bonds, and/or loans maturing in the future.
4. **Capital Projects Funds**
   - Capital Projects Funds account for financial resources to be used for the acquisition or construction of major capital facilities and projects (other than those finance by proprietary funds and trust funds).
5. **Permanent Funds**
   - The Permanent Fund is previously know as Non-Expendable Trust Funds. It is used to report resources that are legally restricted to the extend that only earnings, and not principal, may be used for purposes that support the governments purpose.

What are Proprietary Fund Types?

- Proprietary Fund Types account for the government's "business type" activities. Business type activities are those supported by charges or fees for service.
- Proprietary Funds have similar accounting to private sector.
- Two Proprietary Funds are
  - Enterprise Funds
  - Internal Service Funds

What are the 2 proprietary fund types?

1. Enterprise Fund
   - Resources used to supply good and services, for a fee, to users who are entirely or primarily external to the governmental unit.
   - Requirements for activity to be an Enterprise Fund
     - Debt backed by fees and charges
     - Legal requirement to cover full operating costs
     - Policy decision to recover full cost
2. Internal Service Fund
   - Resources used to supply good or services, based on cost reimbursement, within the governmental unit and to other governments.

What are Fiduciary Fund Types?

- Fiduciary Funds report assets held in a trustee or agency capacity for others and therefore cannot be used to support the government's own programs.
- Fiduciary Funds include
  - Pension Fund
  - Investment Trust Fund
  - Private Purpose Trust Fund
  - Agency Fund

What are the 4 Fiduciary Type Funds?

1. ***Pension Trust Fund***
   - Resources held in trust for employee retirement plans and other employee benefit plans.
2. ***Investment Trust Fund***
   - Resources of an external investment pool managed by a sponsoring government.
3. ***Private-Purpose Trust Fund***
   - Resources of all other trust arrangements maintained for benefit of individuals, other governments or private organizations.
4. ***Agency Fund***
   - Resources held in a custodial capacity that must be disbursed according to law or contractual agreement.

What are the minimum revenue account classifications?

1. Fund
2. Source within the fund
   - Taxes
   - Charges for services
   - Fines and forfeits
   - License and permits
   - Interest on investments
   - Intergovernmental revenues

What are the 5 expenditure account classifications?

1. Fund
2. Function/Program
   - Public safety
   - Administration, etc.
3. Organizational Unit
   - Individual Departments
4. Activity
   - Personnel
   - Contractual agreements, etc..
5. Object
   - Individual accounts such as wages or utilities

What is the measurement focus and basis of accounting for the major fund types?

Governmental		X		X
Proprietary	X		X	
Fiduciary	X		X	

What is the flow of economic resources measurement focus?

The "flow of economic resources" measurement focus measures all assets that are available to the entity, not only cash or soon to be cash assets. Both long-term assets and long-term liabilities are measured when using the "flow of economic resources" measurement focus. In addition, depreciation is also recorded as a cost of operations.

What is the current financial resource measurement focus?

When the "flow of current financial resources" measurement focus is used, the focus is on cash and/or assets that are expected to be converted to cash within the accounting period, or shortly thereafter. This measurement looks at whether the financial resources obtained during the accounting period are enough to cover all claims made against the fund during the same period. The distinguishing characteristic of the "flow of current financial resources" measurement focus is that long-term capital assets and obligations are not reported.

What is the cash basis of accounting?

- The Cash Basis of Accounting is an accounting method wherein revenues are recognized when cash is received and expenses are recognized when paid.

What is the accrual basis of accounting?

- Under the accrual basis of accounting, expenses are matched with revenues on the income statement when the expenses expire or title has transferred to the buyer, rather than at the time when expenses are paid.
- The matching principal

What is the modified accrual basis of accounting?

- Modified accrual accounting is an accounting method that combines accrual-basis accounting with cash-basis accounting. Modified accrual accounting recognizes revenues when they become available and measurable and, with a few exceptions, recognizes expenditures when liabilities are incurred. A modified accrual accounting system can also divide available funds into separate entities within the organization to ensure that the money is being spent where it was intended.

What are the contents of a governmental financial report and audit?

- Independent auditor's report
  - The independent auditor's report is found at the beginning of the financial statement report. This is the external auditor's opinion on whether the financial statements are presented fairly and free from material misstatements. You should read the opinion to determine if there are any opinion modifications which bring attention to the adoption of new accounting standards, qualifications (perhaps the entity is not following accepted standards) or other significant matters disclosed within the financial statements.

What are the contents of a governmental financial report and audit? (continued)

- Management's discussion and analysis
  - The MD&A is a multi-page narrative written by the government's management presenting summary information on the government's finances, and includes their analysis of the reasons for significant changes from year to year. The MD&A should clearly present the most significant financial issues. A well-written MD&A can sometimes present the entire story, and the remainder of the financial statements merely support the themes written about in the MD&A.

What are the contents of a governmental financial report and audit? (continued)

- Government-wide financial statements: Statement of net position and statement of activities
  - The first two statements shown in the audit report represent the government as a whole, with separate columns to display all governmental activities separate from the business type activities. Component units (separate legal entities for which the government is financially accountable) are also reported, if any, in a third column. These two statements present a longer-term focus on the government's financial health. They are intended to present the annual cost of providing government services, and whether the taxpayers have (or have not) funded the cost of those services. A positive net position (shown at the bottom of the statement of net position) indicates that the taxpayers have generally funded the cost of services received to date.

What are the contents of a governmental financial report and audit? (continued)

- Governmental funds: Balance sheet and statement of revenue and expenditures
  - The governmental fund statements present a shorter-term focus. The accounting basis is intended to measure how the government spent the resources given to it, and how much it currently has available to spend. When budgets are established, they are compiled at the fund level. Fund balance, then, generally measures how much a government has available to appropriate into the future budgets. Separate activities are accounted for in separate funds, in order to show how specific revenue is being spent. In most cases, the General Fund is the largest fund and accounts for most activities that are not required to be accounted for in other funds such as legally restricted dollars (grants, street funding, etc.) or enterprise activities such as water and sewer. In cities, the general fund accounts for public safety activity as well, but in most townships, the police and fire funds are separate funds as they have separate tax millages to support those activities.

What are the contents of a governmental financial report and audit? (continued)

- Proprietary funds: Statement of net position and statement of revenue, expenses, and changes in net position
- The proprietary funds represent two distinct types of activities:
  - Business-type activities (enterprise funds), where the government is providing a good or service in exchange for fees, and generally the fees are intended to cover the full costs. Examples would be providing water, sewer, electricity, parking, golf or similar recreation, etc.
  - Internal service funds, which are funds created to account for activity that will be "sold" internally to other funds of the government.
- These funds typically are meant to be self-supporting and the positive net position indicates that the customers have paid the full cost of the services provided. However, it is also important to focus on working capital (current assets less current liabilities) to determine the financial health of these types of funds and their ability to stay current on payments.

What are the contents of a governmental financial report and audit? (continued)

- Notes to the financial statements
  - The footnotes to the financial statements provide significant detail to gain a more complete understanding of the government's finances. You will find a brief description of the nature of the government, accounting policies related to specific account balances, details of capital assets (Is the government continuing to invest in infrastructure, critical equipment, etc? One measure is to compare depreciation, which is the using-up of assets to the new asset additions, which are replacing those depleted assets), long-term debt (Are debt balances increasing or decreasing?), and employee benefit obligations (pension and retiree health care).

What are the contents of a governmental financial report and audit? (continued)

- Budgetary comparison schedules
  - The budgetary comparison schedules include the General Fund and each major special revenue fund reported within the financial statements. These schedules show the original budget and the last amended budget, compared to actual results. Significant amounts either over or under budget warrant additional follow up to understand why.

What are the contents of a governmental financial report and audit? (continued)

- Other post employment benefits funding schedules
  - This section contains a schedule to show the history of the funding levels for OPEB. A key is the trend related to the funding ratio. Is it increasing or decreasing? If the government has not put any funding aside in a trust for retiree healthcare, the funding level will remain at zero. Ideally, the trend should be toward increasing the asset balance and either moderating or reducing the liability levels over time. If these two things happen, the funding percentage will move upward.

What are the contents of a governmental financial report and audit? (continued)

- Net pension liability and pension contribution schedules
  - These two schedules focus on the health of the pension plan. Again, the idea is to hopefully show an increase in the funding level over time. In addition, the contribution schedule gives a sense as to whether the annual required contribution is increasing or decreasing over time and whether the entity has made the full contribution.

What are the contents of CAFR?

- Comprehensive Annual Financial Statement
  - Introductory Section
    - General information
    - Letter of Transmittal
  - Financial Section
    - MD&A
    - GAAP Financial Statements
    - Other information not required by GAAP
  - Statistical Section
    - Typically a 10 year comparison
    - Includes charts and graphs to illustrate trend to the user

ENJOY YOUR EVENING!