**UNIT FOUR**

**4. Capital Project fund**

4.1 GENERAL OUTLINE OF CAPITAL PROJECT FUND

Capital project Funds account for financial resources to be used for the acquisition or construction of major capital facilities (other **than those financed by proprietary funds & trust funds)**. Examples: Administration Buildings, Civic Centers and libraries etc. These funds **do not account** for the acquisition of smaller fixed assets, such as **vehicles, machinery & office equipment** which are normally budgeted for & recorded as expenditure in the General fund. It is also possible that a construction project could simply have a **subsidiary ledger within the General fund, rather than its own distinct fund.** The existence of the capital project fund, as any other fund will depend on the legal requirement and the need for good financial management.

***Note*** capital project fund **do not account for the fixed assets acquired only for the construction of the fixed assets. It exists only for the period of acquisition or construction of the fixed assets. After the acquisition or construction is completed, the capital projects fund will be abolished.** The **fixed assets** constructed are accounted for in the **general capital asset account** at the governmental wide level. It does not also account for the repayment & servicing of any debt obligations issued to raise money to finance the acquisition of capital facilities. Such debt & debt related servicing activities are accounted for in the General long term debt accounts & Debt service funds. Since the purpose of capital project fund is to account for **the acquisition and deposition of revenues for specific purpose**, it contains balance sheet accounts for **only liquid assets and for the liabilities** to be liquidated by those assets.

**4.1.1 Operation of Capital Project Funds**

Capital project funds are usually established on **a project – by – project basis**, because legal requirements may **vary** from one project to another. So, the existence of capital project fund as any other fund will depend on the legal requirement & the need for good financial management.

The **focus o**f capital project fund is the entire **life of the project**. It is by definition an expendable fund, and all its resources are expected to be used up. However, capital project funds **do not** have the same year – by – year focus as the General fund. Because of the **multi – year focus** of capital project fund, some accountants prefer not to close a capital project fund annually, but others do. Whether or not to close the capital project fund annually will depend on the unique factors of each case & will be strongly influenced by the requirement of the **financing source.**

**4.1.1.1 Financing Capital Project Funds**

Capital projects obviously need large amount of financing. Typical source of financing includes:

* **Long term** debt issue proceeds
* **Grants** from other governmental units
* **Transfers** from other funds within the governmental entity
* **Interest income** from temporary investments
* **Gifts** from individuals or foundations
* **Special taxes**
* A combination of more than one of the above

Intergovernmental grants, gifts, special taxes & investment interests are considered **as revenues**, whereas, Inter Fund Transfers & Long Term Debt issue proceeds are **not revenues** and are presented as **other financing sources** and are presented that way on the statement of changes in financial position.

Whether to have a **separate capital project funds** for each project or **to account for all capital project funds** in one fund depends in part on what type **of financing** involved. Different bond issues & different inter-governmental transfers might well have **different legal requirements & each might require a separate capital project fund.** On the other hand if one bond issue is used to finance several projects, a single fund may be both permissible and advisable.

**4.1.1.2 Other consideration of CPF**

1. **Means of Acquisition:** Accomplishment of capital acquisition or construction project may be brought about in one or more of the following ways:

1. Outright purchase from Fund’s cash.
2. By construction, utilizing the governmental units own force.
3. By construction, utilizing the services of private contractors.
4. By capital lease agreement.

**2. Costs Included:**  All expenditures for setting the project ready are put in the capital project fund, including **architect fees, transport costs, damages, etc**. Usually, major capital facilities are constructed **by contracted labor**. **Construction costs incurred are charged to expenditures**. At the completion of the project, the **cost of the facility** is recorded as a **fixed asset in the general capital asset account** at the governmental wide level. Until then, any costs incurred are shown as construction work in progress in the general capital asset account. Generally, the year – end closing entry in the capital project fund triggers the recording of an amount in the General capital Asset Account equal to the credit to the expenditures account.

**3. Retained Percentage:** It is common in construction contracts for the entity **to hold back some percentage of the last paymen**t of the contract and to require contractor on large scale contract to give performance bond. This is to prevent the contractor from **doing a poor quality** work, especially in a **rush to finish at** the end. Basically, the entity will pay part of the final sum, and then have its **own engineers come and inspect the contractor’s** work. If the contractor’s work passes the inspection, the balance of the amount owed is paid. If the engineer finds poor quality or undone work, the contractor must then correct the problem before the final retained sum is paid. This amount withhold by the governmental entity is known as **retained percentage.**

**4. Encumbrance:** Some governmental units **include annual capital budgets** as part of their **annual appropriated budget** in which case the **annual capital** is recorded in the general ledgers of the various **capital project funds**. However, since the amount involved in a capital project is **usually large, an encumbrance account is highly recommended & it is necessary in case of multiple subcontractors for a project**. Because of this, an encumbrance accounting procedures alone are usually deemed sufficient for control purposes. So, recording of the budget in the general ledger might **not** be necessary. In capital project fund, **encumbranc**e is also recorded by the same amount in which the construction contract agreement **is made between the governmental unit and the contractor a**nd also in the same manner as that of the general and special revenue fund.

**5. Treatment of Residual Equity or Deficits:** If necessary expenditures & other financing uses are planned & controlled carefully, **actual does not exceed plans**. Revenues & other financing source of the capital project fund should equal or slightly exceed the expenditures and other financing uses leaving a **residual equity (surplus)** and if long term debt had been incurred for the purpose of the capital project fund and under this case, there **are three possible** options;

1. The balance could be transferred **to** the debt service fund, as residual equity transfer for retiring the debt, which has been incurred for the purpose of the project.
2. If the residual equity were deemed to have come **from grants or shared revenues** restricted for capital acquisitions or constructions, legal advice may indicate that any residual equity may return to its source in proportional amount or;
3. The balance might be **retained** for future maintenance purpose.

In some situations, in spite of careful planning and cost control, expenditures and other financing use of a capital project fund may exceed its revenues and other financing source resulting in a negative fund balance (deficit). If the deficit **is small**, an additional transfer will probably be requested from one or more other funds. If the deficit is relatively **large and**/or intended transfers are not feasible, the governmental unit may seek additional grants or shared revenues from other governmental units to cover the deficits. **If no other alternative** is available, the governmental unit would need to finance the deficit by issuing bonds. Under these circumstances, a legal or disciplinary action might have been sought against the project manager, since public money was being used.

**6. Investment:** All the money necessary to pay for capital project is usually raised near the **inception** of the project by issuing bond; but contractors are paid as work in progresses. Excess cash, therefore, may be temporarily invested in high quality interest bearing securities such as: Treasury bills, Bank notes, Certificates of deposit and government bonds with short maturities.

**4.2 Accounting for Capital Project Fund**

Financial activities such as revenues earned and expenditures incurred for the construction or acquisition of capital projects are recorded in almost the **same manner** as that of the General and Special Revenue funds. **At the end of each fiscal year prior to a completion of a capital project**, the Revenues, other financing sources, Expenditures, other financing uses and encumbrance ledger accounts of the capital projects fund are closed to **the unreserved and undesignated fund balance account.**

Upon **completion of the project**, the entire capital project fund is closed by a transfer of any unused cash to the Debt Service fund or to the General fund, as **appropriate.** The **unreserved and undesignated fund** balance ledger account of the receiving fund would be for **Residual equity transfer**. Any cash deficiency in the capital projects fund probably would be made up by a General fund. **This operating transfer would be credited to the other financing sources ledger account of the capital projects fund and debited to the other financing uses account of the general fund**. The assets constructed with the resources of the capital projects fund are **not** included in that funds balance sheet. The **constructed plant** assets are recorded in the **governmental units general capital assets** account at the governmental wide level. Furthermore, the bonds issued to finance the capital projects fund **are not a liability of the fund**. **Prior to** maturity date of the bond, the liability is carried to **the General Long Term Debt account** and when **the bond matures, it will be transferred to Debt service fund**. The following illustration will show how the construction and related activities are accounted for in a capital projects funds.

**Illustration - 4.1**: Assume the town of Burkitu wants to construct a new building on the site owned by the town. The construction is expected to cost Br.50, 000,000. It is expected to be completed within two years on June 30, 2007. In a special meeting held on July 2, 2005, the members of the town council approved a Br. 30,000,000 issuance of general obligation Bonds maturing in 20 years. The proceeds of this sale will be used to help finance the construction of the new building. The remaining Br. 20, 000,000 will be financed by an irrevocable state Grant that has been awarded. The following transactions occurred during the fiscal year ended June 30, 2006.

1. The General fund loaned Br. 500,000 to the building capital projects fund for Drafting, Engineering and other preliminary expenses by receiving a note which is later to be settled from the bond issue proceeds. The journal entry to record this will be:

Cash ------------------------- 500,000

Inter fund loan Payable----- 500,000

1. Out of the irrevocable grant of Br. 20,000,000, the state contributed Br. 5,000,000 and the remaining is deemed to be susceptible to accrual. This will be recorded as

Cash ----------------------- 5,000,000

Due from state grant-------------- 15,000,000

Revenue………………………….. 20,000,000

1. Preliminary Engineering and Planning costs of Br. 320,000 were paid to the contractor.

Construction Expenditure--------- 320,000

Cash ---------------------------- 320,000

1. The Bonds were sold at 101%. The bond indenture agreement requires that any premium to be set aside in the related Debt Service fund.

Cash [101%\*30,000,000] ------------------ 30,300,000

Other Financing source- Bond proceeds ---------- --30,000,000

Due to debt service fund ------------------------------- 300,000

1. The town of Burkitu building capital project fund invested its Br. 10,000,000 bond proceeds on the federal Government treasury bills.

Short Term Investment – Treasury Bills ---------10,000,000

Cash ----------------------------------------- 10,000,000

1. A construction contract for Br. 44,270,000 is authorized and signed with the contractor.

Encumbrances ---------------------44,270,000

Fund balance Reserved for Encumbrances ------ 44,270,000

1. Orders were placed for materials estimated to cost Br.550,000.

Encumbrances ------------- 550,000

Fund Balance Reserved for Encumbrances------- 550,000

1. The materials previously ordered (transaction 7) were received at a cost of Br.510,000.

a) Fund balance reserved for Encumbrance ---- 550,000

Encumbrance --------------------------------550,000

b) Construction expenditure------------------------- 510,000

Construction Payable ----------------------------510,000

1. In addition to the construction contract of transaction 6, Br. 3,900,000 was incurred for the services of the architects and engineers; of this amount Br. 3,100,000 was paid.

Construction expenditure -------------------- 3,900,000

Construction payable --------------------------------- 800,000

Cash ------------------------------------------------- 3,100,000

1. Received cash of Br. 1,000,000 from the General fund as an operating transfer.

Cash -----------------------------------------1,000,000

Other financing source- Operating Transfers In----1,000,000

1. A partial payment of Br.10,000,000 was received from the state irrevocable grants and the General fund loan was repaid with interest amounting to Br.10, 000.

Cash ------------------ 10,000,000

Due from state grant ------------------- 10,000,000

Bond anticipation notes payable------ ----500,000

Interest Expenditure --------------------- 10,000

Cash ---------------------------------- 510,000

1. When the project was approximately half finished, the contractor submitted billing for a payment of 12,000,000.

Fund balance Reserved for Encumbrance------- 12,000,000

Encumbrance ---------------------------------------- 12,000,000

Construction Expenditure---------------------------12,000,000

Construction payable ---------------------------------12,000,000

1. The contractor’s initial claim was fully verified and paid.

Construction payable ----------------------- 12,000,000

Cash---------------------------------------------- 12,000,000

**4.3 Financial Reporting for Capital Project Fund.**

Each capital project fund that meets the definitions of major fund must be reported in a balance sheet and statement of revenue, expenditure and change in fund balance. These two financial statements are prepared for the town of Burkitu after posting and preparing trial balance for the forgoing transactions as follows:

**Town of Burkitu**

**Library Capital Project Fund**

**Trial Balance**

**June 30, 2006**

**Account Title** **Debit Credit**

Cash Br.20,870,000

Short term investment – Treasury Bills 10,000,000

Due from state Grant 5,000,000

Construction payable Br.1, 310,000

Due to DSF 300,000

Fund balance Reserved for encumbrance 32,270,000

Unreserved and Undesignated fund balance -

Revenues 20,000,000

OFS – Bond Proceeds 30,000,000

OFS – Operating transfers 1,000,000

Construction Expéditeurs 16,730,000

Interest expéditeurs 10,000

Encumbrances 32,270,000 \_\_\_\_\_\_\_\_\_

**Total**  Br.84,880,000 Br.84,880,000

**Town of Burkitu**

**Library Capital Projects Fund**

**Statement of Revenues, Expenditures and Changes in Fund Balance**

**For The Year Ended, June 30, 2006**

Revenues:

Irrevocable State grant Br. 20,000,000

Expenditures:

Construction Expenditures Br.16,730,000

Interest Expenditure 10,000 16,740,000

Excess of Revenue over Expenditure 3,260,000

Other financing sources (Uses)

OFS – Bond Issue Proceeds 30,000,000

OFS – Operating transfers in 1,000,000 31,000,000

Excess of Revenue and OFS over Expenditure 34,260,000

Add: Fund balance – July 1, 2005 \_\_\_\_\_-\_\_\_\_

Fund balance – June 30, 2006 Br.34,260,000

**Town of Burkitu**

**Library Capital Projects Fund**

**Balance Sheet**

**June 30, 2006**

**Assets**

Cash Br.20,870,000

Short Term Investment – Treasury bills 10,000,000

Due from state Grant 5,000,000

Total Asset Br. 35,870,000

**Liabilities and Fund Balance**

Construction Payable Br.1,310,000

Due to DSF 300,000

Fund Balance:

Reserved for Encumbrance 32,270,000

Unreserved and undesignated 1,990,000

Total Liabilities and Fund balance Br.35,870,000