
Basic Governmental Accounting

Presented by:

Chip Harris, CPA, Partner

Chester Moyer, CPA, Manager

Ted Williamson, CPA, Manager

Kaleb Lilly, CPA, Manager

September 17, 2008

Course Outline

- ❖ Introduction to Governmental Accounting
- ❖ Principles of Governmental Accounting
- ❖ Financial Statements of Governments (Part 1)
- ❖ **BREAK**
- ❖ Financial Statements of Governments (Part 2)
- ❖ Accounting for Specific Types of Governmental Transactions

Introduction to Governmental Accounting

Presented by:
Chip Harris, CPA, Partner

Who Uses Governmental Accounting?

- ❖ State governments
- ❖ City and county governments
- ❖ Public colleges and universities
- ❖ School districts
- ❖ Police and fire protection districts
- ❖ Water and sewer districts
- ❖ Zoo and museum districts
- ❖ Other special purpose governments

Who Does Not Use Governmental Accounting?

- ❖ Federal government and its departments
- ❖ Private colleges and universities
- ❖ Not-for-profit organizations
- ❖ For-profit businesses

Purposes of Governmental Accounting

- ❖ To maintain accurate records of the government's assets, obligations, and transactions
- ❖ To provide management with the information necessary to make financial decisions
- ❖ To ensure that the government is using the public's financial resources responsibly
- ❖ To ensure that the government is adhering to its legally adopted budget
- ❖ To produce the government's annual financial statements

Who Uses a Government's Financial Statements?

- ❖ Bond rating agencies
- ❖ Bond trustees
- ❖ Federal government (if federal grants are received)
- ❖ GFOA
- ❖ Management
- ❖ Citizens

Who Establishes Accounting Rules?

- ❖ **Federal government** accounting rules are established by the **Federal Accounting Standards Advisory Board (FASAB)**
- ❖ Accounting rules for **for-profit businesses and not-for-profit organizations** are established by the **Financial Accounting Standards Board (FASB)**
- ❖ Accounting rules for **governments** are established by the **Governmental Accounting Standards Board (GASB)**

Governmental Accounting Standards Board (GASB)

- ❖ Establishes “generally accepted accounting principles” or “GAAP” for governments
- ❖ Recognized as the standards-setting body for governments in 1989
- ❖ Periodically issues Statements which contain additions or modifications to existing GAAP
- ❖ GASB staff also issues pronouncements such as Interpretations and Technical Bulletins which clarify certain aspects of GAAP not addressed in the Statements

Governmental vs. For-Profit Accounting

❖ Similarities:

- ▶ Use double-entry system of accounting (debits and credits)
- ▶ Use same five basic types of accounts: assets, liabilities, net assets/equity, revenues, expenses
- ▶ Financial statements include a “balance sheet” or similar statement showing the entity’s financial position as of a point in time

Governmental vs. For-Profit Accounting

❖ Similarities *(cont.)*:

- ▶ Financial statements include an “income statement” or similar statement showing the entity’s financial results over a period of time
- ▶ Financial statements include notes which provide information to supplement the balance sheet and income statement
- ▶ Accrual basis accounting is used, meaning revenues are recorded when earned and expenses when incurred

Governmental vs. For-Profit Accounting

❖ Differences:

- ▶ For-profit statements focus on the business's ability to generate money, while government statements focus on the sound management of public resources
- ▶ For-profit businesses generate most of their income through exchange transactions, while governments generate most of their income through non-exchange transactions such as taxes or grants

Governmental vs. For-Profit Accounting

❖ Differences *(cont.)*:

- ▶ Government financial statements involve fund accounting
- ▶ Certain governmental funds use the “modified accrual” basis of accounting, under which certain long-term transactions are not recorded until cash is received or paid
- ▶ Various additional statements, footnote disclosures, and supplementary information are required for governments

Principles of Governmental Accounting

Presented by:
Chester Moyer, CPA, Manager

Funds and Fund Accounting

- ❖ A “fund” is a fiscal or accounting entity with a self-balancing set of accounts
- ❖ Represents a portion of the government’s financial position or activities that is segregated for a specific purpose or in accordance with special regulations or restrictions
- ❖ A fund contains all of the cash, other financial resources, and related liabilities and activity associated with the objective of the fund

Types of Funds

- ❖ Governmental Funds: Account for the activities typically associated with a government (e.g. levying and collecting taxes, providing services)
- ❖ Proprietary Funds: Account for activities that charge fees to users with the intent that these user charges will offset all expenses
- ❖ Fiduciary Funds: Account for activities where the government holds assets for others in a fiduciary capacity

Types of Governmental Funds

- ❖ General Fund: The primary fund of the government; used to account for all transactions not accounted for in another fund. Governments may only have one general fund.
- ❖ Special Revenue Funds: Used to account for the proceeds of revenues raised for a specific purpose (e.g. a tax levied to benefit public parks, grants received for a specific health or human service purpose)

Types of Governmental Funds

- ❖ Debt Service Fund: Used to account for resources set aside for, and the payment of, general long-term debt principal and interest
- ❖ Capital Projects Fund: Used to account for financial resources to be used for the acquisition or construction of major capital facilities
- ❖ Permanent Fund: Used to account for resources that are legally required to be invested into perpetuity with only the earnings being spent

Types of Proprietary Funds

- ❖ Enterprise Fund: Used to account for activities where fees are charged to **external** users. Examples include airports, water utilities, and parking operations.
- ❖ Internal Service Fund: Used to account for activities where fees are charged to **internal** users. Examples include municipal motor pools or pooled self-insurance programs.

Types of Fiduciary Funds

- ❖ Pension and Employee Benefit Trust Fund: Used to account for assets held in trust under pension plans, defined contribution plans, or other post-employment benefit plans
- ❖ Investment Trust Fund: Used to account for investment pools in which other legally separate governments participate

Types of Fiduciary Funds

- ❖ Private Purpose Trust Fund: Used to account for any other trust arrangement where assets are held for the benefit of individuals, private organizations, or other governments
- ❖ Agency Fund: Used to account for assets held by the government in a temporary, custodial capacity. Examples include bond posted for pending court cases, or property taxes collected on behalf of other governmental entities.

Modified Accrual Basis of Accounting

- ❖ Measurement focus is on **current financial resources**.
- ❖ Revenues and expenditures are only recorded to the extent that they reflect **near-term** inflows and outflows of cash.
- ❖ Liabilities are recorded for expenditures that will be paid in cash in the near-term, such as accounts payable and payroll transactions.

Modified Accrual Basis of Accounting

- ❖ Revenue is accrued only if the proceeds will be available to pay the liabilities of the current period. (Most governments adopt the convention that cash must be received within 60 days of year-end to be recorded as revenue.)
- ❖ Payments of debt principal and interest are recorded as expenditures when paid. Long-term debt liabilities are not recorded.
- ❖ Capital outlays are recorded as recorded as expenditures when paid. Capital assets are not recorded.

“Full” Accrual Basis of Accounting

- ❖ Focus is on the total **economic resources**
- ❖ Similar to the basis of accounting used by for-profit businesses
- ❖ Revenue is always recorded when earned, and expenses are always recorded when incurred
- ❖ Long-term debt is accrued as a liability
- ❖ Capital assets are recorded and depreciated (if applicable)

When Are Bases of Accounting Used?

- ❖ **Governmental funds** use the modified accrual basis of accounting.
- ❖ **Proprietary funds** use the full accrual basis of accounting.
- ❖ **Fiduciary funds** use the full accrual basis of accounting.
- ❖ The **government-wide financial statements** (which will be discussed in Section 2) use the full accrual basis of accounting.

The Financial Reporting Entity

In some instances, GAAP requires governments to include the financial information of other organizations within its financial statements.

- ❖ The **primary government** is the government that is the focus of the financial statements.
- ❖ A **component unit** is a legally separate organization that is required to be included within the primary government's financial statements.

Criteria for Including a Component Unit

A primary government must report another organization as a component unit if **at least one** of the following criteria is met:

- ❖ The primary government appoints a voting majority of the organization's governing board, **and** the primary government is either able to impose its will on the organization or has an ongoing financial benefit or burden relationship with the organization;

Criteria for Including a Component Unit *(cont.)*

- ❖ The organization is fiscally dependent on the primary government; or
- ❖ Excluding the organization from the primary government's financial statements would result in misleading financial reporting.

Ways to Present a Component Unit

There are two ways that a government may present component units in its financial statements:

- ❖ **Blended component units**: The financial position and activity of the component unit is blended with the position and activity of the primary government on the financial statements;
- ❖ **Discretely presented component units**: The financial position and activity of the component unit are presented in a discrete column on the primary government's government-wide financial statements

Criteria for Blending a Component Unit

- ❖ A primary government must report a component unit as blended if **at least one** of the following criteria is met:
 - The governing boards of the primary government and component unit are substantially the same; **or**
 - The component unit provides services entirely or almost entirely for the primary government.
- ❖ All other component units are discretely presented.

Questions



Financial Statements of Governments

Presented by:
Ted Williamson, CPA, Manager

Required Financial Statements

The requirements for government financial statements come from two sources:

- ❖ **GASB Statement No. 34** establishes the requirements for basic financial statements that all governments must follow.
- ❖ The **GFOA** establishes additional requirements for comprehensive annual financial reports (CAFR) for governments that pursue the GFOA's certificate of excellence in financial reporting.

Basic Financial Statements

- ❖ Government-wide financial statements
- ❖ Governmental fund financial statements
- ❖ Proprietary fund financial statements
- ❖ Fiduciary fund financial statements
- ❖ Footnotes
- ❖ Required supplementary information

Government-wide Financial Statements

- ❖ Consist of two statements:
 - ▶ Statement of Net Assets
 - ▶ Statement of Activities
- ❖ Use the full accrual basis of accounting
- ❖ Contain the financial position and results of the entire government, excluding fiduciary funds
- ❖ Also include discretely presented component units

Government-wide Financial Statements

Separate columns or rows are used to present:

- ❖ Governmental activities
- ❖ Business-type activities
- ❖ Discretely presented component units
(Governments may present each DPCU in a separate column or row, or may combine these into one column with supporting detail in an additional statement or the footnotes)

Definitions

❖ Governmental activities:

- ▶ Activities generally financed through taxes, grants or disbursements from other governments, or other nonexchange transactions
- ▶ Consists of activities recorded in governmental funds and internal service funds

❖ Business-type activities:

- ▶ Activities primarily financed by user charges
- ▶ Consists of activities recorded in enterprise funds

Statement of Net Assets

- ❖ Essentially the government-wide “balance sheet”
- ❖ Can use either the “assets - liabilities = net assets” or the “assets = liabilities + net assets” format
- ❖ Should indicate the liquidity of assets and liabilities, either by presenting them in order of liquidity, or by presenting a classified statement of net assets.

Statement of Net Assets *(cont.)*

- ❖ Liabilities with an average maturities of greater than one year should be separated into amounts due within one year and amounts due in more than one year
- ❖ Difference between assets and liabilities is presented as net assets.

Components of Net Assets

Net assets are displayed in three components:

- ❖ **Invested in capital assets, net of related debt:**
Equals capital assets less all debt used to acquire those assets
- ❖ **Restricted net assets:** Equals net assets restricted by external parties or enabling legislation
- ❖ **Unrestricted net assets:** All remaining net assets.

Statement of Activities

- ❖ Essentially the government-wide “income statement”
- ❖ Uses the “net expense” format:
 - Expenses are displayed by function
 - Expenses for each function are reduced by program revenues directly attributable to that function, resulting in a net functional expense
 - General revenues offset expenses for the government as a whole

Expenses

- ❖ All expenses should be displayed by function unless they qualify as “special items” or “extraordinary items”.
- ❖ Depreciation expense should be allocated to each function to the extent possible.
- ❖ Interest expense should be reported as a separate expense line item.
- ❖ Governments may, but are not required to, reallocate indirect expenses out of the “general government” function to the other functions.

Program Revenues

- ❖ Represent the revenue sources that directly fund a specific program
- ❖ Displayed in separate columns as an offset to program expenses
- ❖ Three types of program revenues:
 - ▶ Charges for services
 - ▶ Operating grants and contributions
 - ▶ Capital grants and contributions

General Revenues

- ❖ All revenues other than program revenues
- ❖ Support the operations of the government as a whole (as opposed to a specific function)
- ❖ Displayed at the bottom of the statement of activities after the calculation of “total net expense”
- ❖ All taxes (even taxes levied for a specific purpose) are general revenues.

Special and Extraordinary Items

- ❖ **Extraordinary items**: Transactions or events that are unusual in nature **AND** infrequent in occurrence
- ❖ **Special items**: Transactions or events within the control of management that are either unusual in nature **OR** infrequent in occurrence
- ❖ Displayed at the bottom of the statement of activities after general revenues

EXERCISE #1

BREAK

Governmental Fund Financial Statements

- ❖ Consist of two statements:
 - Balance Sheet
 - Statement of Revenues, Expenditures, and Changes in Fund Balances
- ❖ Use the modified accrual basis of accounting
- ❖ Presents “major funds” and aggregated “nonmajor” funds

Major Funds

- ❖ Essentially the most important funds of the government
- ❖ The general fund is always a major fund.
- ❖ Other funds exceeding the major fund threshold as discussed on the next slide must be reported as major.
- ❖ Governments may choose to present funds not otherwise required to be major as major funds.
- ❖ Major fund criteria do not apply to internal service funds or fiduciary funds.

Major Fund Threshold

A fund must be reported as major if it meets both of the following criteria:

- ❖ Assets, liabilities, revenues, or expenses/expenditures of the fund exceed 10% of the assets, liabilities, etc. of all funds of that type (that is, governmental or enterprise funds);
AND
- ❖ Assets, liabilities, revenues, or expenses/expenditures of the fund exceed 5% of the assets, liabilities, etc. of all governmental and enterprise funds combined

Balance Sheet

- ❖ Displays columns for each major governmental fund, nonmajor governmental funds, and a total column
- ❖ Must use the “assets = liabilities + fund balance” format
- ❖ Interfund assets and liabilities are presented as needed
- ❖ Difference between assets and liabilities is presented as fund balance

Components of Fund Balance

Fund balance is displayed in two components:

- ❖ **Reserved**: Equals the portion of fund balance not available for appropriation, either due to legal restrictions on spending or the illiquidity of assets.
- ❖ **Unreserved**: Equals the portion of fund balance available for appropriation. The government may divide unreserved fund balance into “designated” and “undesignated” sections if so desired.

Statement of Revenues, Expenditures and Changes in Fund Balance

- ❖ Displays columns for each major governmental fund, nonmajor governmental funds, and a total column
- ❖ Presents revenues, expenditures, other financing sources and uses, and special and extraordinary items (as defined previously)
- ❖ Interfund transfers are presented as needed

Statement of Revenues, Expenditures and Changes in Fund Balance *(cont.)*

The following format is required:

Revenues

Expenditures

Excess (deficiency) of revenues over
expenditures

Other financing sources or uses

Special and extraordinary items

Net change in fund balances

Other Financing Sources and Uses

- ❖ Proceeds of long-term debt
- ❖ Issuance premiums or discounts
- ❖ Payments to escrow agents for bond refundings
- ❖ Transfers
- ❖ Sales of capital assets

Reconciliation to Government-Wide Statements

- ❖ Governments are required to include a reconciliation of each governmental fund statement to the corresponding government-wide statement.
- ❖ The reconciliation may be presented at the bottom of each statement, or in separate statements.

Typical Reconciling Items

- ❖ Effect of recording capital assets and depreciation on the government-wide statements vs. capital outlay expense on the governmental funds statements
- ❖ Effect of recording long-term debt liabilities on the government-wide statements vs. debt service expense on the governmental funds statements
- ❖ Effect of recording revenues and expenses on the full accrual basis vs. the modified accrual basis
- ❖ Effect of consolidating internal service funds into governmental activities on the government-wide statements

Proprietary Fund Financial Statements

- ❖ Consist of three statements:
 - ▶ Statement of Net Assets/Balance Sheet
 - ▶ Statement of Revenues, Expenses, and Changes in Fund Net Assets/Equity
 - ▶ Statement of Cash Flows
- ❖ Use the full accrual basis of accounting
- ❖ Presents “major funds” and aggregated “nonmajor” funds (as discussed earlier)
- ❖ Separate presentation of internal service funds

Statement of Net Assets

- ❖ Can use either the “assets - liabilities = net assets” or the “assets = liabilities + net assets” format
- ❖ Must classify assets and liabilities as current and noncurrent
- ❖ Must show net assets in the same three categories as with the government-wide statement

Statement of Revenues, Expenses and Changes in Fund Net Assets

- ❖ Revenues should be reported by major source, net of discounts and allowances
- ❖ Expenses may be presented either by natural classification or functional classification
- ❖ Revenues and expenses should be segregated in operating and nonoperating categories

Statement of Revenues, Expenses and Changes in Fund Net Assets (cont.)

The following format is required:

Operating Revenues

Operating Expenses

Operating Income

Nonoperating Revenues and Expenses

Income Before Capital Contributions and Transfers

Capital Contributions and Transfers

Change in Net Assets

Statement of Cash Flows

The statement of cash flows is divided into four sections:

- ❖ Operating Activities (e.g. receipts from customers, payments to suppliers and employers)
- ❖ Noncapital Financing Activities (e.g. transfers and advances between funds)
- ❖ Capital and Related Financing Activities (e.g. debt and capital asset transactions)
- ❖ Investing Activities (e.g. purchases, sales, and earnings on investments)

Statement of Cash Flows (*cont.*)

- ❖ The operating activities section of the statement of cash flows must be presented using the direct method.
- ❖ A reconciliation of operating income to net cash flows from operating activities must be presented.

Reconciliation to Government-Wide Statements

- ❖ Similar to governmental funds, the proprietary fund statements must be reconciled to the government-wide statements.
- ❖ Generally, there are fewer reconciling items for proprietary funds.
- ❖ The reconciliation may be presented at the bottom of each statement, or in separate statements.

Fiduciary Fund Financial Statements

- ❖ Consist of two statements:
 - Statement of Fiduciary Net Assets
 - Statement of Changes in Fiduciary Net Assets
- ❖ Use the full accrual basis of accounting
- ❖ Concept of major funds is not applicable
- ❖ Instead, statements are organized by type of fiduciary fund: pension and benefit trust funds, investment trust funds, private purpose trust funds, and agency funds

Statement of Fiduciary Net Assets

- ❖ Displays columns for each type of fiduciary fund
- ❖ Does NOT display a total column
- ❖ Must use the “assets - liabilities = net assets” format
- ❖ Net assets are displayed in total only (i.e. the three net asset categories do not apply to fiduciary funds)

Statement of Changes in Fiduciary Net Assets

- ❖ All items increasing fiduciary fund net assets are displayed as “additions”
- ❖ All items decreasing fiduciary fund net assets are displayed as “deductions”
- ❖ Investment expenses are netted against investment income
- ❖ Difference between additions and deductions is change in fiduciary net assets

Reporting of Agency Funds

- ❖ Agency funds represent assets held for others in a temporary fiduciary capacity.
- ❖ By definition, assets always equal liabilities within agency funds.
- ❖ Accordingly, agency funds do not appear on the statement of changes in fiduciary net assets.

Footnotes

- ❖ Provide additional information which supplement the financial statements.
- ❖ Are located immediately after the financial statements within the basic financial statement document.
- ❖ Certain notes are required to be included as part of a “summary of significant accounting policies”.
- ❖ Other notes must be included depending upon the types of assets, liabilities, revenues, and expenses that the government has.

SSAP

Among the items required to be disclosed in the summary of significant accounting policies are the following:

- ❖ Description of any component units included in the financial reporting entity
- ❖ Description of the financial statements and the basis of accounting for each
- ❖ Revenue recognition policies, including period of availability under modified accrual basis
- ❖ Transactions treated as program revenues

SSAP (cont.)

- ❖ Operating vs. nonoperating revenue and expense for proprietary funds
- ❖ Policy for determining cash and cash equivalents
- ❖ Capital asset capitalization policies and asset useful lives
- ❖ Policy for eliminating intra-entity activity on the government-wide statements
- ❖ Inventory method (e.g. FIFO, LIFO, etc.)

Required Supplementary Information

- ❖ Management's Discussion and Analysis
- ❖ Budgetary Comparison Schedules
- ❖ Schedules of Funding Progress for Pension and Other Post-Employment Benefit Plans

Management's Discussion and Analysis

- ❖ Document containing management's analysis of the government's financial results
- ❖ Located in front of the government-wide statements
- ❖ Should focus on primary government only
- ❖ Should contain prior year comparative numbers
- ❖ Must be fact based—**NO subjective language**
- ❖ GAAP identifies certain items that must be discussed. Governments should not discuss items beyond these

Required Elements of MD&A

- ❖ Description of the basic financial statements
- ❖ Condensed government-wide financial info
- ❖ Analysis of government-wide results
- ❖ Analysis of balances and transactions in individual funds
- ❖ Variations between original budget, final budget, and actual expenses for the general fund
- ❖ Description of significant capital asset and debt activity
- ❖ Other important known facts

Budgetary Comparison Schedules

- ❖ Required for the general fund and all major special revenue funds with a legally adopted budget
- ❖ May be presented as a financial statement or as RSI
- ❖ Must display the original budget, the final budget, and actual revenues and expenditures on the budgetary basis of accounting
- ❖ Various footnote disclosures relative to schedule are required

Required Footnote Disclosures

- ❖ The government's budget process
- ❖ Legal level of budgetary control
- ❖ Budget basis of accounting
- ❖ Reconciliation of budget basis of accounting to GAAP
- ❖ Expenditures in excess of appropriations
- ❖ Material budget violations (always disclosed in the footnotes to the financial statements)

Schedule of Funding Progress

- ❖ Required for pension plans and other post-employment benefit plans
- ❖ Indicates the extent to which the government is funding its pension and post-employment benefit obligations as calculated by an actuary
- ❖ Required for the current fiscal year and the two preceding fiscal years

CAFR

- ❖ Stands for “Comprehensive Annual Financial Report”
- ❖ Required for government’s pursuing the GFOA’s certificate of excellence in financial reporting
- ❖ Consist of three sections:
 - ▶ Introductory Section
 - ▶ Financial Section
 - ▶ Statistical Section

Introductory Section

- ❖ Letter of transmittal
- ❖ Prior year's GFOA certificate of achievement for excellence in financial reporting (if applicable)
- ❖ List of principal officials
- ❖ Organizational chart

Financial Section

- ❖ Basic financial statements as described earlier
- ❖ Other supplementary information:
 - Combining schedules of nonmajor funds
 - Combining schedules of internal service funds and fiduciary funds
 - Statement of changes in assets and liabilities of agency funds
 - Budgetary comparison schedules for all governmental funds not presented in RSI

Statistical Section

- ❖ Charts of statistics covering last ten fiscal years
- ❖ These general categories are covered:
 - ▶ Financial Trends
 - ▶ Revenue Capacity
 - ▶ Debt Capacity
 - ▶ Demographic and Economic Information
 - ▶ Operating Information

Questions



Accounting for Specific Types of Governmental Transactions

Presented by:

Kaleb Lilly, CPA, Manager

Transactions To Be Covered

- ❖ Revenue Recognition
- ❖ Cash and Investments
- ❖ Capital Assets
- ❖ Long-Term Debt
- ❖ Pension and Other Post-Employment Benefits

Revenue Recognition

Governmental revenue transactions are divided into five basic categories:

- ❖ Exchange and exchange-like transactions
- ❖ Derived tax revenues
- ❖ Imposed non-exchange revenues
- ❖ Voluntary non-exchange transactions
- ❖ Government-mandated nonexchange transactions

Exchange and Exchange-like

- ❖ **Definition:** Transactions where each party gives and receives essentially equal value
- ❖ **Examples:** User fees, parks and recreation fees, license and permit fees
- ❖ **Revenue Recognition:** When the exchange occurs
- ❖ **Asset Recognition:** When the exchange occurs

Derived Tax Revenues

- ❖ **Definition:** Assessments imposed on the exchange transactions of others
- ❖ **Examples:** Sales taxes, income taxes
- ❖ **Revenue Recognition:** When the underlying exchange transaction occurs
- ❖ **Asset Recognition:** When the underlying exchange transaction occurs or resources are received, whichever is first

Imposed Non-Exchange Revenues

- ❖ **Definition:** Assessments imposed on non-governmental entities other than assessments on exchange transactions
- ❖ **Examples:** Property taxes, fines
- ❖ **Revenue Recognition:** In the period when use of the resources are required or first permitted
- ❖ **Asset Recognition:** When the government has an enforceable legal claim to the resources or when the resources are first received, whichever is first

Voluntary and Government-Mandated Non-Exchange Transactions

- ❖ **Definition:** Agreements other than exchanges entered into willingly (voluntary) or imposed by one government on another (government-mandated)
- ❖ **Examples:** Grants, Donor Contributions
- ❖ **Revenue Recognition:** When all eligibility requirements are met
- ❖ **Asset Recognition:** When all eligibility requirements are met or resources are first received, whichever is first

Eligibility Requirements

- ❖ **Required Characteristics of Recipients:** The recipient is the type of entity specified in the agreement
- ❖ **Time Requirements:** The period when the resources are required or first permitted to be used has begun
- ❖ **Reimbursements:** The government has already made the disbursements for which it is requesting reimbursement
- ❖ **Contingencies:** The transaction is not contingent on any external factors

Impact of Accounting Basis

- ❖ For **full accrual** statements, revenue recognition requirements are as described on the previous slides
- ❖ For **modified accrual** statements, in addition to the recognition requirements described on the previous slides, the revenue must also be available to pay to meet the current period's liabilities (usually within 60 days of year end)

Cash and Investments

- ❖ Governments report investments at **fair value** (i.e. market value including unrealized gains)
- ❖ Governments must disclose what they define as a “cash equivalent” (e.g. investments with an original maturity of less than 90 days)
- ❖ Cash and investments in an investment pool should be allocated to each participating fund for purposes of the financial statements
- ❖ “Negative cash” should never be displayed— instead, interfund balances should be used to resolve negative cash

Cash and Investment Disclosures

- ❖ Must disclose balances by type of instrument
- ❖ This disclosure should reconcile to the basic financial statements
- ❖ Must also discuss the government's investment policy
- ❖ Must disclose the government's exposure to various cash and investment risks

Cash and Investment Risk Disclosures

- ❖ **Interest Rate Risk:** Categorize the government's interest-bearing instruments by maturity date
- ❖ **Credit Risk:** Disclose the credit rating of all instruments other than those guaranteed by the federal government
- ❖ **Concentration of Credit Risk:** Disclosure is needed if more than 5% of the government's investments are invested in the securities of a single issuer (other than instruments guaranteed by the federal government)

Cash and Investment Risk Disclosures

- ❖ **Custodial Credit Risk:** Disclose the balance of uninsured and unregistered investments held by a counterparty or by the counterparty's trust department but not in the name of the government
- ❖ **Foreign Currency Risk:** Disclose by investment type the balance of investments denominated in a foreign currency

Capital Assets

Capital assets for governments include:

- ❖ Land
- ❖ Buildings and building improvements
- ❖ Vehicles
- ❖ Equipment and machinery
- ❖ Infrastructure
- ❖ Works of art and historical treasures
- ❖ Construction in progress

Recording of Capital Assets

- ❖ On the modified accrual basis, capital assets are not recorded. Instead, capital outlay expenditures are recorded when capital assets are purchased.
- ❖ On the full accrual basis, capital assets are capitalized and recorded at historical cost.
- ❖ Governments must present a rollforward of capital assets (beginning of year assets + additions – deletions = end of year assets) by type of asset in the footnotes.

Depreciation of Capital Assets

- ❖ Most capital assets (buildings and building improvements, vehicles, equipment, machinery) must be depreciated over their useful lives.
- ❖ Land is never depreciated.
- ❖ Construction in progress is not depreciated until it is placed in service.
- ❖ Infrastructure is depreciated unless the “modified approach” is used.
- ❖ Works of art and historical treasures are depreciated unless certain criteria are met.

Modified Approach

- ❖ Do not need to depreciate infrastructure
- ❖ Government must have an asset management system that encompasses the following:
 - Up-to-date inventory of infrastructure assets
 - Performs condition assessments on infrastructure and summarize the results
 - Estimates annual maintenance costs
- ❖ Government must document the condition level to which infrastructure is being maintained.

Works of Art Criteria

Governments are not required to capitalize and depreciate works of art if **ALL** of the following criteria are met:

- ❖ The collection is held for public exhibition, education, or research (not for financial gain);
- ❖ The collection is protected, kept unencumbered, cared for and preserved; **AND**
- ❖ The government has a policy that proceeds from sales of collection items must be used to acquire other collection items

Long-Term Debt

- ❖ On the modified accrual basis, long-term debt is not recorded. Instead, debt proceeds are recorded as an other financing source, and principal payments are recorded as an expense.
- ❖ On the full accrual basis, long-term debt is capitalized and recorded at historical cost.
- ❖ Governments must separately present long-term debt due within a year and long-term debt due in more than one year.

Interest Expense, Discounts, Premiums, and Issuance Costs

- ❖ On the **full accrual** basis, interest expense is recorded as incurred.
- ❖ On the **full accrual** basis, discounts, premiums, and issuance costs are capitalized and amortized over the life of the bonds.
- ❖ On the **modified accrual** basis, interest and bond issuance costs are recorded as expenditures when paid.
- ❖ On the **modified accrual** basis, discounts and premiums are recorded as other financing sources and uses.

Tax Increment Financing (TIF)

- ❖ Frequently used to redevelop blighted areas.
- ❖ The government issues notes to a developer, promising to repay a portion of the project costs.
- ❖ The notes are repayable only from the incremental property and sales tax revenue generated by the development.
- ❖ Even though the government does not receive an asset as part of this transaction, TIF debt **IS** considered a liability of the government and must be included in long-term debt.

Debt Refundings

- ❖ New debt is issued at a lower interest to pay off old debt issued at a higher interest rate
- ❖ **Current refunding:** The old debt is legally retired
- ❖ **Advance refunding:** The proceeds of the new debt are placed in escrow to pay off the old debt as installments come due
- ❖ Under either scenario, the new debt is added to long-term debt. The old debt and the proceeds of the new debt are removed from the financial statements. The difference is amortized over the life of the new bonds.

Long-Term Debt Disclosures

- ❖ Must present a rollforward of long-term debt
- ❖ Must disclose significant terms of outstanding debt (e.g. purpose of debt, interest rate, maturity dates, associated debt covenants)
- ❖ Must disclose principal and interest requirements for each of the next five years and in five year increments thereafter
- ❖ Must disclose differential in debt service requirements and economic gain between refunded debt and the new debt

Pension and OPEB Benefits

Pension and other post-employment benefits (OPEB) fall into two basic categories:

- ❖ **Defined Benefit:** The amount of future benefits to be provided to employees are specified. (Usually the amount is based on the employee's age, years of service, or salary.)
- ❖ **Defined Contribution:** The amount to be contributed toward to the employees' account is specified. The employee is entitled to whatever these contributions happen to earn.

Accounting Requirements

- ❖ For **defined contribution** plans, only disclosures are necessary.
- ❖ For **defined benefit** plans, in addition to disclosures, an asset or liability may be necessary as demonstrated on the following slide.
- ❖ This asset or liability is only recorded on the **full accrual** basis of accounting.
- ❖ When a trust account has been established, the account's assets, liabilities, and activities are recorded in a pension trust fund.

Defined Benefit Plan Asset/Liability

The net pension/OPEB obligation/asset is calculated as follows:

- Actuarially required contribution for this year
- + Interest on beginning of year balance
- Actuarial adjustment to beginning of year balance
- Amount actually contributed to the plan
- Current year change in obligation/asset
- + Beginning of year balance
- End of year obligation/asset

Required Disclosures

- ❖ Description of the plan
- ❖ Funding policy
- ❖ Amount contributed by employer and employees in the current year
- ❖ Actuarial assumptions (defined benefit plans only)
- ❖ Historical trend information for current year and two previous years, showing the percentage of the actuarially required contribution that was made (defined benefit plans only)

Questions



EXERCISE #2
