

2016

Wiley

GAAP_{FOR} GOVERNMENTS

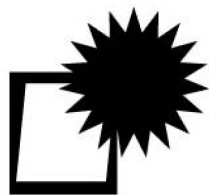
Interpretation and Application of
GENERALLY ACCEPTED
ACCOUNTING PRINCIPLES
for State and Local Governments

Warren Ruppel

WILEY

WILEY

GAAP for
Governments
2016



Subscriber Update Service

BECOME A SUBSCRIBER!

Did you purchase this product from a bookstore?

If you did, it's important for you to become a subscriber. John Wiley & Sons, Inc. may publish, on a periodic basis, supplements and new editions to reflect the latest changes in the subject matter that you ***need to know*** in order stay competitive in this everchanging industry. By contacting the Wiley office nearest you, you'll receive any current update at no additional charge. In addition, you'll receive future updates and revised or related volumes on a thirty-day examination review.

If you purchased this product directly from John Wiley & Sons, Inc., we have already recorded your subscription for this update service.

To become a subscriber, please call **1-877-762-2974** or send your name, company name (if applicable), address, and the title of the product to

mailing address:

**Supplement Department
John Wiley & Sons, Inc.
One Wiley Drive
Somerset, NJ 08875**

e-mail:

subscriber@wiley.com

fax:

1-732-302-2300

online:

www.wiley.com

For customers outside the United States, please contact the Wiley office nearest you:

Professional & Reference Division
John Wiley & Sons Canada, Ltd.
22 Worcester Road
Etobicoke, Ontario M9W 1L1
CANADA
416-236-4433
Phone: 1-800-567-4797
Fax: 416-236-4447
Email: canada@jwiley.com

John Wiley & Sons Australia, Ltd.
33 Park Road
P.O. Box 1226
Milton, Queensland 4064
AUSTRALIA
Phone: 61-7-3859-9755
Fax: 61-7-3859-9715
Email: brisbane@johnwiley.com.au

John Wiley & Sons, Ltd.
The Atrium
Southern Gate, Chichester
West Sussex, PO19 8SQ
ENGLAND
Phone: 44-1243-779777
Fax: 44-1243-775878
Email: customer@wiley.co.uk

John Wiley & Sons (Asia) Pte. Ltd.
2 Clementi Loop #02-01
SINGAPORE 129809
Phone: 65-64632400
Fax: 65-64634604/5/6
Customer Service: 65-64604280
Email: enquiry@wiley.com.sg

WILEY

GAAP for Governments 2016

Interpretation and Application of
GENERALLY ACCEPTED
ACCOUNTING PRINCIPLES
for State and Local Governments

Warren Ruppel

WILEY

This edition first published 2016
© 2016 John Wiley & Sons Ltd

Registered office

John Wiley & Sons Ltd, The Atrium, Southern Gate, Chichester, West Sussex, PO19 8SQ, United Kingdom.

For details of our global editorial offices, for customer services and for information about how to apply for permission to reuse the copyright material in this book please visit our website at www.wiley.com.

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, except as permitted by the UK Copyright, Designs and Patents Act 1988, without the prior permission of the publisher.

Wiley publishes in a variety of print and electronic formats and by print-on-demand. Some material included with standard print versions of this book may not be included in e-books or in print-on-demand. If this book refers to media such as a CD or DVD that is not included in the version you purchased, you may download this material at <http://booksupport.wiley.com>. For more information about Wiley products, visit www.wiley.com.

Designations used by companies to distinguish their products are often claimed as trademarks. All brand names and product names used in this book are trade names, service marks, trademarks or registered trademarks of their respective owners. The publisher is not associated with any product or vendor mentioned in this book.

Limit of Liability/Disclaimer of Warranty: While the publisher and author have used their best efforts in preparing this book, they make no representations or warranties with respect to the accuracy or completeness of the contents of this book and specifically disclaim any implied warranties of merchantability or fitness for a particular purpose. It is sold on the understanding that the publisher is not engaged in rendering professional services and neither the publisher nor the author shall be liable for damages arising herefrom. If professional advice or other expert assistance is required, the services of a competent professional should be sought.

ISBN 978-1-118-97990-7 (pbk) ISBN 978-1-118-97992-1 (ebk)
ISBN 978-1-118-97993-8 (ebk) ISBN 978-1-118-97994-5 (ebk)

Set in 10/12pt TimesLTStd by Thomson Digital, Noida, India
Printed in the United States of America by Bind Rite

CONTENTS

	Preface	vii
	About the Author	ix
1	New Developments	1
2	Foundations of Governmental Accounting	11
3	Fund Accounting Fundamentals	33
4	General Fund and Special Revenue Funds	53
5	Capital Projects Funds	65
6	Debt Service Funds	77
7	Proprietary Funds	85
8	Fiduciary Funds	97
9	Financial Statements Prepared by Governments	103
10	The Importance of Budgets to Governments	169
11	Definition of the Reporting Entity	181
12	Cash and Investments—Valuation and Disclosures	225
13	Derivative Instruments	269
14	Capital Assets	295
15	Debt and Other Obligations	321
16	Landfill Closure and Postclosure Care Costs	359
17	Postemployment Benefits—Pension and Other	369
18	Compensated Absences	421
19	Accounting for Leases	431
20	Nonexchange Transactions	451
21	Risk Financing and Insurance-Related Activities/Public Entity Risk Pools	465
22	Pension and OPEB Plan Financial Statements	491
23	Educational and Other Governmental Entities	567
	Appendix: Disclosure Checklist	581
	Index	623

PREFACE

Governmental accounting is a specialized area that has undergone significant changes over the past few decades. As governmental accounting standards have developed, the complexities of preparing financial statements for governmental entities have greatly increased. Providing meaningful financial information to a wide range of users is not an easy task. Adding to these challenges, the Governmental Accounting Standards Board (GASB) brought sweeping changes to the governmental financial reporting model and is now continuing the process of addressing many important accounting areas related to that model.

Given this rapidly changing environment, the financial statement preparer needs a technical resource that provides more than accurate, competent technical information. The resource needs to be written to fit today's governmental accounting environment. It needs to take a fresh look at some of the long-standing accounting questions faced by governments and to provide meaningful up-to-date information on recently issued and soon-to-be-issued accounting pronouncements.

The purpose of this book is to meet these needs by providing a useful, complete, and practical guide to governmental accounting principles and financial reporting. Throughout, the book will provide the reader with:

- An understanding of the concepts and theories underlying each topic discussed.
- A complete, authoritative reference source to assure the reader that all aspects of a particular topic are covered.
- Practical guidance to allow financial statement preparers and auditors to meet the requirements of generally accepted accounting principles for governments and to efficiently and effectively implement new requirements.

The approach used in this book is to provide the reader with useful information in a usable format. Accounting theory must correspond with practical examples to be useful, because theory seldom matches the specific situation. For technical information to be usable, it must be clearly presented without clutter and unnecessary repetition. The substance of accounting requirements must also be understood in order for them to be properly applied. Understanding the reasons why technical requirements exist is an important ingredient in properly applying accounting standards.

The 2016 edition of this book begins with an overview of governmental accounting principles and a description of the various types of funds currently in use by governmental entities. It then describes basic financial statements and provides guidance for reporting various assets, liabilities, revenues and expenses/expenditures. Finally, it examines the accounting and financial reporting requirements for several specific types of governmental entities. The book also includes a "Disclosure Checklist," which should prove very helpful in determining the completeness of a governmental entity's financial statement disclosures.

This book would not have come to fruition without the hard work and perseverance of a number of individuals. John DeRemigis of John Wiley & Sons had the confidence to work with me in developing the original concept for the book and in ensuring its continuing quality and success. Pam Reh's efforts in producing past editions of the book are greatly appreciated, as are the current members of the Wiley team.

Of course, the time and effort needed to write and maintain this book would not be possible without a supportive family, for which I am grateful to my wife Marie, and my sons Christopher and Gregory.

Warren Ruppel, CPA
Woodcliff Lake, NJ
August 2015

ABOUT THE AUTHOR

Warren Ruppel, CPA, is a Partner at Marks Paneth LLP, New York, in the firm's Nonprofit and Government Group. He formerly was the assistant comptroller for accounting of The City of New York, where he was responsible for all aspects of the City's accounting and financial reporting. He has over thirty years of experience in governmental and not-for-profit accounting and financial reporting. He began his career at KPMG after graduating from St. John's University, New York. His involvement with governmental accounting and auditing began with his first audit assignment—the second audit ever performed of the financial statements of The City of New York. From that time he served many governmental and commercial clients until he joined Deloitte & Touche in 1989 to specialize in audits of governments and not-for-profit organizations. Mr. Ruppel has also served as the chief financial officer of an international not-for-profit organization.

Mr. Ruppel has served as an instructor for many training courses, including specialized governmental and not-for-profit programs and seminars. He has also been an adjunct lecturer of accounting at the Bernard M. Baruch College of the City University of New York. He is the author of five other books, *OMB Circular A-133 Audits*, *Not-for-Profit Organization Audits*, *Not-for-Profit Accounting Made Easy*, *Government Accounting Made Easy*, and *Not-for-Profit Audit Committee Best Practices*. He is also the government specialist for SmartPros online *CPA Report*, in which he appears quarterly to provide a governmental accounting and auditing update.

Mr. Ruppel is a member of the American Institute of Certified Public Accountants as well as the New York State Society of Certified Public Accountants, where he serves on the Board of Directors and chairs its Audit Committee. He also serves on the Governmental Accounting and Auditing Committee and is a past President of the Foundation for Accounting Education. He is a past president of the New York Chapter of the Institute of Management Accountants. Mr. Ruppel is a member of the New York State Government Finance Officers Association, where he serves on its Accounting, Auditing and Financial Reporting Committee. He also serves on the Special Review Committee of the national Government Finance Officers Association. In addition, he is a member of the Executive Advisory Board to the Department of Accounting and Taxation of St. John's University.

1 NEW DEVELOPMENTS

Introduction	1	Preliminary Views	4
Recently Issued GASB Statements and Their Effective Dates	1	Preliminary Views— <i>Leases</i>	4
Exposure Drafts	2	Definition of a Lease	5
Exposure Draft— <i>Implementation Guide No. 20XX-1</i>	2	Lease Term	5
Effective Date	3	Lessee Accounting	5
Exposure Draft— <i>Accounting and Financial Reporting for Irrevocable Split-Interest Agreements</i>	3	Lessor Accounting	6
Exposure Draft— <i>Blending Requirements for Certain Component Units—An Amendment of GASB Statement No. 14</i>	3	Short-Term Lease Exception	6
Exposure Draft— <i>Accounting and Financial Reporting for Certain External Investment Pools</i>	4	Lease Terminations and Modifications	6
		Subleases and Leaseback Transactions	6
		Leases with Related Parties and Intra-Entity Leases	6
		Preliminary Views— <i>Financial Reporting for Fiduciary Responsibilities</i>	7
		GASB Project Plan	8
		Summary	9

INTRODUCTION

The 2016 Governmental GAAP Guide incorporates all of the pronouncements issued by the Governmental Accounting Standards Board (GASB) through August 2015. This chapter is designed to keep the reader up to date on all pronouncements recently issued by the GASB and their effective dates, as well as to report on the Exposure Drafts, Preliminary Views, and Invitations to Comment for proposed new statements or interpretations that are currently outstanding. This chapter also includes relevant information on the GASB's Technical Agenda for the upcoming year to give readers information as to potential areas for future GASB requirements.

RECENTLY ISSUED GASB STATEMENTS AND THEIR EFFECTIVE DATES

	<i>GASB Statement</i>	<i>Effective Date</i>	<i>Where in this book</i>
68	<i>Accounting and Financial Reporting for Pensions— An Amendment of GASB Statement No. 27</i>	Periods beginning after June 15, 2014	Chapter 17
69	<i>Government Combinations and Disposals of Government Operations</i>	Periods beginning after December 15, 2013	Chapter 11
70	<i>Accounting and Financial Reporting for Nonexchange Financial Guarantees</i>	Periods beginning after June 15, 2013	Chapter 15

71	<i>Pension Transition for Contributions Made Subsequent to the Measurement Date – An Amendment of GASB Statement No. 68</i>	Periods beginning after June 15, 2014 – to be applied simultaneously with GASB 68	Chapter 17
72	<i>Fair Value Measurement and Application</i>	Periods beginning after June 15, 2015	Chapter 12
73	<i>Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68</i>	Fiscal years beginning after June 15, 2016 for pensions not within the scope of GASB 68 Fiscal years beginning after June 15, 2015 for asset reporting and GASB 67 and 68 Amendments	Chapter 17
74	<i>Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans</i>	Fiscal years beginning after June 15, 2016	Chapter 22
75	<i>Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions</i>	Fiscal years beginning after June 15, 2017	Chapter 17
76	<i>The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments</i>	Periods beginning after June 15, 2015	Chapter 2
77	<i>Tax Abatement Disclosures</i>	Periods beginning after December 15, 2015	Chapter 9
	<i>Concepts Statement No. 6 Measurement of Elements of Financial Statements</i>	N/A –for use by GASB in setting future standards	Chapter 2

The GASB has a number of Exposure Drafts and Preliminary Views that it has issued which will affect future accounting and financial reporting requirements when final standards are developed. The following provides a brief synopsis of what is being covered by each Exposure Draft and Preliminary Views document. Readers should always be aware that the GASB often modifies proposal stage literature based upon its continuing deliberations and consideration of comments that it receives on each Exposure Draft and Preliminary Views Document.

EXPOSURE DRAFTS

Exposure Draft—Implementation Guide No. 20XX-1

In December 2014 the GASB issued two Exposure Drafts related to the amendment of the GAAP hierarchy for governments. Under the first Exposure Draft, the GAAP hierarchy would be as follow:

The sources of authoritative GAAP are categorized in descending order of authority as follows:

- a. Officially established accounting principles—Governmental Accounting Standards Board (GASB) Statements.
- b. GASB Technical Bulletins; GASB Implementation Guides; and literature of the American Institute of Certified Public Accountants (AICPA) if specifically cleared by the GASB.

The GASB issued GASBS 76. The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments which is effective for periods beginning after June 15, 2015.

This Exposure Draft related to the Implementation Guides is an updated, cumulative implementation guide which, given its higher level of authority in the GAAP hierarchy, had to go through the due process procedures.

Effective Date

The requirements of GASBS 76 are effective for periods beginning after June 15, 2015, with earlier application encouraged. When issued the Implementation Guide Exposure Draft is expected to have the same implementation date.

Exposure Draft—Accounting and Financial Reporting for Irrevocable Split-Interest Agreements

This Exposure Draft was issued in June 2015 to address the accounting and financial reporting for irrevocable split-interest agreements. The requirements are similar to those used by not-for-profit organizations for similar type agreements, except for the recognition of deferred inflows of resources. These accounting requirements will more likely affect governmental colleges and universities as well as governmental hospitals, which are the most common recipients of these types of contributions.

Split-interest agreements are a specific type of giving arrangement used by donors to provide resources to two or more beneficiaries, including governments. Split-interest agreements can be created through trusts or equivalent arrangements under which a donor transfers resources to an intermediary to hold and administer for the benefit of the government and at least one other beneficiary. Examples of these types of arrangements include charitable lead trusts, charitable remainder trusts, charitable annuity gifts, and life-interests in real estate.

The accounting requirements resulting from this Exposure Draft would require that a government that receives resources pursuant to an irrevocable split-interest agreement recognize assets, liabilities, and deferred inflows of resources.

In addition, Exposure Draft would require that a government recognize as assets beneficial interests in irrevocable split-interest agreements that are administered by a third party, if those beneficial interests are under the control of the government and embody present service capacity.

The requirements of the Statement expected from this Exposure Draft are expected to be effective for financial statements for periods beginning after December 15, 2016, and would be applied retrospectively. Earlier application is expected to be encouraged.

Exposure Draft—Blending Requirements for Certain Component Units—An Amendment of GASB Statement No. 14

The GASB issued this Exposure Draft in June 2015 to amend the blending criteria established in GASB Statement No. 14 (GASBS14) *The Financial Reporting Entity*, as amended.

The proposed Statement resulting from this Exposure Draft would establish an additional blending criterion for the financial statement presentation of component units of all state and local governments. The proposed criterion would require blending of component units incorporated as not-for-profit corporations when the primary government is the sole corporate member of the corporation. This proposed blending criterion would not apply to component units included in the financial reporting entity by Statement No. 39, *Determining Whether Certain Organizations Are Component Units*.

The requirements of the Statement resulting from this Exposure Draft are expected to be effective for financial statements for reporting periods beginning after June 15, 2016 with earlier application encouraged.

Exposure Draft—Accounting and Financial Reporting for Certain External Investment Pools

In June 2015 the GASB issued an Exposure Draft to address accounting and financial reporting issues for certain external investment pools and their participants.

Under the requirements that result from this Exposure Draft, if an external investment pool meets specified criteria, the pool would be able to elect to measure for financial reporting purposes all of its investments at amortized cost. Likewise, the pool participants would be able to measure for financial reporting purposes their investments in the external investment pool at amortized cost.

The provisions resulting from this Exposure Draft would replace the existing concept of a “2a7-like” pool, since these types of pools have been superceded and without new accounting guidance the amortized cost election would no longer be available based upon the 2a7-like pool criteria.

The accounting guidance resulting from this Exposure Draft would establish criteria to identify a qualifying external investment pool. The specific criteria would address (1) how the external investment pool transacts with participants; (2) requirements for portfolio maturity, quality, diversification, and liquidity; and (3) calculation of a shadow price. Professional judgment would be required to determine if any instances of noncompliance during the reporting period were significant and, therefore, would prevent the external investment pool from measuring for financial reporting purposes all of its investments at amortized cost.

Upon implementation of the accounting requirements resulting from this Exposure Draft, an external investment pool that elects to measure its investments in accordance with other GASB Statements would not be allowed to reverse that election. However, an external investment pool that meets all of the specified criteria contained in the Exposure Draft and elects to measure for financial reporting purposes all of its investments at amortized cost would be allowed to change that election in a future reporting period.

The requirements resulting from this Exposure Draft would also establish additional note disclosure requirements for external investment pools that measure for financial reporting purposes all of their investments at amortized cost and for governments that participate in those pools. These required disclosures for both the qualifying external investment pools and their participants would include information about limitations or restrictions on participant withdrawals.

The requirements of the Statement resulting from this Exposure Draft are expected to be effective for financial statements for reporting periods beginning after June 15, 2015, except for certain portfolio quality provisions and the provisions related to shadow price calculations. Those exceptions are expected to be effective for reporting periods beginning after December 15, 2015. Earlier application would be encouraged.

A qualifying external investment pool that previously had not reported all of its investments at amortized cost would be allowed to elect to measure for financial reporting purposes all of its investments at amortized cost only upon initial application of the Statement resulting from this Exposure Draft.

PRELIMINARY VIEWS

Preliminary Views—Leases

In November 2014 the GASB issued a Preliminary Views document relating to lease accounting. The FASB has a similar project on its agenda and the GASB preliminary views in this document take a similar, but not quite the same, approach to lease accounting. The GASB’s

preliminary views are based on the underlying principle that all leases are financings of the right to use an underlying asset. This underlying principle is virtually the same as that being contemplated by the FASB, although lease classification is simpler and certain government related topics (e.g. fiscal funding clauses) are addressed.

NOTE: A standard resulting from this PV document and future Exposure Draft will carry with it a significant implementation burden, as calculation of various values for individual leases will be required. The concept of an “operating lease” that is essentially expensed based upon rental payments will no longer exist. The underlying principle is that once a lease is signed, the government is obligated for the lease payments under that lease and would record a liability (at present value) for those future lease payments to which it has committed.

The following paragraphs are a summary of the PV document’s preliminary views.

Definition of a Lease

A lease would be defined as a contract that conveys the right to use a nonfinancial asset (the underlying asset) for a period of time in an exchange or exchange-like transaction. Any contract that meets this definition would be accounted for under the leases guidance, unless specifically excluded. Leases that transfer ownership or contain a bargain purchase option would be accounted for as financed purchases and would not be accounted for under the leases guidance.

Contracts that contain both lease and service components generally would be separated so that each component is accounted for on its own. Contracts that contain leases of multiple assets may be separated in certain circumstances. Contracts entered into at or near the same time with the same counterparty would not be presumed to be part of the same lease unless there is evidence to the contrary.

Lease Term

The lease term is defined in the PV document as the period during which a lessee has a noncancellable right to use an underlying asset, plus the following, if applicable:

1. Periods covered by a lessee’s option to extend the lease if it is probable, based on all relevant factors, that the lessee will exercise that option
2. Periods covered by a lessee’s option to terminate the lease if it is probable, based on all relevant factors, that the lessee will not exercise that option.

Fiscal funding or cancellation clauses would continue to be disregarded for financial reporting purposes if the possibility of cancellation is remote. A government would reassess the lease term only if the lessee does one or both of the following:

1. Elects to exercise an option to extend the lease even though the government had previously determined that it was not probable that the lessee would do so
2. Does not elect to exercise an option to terminate the lease even though the government had previously determined that it was probable that the lessee would do so.

Lessee Accounting

Lessees would recognize a lease liability and an intangible lease asset at the beginning of a lease, unless it is a short-term lease as defined below. The liability would be measured at the present value of certain lease payments to be made over the lease term. The lease asset would be measured at the value of the lease liability plus any prepayments and certain initial direct costs. A

lessee would recognize interest expense on the lease liability and amortization expense on the lease asset. Disclosures would include a description of leasing arrangements, the amount of lease assets recognized, and a schedule of future lease payments to be made.

Lessor Accounting

Lessors would recognize a lease receivable and a deferred inflow of resources at the beginning of a lease, unless it is a short-term lease as defined below. The receivable would be measured at the present value of certain lease payments to be received over the lease term. The deferred inflow of resources would be measured at the value of the lease receivable plus the amount of any payments received at or prior to the beginning of the lease that relate to future periods. A lessor would recognize interest revenue on the lease receivable and also would recognize revenue over the term of the lease from the deferred inflow of resources. A lessor would not derecognize the underlying asset in the lease. Disclosures would include a description of leasing arrangements, the total amount of revenue recognized from leases, and a schedule of future lease payments to be received.

Short-Term Lease Exception

A short-term lease would be defined as a lease that, at the beginning of the lease, has a maximum possible term under the contract, including any options to extend, of 12 months or less. A lessee in a short-term lease would not follow the regular accounting for leases but, instead, would recognize lease payments as expenses or expenditures based primarily on the payment terms of the contract. A lessor in a short-term lease would not follow the regular accounting for leases but, instead, would recognize lease payments as revenue based primarily on the terms of the contract.

Lease Terminations and Modifications

An amendment to a lease contract would be considered a modification unless the lessee's right to use the underlying asset decreases, in which case it would be a partial termination. A lease termination would be accounted for by adjusting the balances of the lease liability and lease asset by a lessee, or the lease receivable and deferred inflow of resources by a lessor, with any difference being recognized as a gain or loss. A lease modification would be accounted for by adjusting the balances of the related lease liability and lease asset by a lessee, or the related lease receivable and deferred inflow of resources by a lessor. However, if the modification is due to the refunding of related debt, other guidance would apply.

Subleases and Leaseback Transactions

Subleases would be treated as transactions separate from the original lease. A government that has sublet an asset would recognize separately the liability and lease asset as lessee in the original lease and the receivable and deferred inflow of resources as lessor in the sublease. A sale-leaseback transaction would be accounted for under sale-leaseback accounting if there is a qualifying sale. In that case, the sale would be accounted for as any other sale, except any gain or loss would be reported as a deferred inflow of resources or a deferred outflow of resources and recognized over the term of the leaseback. The leaseback would be accounted for in the same manner as any other lease. A lease-leaseback transaction would be recognized as a net lease liability or lease receivable, with disclosure of the gross lease liability and lease receivable.

Leases with Related Parties and Intra-Entity Leases

A lease between related parties would continue to be recognized based on the substance instead of the form of the transaction. Leases within financial reporting entities would continue to

be treated like any other transaction between component units. Leases with blended component units would be eliminated in the financial statements of the reporting entity, while leases with discretely presented component units would be presented separately from other leases.

Preliminary Views—Financial Reporting for Fiduciary Responsibilities

In November 2014 the GASB issued a Preliminary Views document regarding financial reporting for fiduciary responsibilities. The purpose of the PV document is to address how financial statements address a government's accountability for its activities as a fiduciary and when a government should reporting on its fiduciary responsibilities.

NOTE: A GASB Standard that would result from this project would address the reporting for pension or OPBE trust funds, as well as pass-through grants. As described below, control of the assets is a key component in determining the accounting treatment.

The preliminary view expressed in the PV document is that a government is a fiduciary and has a fiduciary responsibility when it controls assets (1) from a pass-through grant for which the government does not have administrative or direct financial involvement, (2) in accordance with a trust agreement or equivalent arrangement in which the government itself is not a beneficiary, or (3) for the benefit of individuals that are not required to be part of the citizenry as a condition of being a beneficiary, or organizations or other governments that are not part of the financial reporting entity.

Further a government "controls assets" in a fiduciary capacity if those assets (1) are used by the government (or its assignee) to provide benefits to specified or intended beneficiaries and (2) have present service capacity that can be (a) used; (b) exchanged for another asset, such as cash; or (c) employed in any other way that provides benefits.

The PV document notes a variety of legal structures or custodial arrangements that define the relationship of a governing body to a fiduciary activity, including (1) directly holding the assets, (2) serving as the trustee for the assets held in a trust agreement or equivalent arrangement, or (3) being legally separate from the entity (other than a trust) that holds or administers the assets.

The PV document provides that a government's control of fiduciary assets should be determined by a combination of the legal structure that defines the relationship of the governing body to the fiduciary activity and whether the government has a responsibility for administering the exchange of assets, as follows:

Under the PV document, a government has control of assets if:

- a. It is directly holding the assets, regardless of its responsibility for administering the exchange of those assets
- b. It is directly responsible for administering the exchange of assets, regardless of the legal structures that might separate the government and the entity that is holding the assets
- c. It has assigned its responsibility for administering the exchange of assets (for example, to an asset manager) but maintains the ability to reassign that responsibility, regardless of the legal structures that might separate the government and the entity that is holding the assets.

Under the PV document, a government does not have control of assets if:

- a. It is acting as a trustee for assets and only has responsibility for establishing parameters (for example, providing a selection of investment options) for those that have the responsibility for administering the exchange of assets

- b. It is neither directly holding nor acting as a trustee for assets and only has responsibility for establishing parameters for those that have the responsibility for administering the exchange of assets
- c. It is not directly holding assets and has no responsibility for administering the exchange of assets.

Fiduciary funds would continue to be used to report the fiduciary activities of a government in its basic financial statements. The PV document is proposing that the classification of fiduciary activities as a particular fiduciary fund would be determined in part by the presence or absence of a trust agreement or equivalent arrangement.

The PV document is also proposing a new custodial fund type to report any fiduciary activity that is not administered through a trust agreement or equivalent arrangement. A custodial fund would be reported as a fiduciary fund and would include certain funds previously classified as agency funds or as trust funds, but for which there is no trust agreement or equivalent arrangement.

A liability would be recognized in fiduciary funds when an event has occurred that compels a government to disburse fiduciary resources. A government would be compelled to disburse fiduciary resources when no further action or condition is required to be met by the beneficiary to be entitled to receive the resources.

All fiduciary funds would report additions and deductions in the statement of changes in fiduciary net position in the basic financial statements. The Board believes that users need detailed information about the additions to and deductions from fiduciary funds. Therefore, governments engaged in fiduciary activities would present (1) additions disaggregated by source and, if applicable, by net investment income, including separate display of investment income and investment costs, and (2) deductions disaggregated by type and, if applicable, separate display of administrative costs.

Some special-purpose governments engaged only in fiduciary activities that are component units of another government have component units of their own that are engaged only in fiduciary activities. Fiduciary fund financial statements of a primary government would include the combined information of that component unit and its component units that are fiduciary in nature.

In addition, the PV document also provides that a stand-alone business-type activity also engaged in fiduciary activities should present fiduciary fund financial statements within its basic financial statements.

GASB PROJECT PLAN

The GASB has a number of additional important projects on its agenda that will likely affect governmental accounting and financial reporting in the future. Some of the more significant projects are as follows.

Asset Retirement Obligations. This project would develop requirements on recognition and measurement for asset retirement obligations, other than landfills. The definition of what constitutes an *asset retirement obligation* and what the term *retirement* encompasses are expected to be addressed.

Financial Reporting Model. This project would take a fresh look at the basic financial reporting model required by GASBS 34, as amended, to determine if it is working effectively and whether any changes to the model need to be made.

Debt Refundings with Existing Resources. This project addresses whether a defeasance of debt can occur with only existing resources are placed with an escrow agent and the deferral of the gain or loss on defeasances.

SUMMARY

The GASB, as always, maintains an active agenda, and the accounting and financial reporting standards for governments are consistently evolving. Financial statement preparers need to keep an eye on emerging new GASB pronouncements to ensure that they have adequate time to plan for their implementation, as well as to inform financial statement users about their potential impacts.

2 FOUNDATIONS OF GOVERNMENTAL ACCOUNTING

Introduction	11	Objectives of Financial Reporting	23
Chapter Overview	12	Communication Methods	25
Entities Covered by Governmental Accounting Principles	12	Concepts Statement 3— <i>Communication Methods in General-Purpose External Financial Reports that Contain Basic Financial Statements</i>	25
Distinguishing a Governmental Entity from a Not-for-Profit Organization	12	Elements of Financial Statements	26
Overview of the History of Governmental Accounting		Measurement of Elements of Financial Statements	26
Standards Setting	14	Hierarchy of Governmental Accounting Standards	27
Objectives of Governmental Accounting and Financial Reporting	15	GAAP Hierarchy for Governments	28
GASB Concepts Statement 1	16	Codification of Certain FASB and AICPA Accounting and Financial Reporting Guidance	29
Primary Characteristics of a Government's Structure and the Services it Provides	16	Summary	31
Control Characteristics Resulting from a Government's Structure	17		

INTRODUCTION

The field of governmental accounting and financial reporting has undergone significant growth and development over the last thirty years. Generally accepted accounting principles for governments were once a loosely defined set of guidelines followed by some governments and governmental entities, but now have developed into highly specialized standards used in financial reporting by an increasing number of these entities. Because of this standardization, users are able to place additional reliance on these entities' financial statements.

The Governmental Accounting Standards Board (GASB) has designed a model for financial reporting by governments that results in a significantly different look to governmental financial statements from those of the past, as well as from those of commercial organizations. There have also been substantive changes in the accounting principles used by governments. Governmental financial statement preparers, auditors, and users must have a complete understanding of these requirements to fulfill their financial reporting obligations.

CHAPTER OVERVIEW

This chapter provides a background on the development and purpose of governmental accounting standards. The topics in this chapter follow.

- Entities covered by governmental accounting principles.
- Overview of the history of governmental accounting standards setting.
- Objectives of governmental accounting and financial reporting.
- Communication methods.
- Elements of financial statements.
- Hierarchy of governmental accounting standards.

ENTITIES COVERED BY GOVERNMENTAL ACCOUNTING PRINCIPLES

This book addresses this topic in much more detail throughout its later chapters as specific types of entities are discussed. However, in general, the following entities are covered by governmental generally accepted accounting principles:

- State governments.
- Local governments such as cities, towns, counties, and villages.
- Public authorities such as economic development, parking, housing, water and sewer, and airport authorities.
- Governmental colleges and universities.
- School districts.
- Public employee retirement systems.
- Public hospitals and other health care providers.

Throughout this book, when “governmental entities” or “governments” are mentioned, the reference is to these types of entities. Governments covered by governmental accounting principles are sometimes distinguished as general-purpose governments (which include states, cities, towns, counties, and villages) and special-purpose governments (which is a term used in GASBS 34, *Basic Financial Statements—and Management’s Discussion and Analyses*, to refer to governments and governmental entities other than general-purpose governments). Both general-purpose and special-purpose governments are covered by governmental generally accepted accounting principles and by this book.

Not-for-profit organizations are not included within the scope of governmental accounting standards unless they are considered governmental not-for-profit organizations (discussed in detail below), nor are the federal government and its various agencies and departments. Not-for-profit organizations and the federal government are sometimes confused with the governments that this book is addressing when they are homogenized into something commonly referred to as the “public sector.” Not all public-sector entities (as described above) are subject to governmental accounting principles and standards.

Distinguishing a Governmental Entity from a Not-for-Profit Organization

Some organizations are difficult to categorize as either a governmental entity or not-for-profit organization. For example, local governments may set up economic development corporations that have many characteristics of not-for-profit organizations, including federal tax-exempt status

under Section 501(c)(3) of the Internal Revenue Code. However, these organizations are usually considered governmental not-for-profit organizations that should follow generally accepted accounting principles for governments. A definition of a governmental not-for-profit organization (subject to the accounting standards promulgated by the GASB) is found in the AICPA Audit and Accounting Guide *State and Local Governments* (the Guide). The Guide defines governmental organizations as “public corporations and bodies corporate and politic.” Other organizations are governmental organizations under the Guide’s definition if they have one or more of the following characteristics:

- Popular election of officers or appointment (or approval) of a controlling majority of the members of the organization’s governing body by officials in one or more state or local governments
- The potential for unilateral dissolution by a government with the net assets reverting to a government
- The power to enact or enforce a tax levy.

In applying the above definitions, a public corporation is described in the Guide as an artificial person, such as a municipality or a governmental corporation, created for the administration of public affairs. Unlike a private corporation, it has no protection against legislative acts altering or even repealing its charter. Public corporations include instrumentalities created by the state, formed and owned in the public interest, supported in whole or part by public funds, and governed by managers deriving their authority from the state. Exhibit 1 provides some consensus examples of public corporations often found at the state and local government level.

Furthermore, entities are presumed to be governmental if they have the ability to issue directly (rather than through a state or municipal authority) debt that pays interest exempt from federal taxation. However, entities possessing only that ability (to issue tax-exempt debt) and none of the other governmental characteristics may rebut the presumption that they are governmental if their determination is supported by compelling, relevant evidence.

The Guide provides that entities are governmental or nongovernmental for accounting, financial reporting, and auditing purposes based solely on the application of the preceding criteria and that other factors are not determinative. As an example the Guide provides that the fact that an entity is incorporated as a not-for-profit organization and exempt from federal income taxation under the provisions of Section 501 of the Internal Revenue Code is not a criterion in determining whether an entity is governmental or nongovernmental for accounting, financial reporting, and auditing purposes.

Exhibit 1

The following are examples of “public corporations” that are often found at the state and local government level. These organizations would usually be considered governmental entities when the definition provided in the Guide is applied.

- Public hospital.
- Public college or university.
- Economic development corporation.
- Housing authority.

- Water and sewer utility.
- Electric or gas utility.
- Industrial development authority.
- Educational construction authority.

Typically, these organizations are created by acts of state legislatures. Their continued existence and legal authority to operate can generally be changed at the discretion of the state legislature.

NOTE: GASBS 34 eliminated some of the apparent inconsistencies that existed in the past about financial reporting for governmental not-for-profit organizations. Prior to implementation of GASBS 34, these organizations were permitted to follow the AICPA financial reporting model for not-for-profit organizations, although they were subject to the disclosure requirements contained in GASB Statements. Under GASBS 34, the accounting and financial reporting for these organizations is clear. They are special-purpose governments that should follow the accounting guidance as delineated under GASBS 34 and should follow all applicable GASB disclosure requirements.

GASBS 39, *Determining Whether Certain Organizations Are Component Units—an amendment of GASB Statement No. 14*, resulted in more not-for-profit organizations being included within the financial reporting entity of a government or governmental entity. In these cases, GASBS 39 does not require that these not-for-profit organizations comply with the financial reporting requirements for governments. Despite their inclusion within a government's reporting entity, many of these types of organizations (such as fundraising foundations) would not be considered governmental organizations and would still report their separately issued financial statements using the standards of the Financial Accounting Standards Board (FASB). The financial statement preparer should incorporate the not-for-profit organization's financial statements (reported using FASB principles) within the governmental reporting model (using GASB principles) which may require that the not-for-profit organization actually be reported somewhat separately from the primary government, such as on a separate page. Appendix E of GASBS 39 provides an illustration of including a not-for-profit organization foundation with a governmental university. GASBS 39 is more fully discussed in Chapter 11.

OVERVIEW OF THE HISTORY OF GOVERNMENTAL ACCOUNTING STANDARDS SETTING

Understanding how governmental accounting standards were developed appears difficult at first because it seems that so many different entities and organizations were involved in the standards-setting process. Working from the current process through history is the easiest way to understand the interrelationships of the various entities involved. Currently, governmental accounting standards are established by the GASB. The GASB is a "sister" organization to the Financial Accounting Standards Board (FASB). The FASB establishes accounting standards for private sector entities, including both commercial entities and not-for-profit organizations. Both the FASB and the GASB are overseen by the Financial Accounting Foundation (FAF), an independent, private-sector organization that, among other things is responsible for the oversight, administration, and finances of the GASB and FASB.

NOTE: One significant difference between the GASB and the FASB is the FASB's role in setting accounting principles for public companies. Under the Sarbanes-Oxley Act of 2002, accounting standards for public companies are the responsibility of the United States Securities and Exchange Commission (SEC). The SEC continues to recognize accounting standards promulgated by the FASB.

Prior to the formation of the GASB, governmental accounting standards were promulgated by the National Council on Governmental Accounting (NCGA). The NCGA was an outgrowth of a group called the National Committee on Governmental Accounting, which itself was an outgrowth of a group called the National Committee on Municipal Accounting (NCMA). These groups were sponsored by the Government Finance Officers Association (GFOA), originally known as the Municipal Finance Officers Association (MFOA).

The first of several collections of municipal accounting standards issued by the NCGA in 1934 became known as the “blue book.” Subsequently, a second blue book was issued by the NCGA in 1951, and a third was issued in 1968, entitled *Governmental Accounting, Auditing, and Financial Reporting* (GAAFR). Subsequent versions of this book were issued in 1980, 1988, and 1994. In 2001, the GFOA issued a major revision of the GAAFR to incorporate the changes to governmental financial reporting as a result of GASBS 34. Another update was published in 2005 to include the new standards for accounting and reporting for postemployment benefits other than pensions established by GASBS 43 and 45. A 2012 update includes reporting deferred inflows and outflows of resources under GASBS 63 and 65. However, these later blue books were different from the 1968 and prior blue books in that they were not meant to be authoritative sources of governmental accounting standards. None of the 1988 through 2012 blue books would be an authoritative source of accounting standards, since the GASB was created in 1984 to serve this purpose; thus the GFOA no longer has the ability to issue authoritative accounting standards. Even with the issuance of the 1980 blue book, the GFOA (then known as the MFOA) decided not to use the blue book as a means of promulgating new accounting standards. Rather, the focus of the blue book was changed to provide financial statement preparers (and their auditors) with detailed and practical guidance to implement authoritative accounting standards. The blue book continues to be used by the GFOA to set the requirements for its “Certificate of Achievement for Excellence in Financial Reporting” program, covered in Chapter 9.

NOTE: The FASB world of accounting standards has recently been dominated by a move to “converge” standards with International Financial Reporting Standards (IFRS) as promulgated by the International Accounting Standards Board. The reader may wonder if there is an equivalent process in place in the world of government accounting standards. The answer is yes, although there is not nearly the same momentum or drive to converge the United States standards with the international standards. Rather, the International Public Sector Accounting Standards Board (IPSASB) has a strategy to converge its International Public Sector Accounting Standards (IPSAS) with IFRS, which are issued by the International Accounting Standards Board. As part of this strategy, IPSASB has developed guidelines for modifying IFRS for application by public sector entities. As discussed later in this chapter, the hierarchy of accounting principles for governments includes IPSAS standards as “other accounting literature.” The FAF, along with the GASB and FASB, has recently developed a strategic plan, which mentions increased involvement of the GASB in international standards as a goal.

OBJECTIVES OF GOVERNMENTAL ACCOUNTING AND FINANCIAL REPORTING

In describing the history of the governmental accounting standards development process, one could logically ask the question “Why were separate accounting and financial reporting standards needed for governments?” The answer to this depends on the identities of the groups of readers and users of the financial statements of state and local governments, the objectives of these readers and users, and the overall objectives of governmental financial reporting.

GASB Concepts Statement 1

The GASB addressed this basic question relatively soon after it was created to serve as an underpinning for all of its future standards-setting work. The GASB issued Concepts Statement 1, *Objectives of Financial Reporting* (GASBCS 1), which identifies the primary users of the financial statements of state and local governments and their main objectives.

To determine the objectives of governmental financial reporting, the GASB first set forth the significant characteristics of the governmental environment. These characteristics are listed below in Exhibit 2.

Exhibit 2: Characteristics of the governmental environment under GASB Concepts Statement 1

- Primary characteristics of a government's structure and the services it provides.
- Control characteristics resulting from a government's structure.
- Use of fund accounting for control purposes.
- Dissimilarities between similarly designated governments.
- Significant investment in non-revenue-producing capital assets.
- Nature of the political process.
- Users of financial reporting.
- Uses of financial reporting.
- Business-type activities.

Each of these characteristics is described in the following pages.

Primary Characteristics of a Government's Structure and the Services it Provides

- The representative form of government and the separation of powers—This emphasizes that the ultimate power of governments is derived from the citizenry. The most common forms of government used in the United States are based on a separation of power among three branches of government: executive, legislative, and judiciary.
- The federal system of government and the prevalence of intergovernmental revenues—This characteristic describes the three primary levels of government: federal, state, and local. Because of differences in abilities to raise revenues through taxes and other means, many intergovernmental grants result in revenues passing from one level to another. For example, federal funds for the Temporary Assistance for Needy Families (TANF) program start at the federal level and flow through the states to local governments, where the program is actually administered.
- The relationship of taxpayers to service receivers—In terms of impact on the objectives of financial reporting, this characteristic of governments may be the most significant. Following are some interesting points that the GASB included in GASBCS 1 that may affect financial reporting objectives:
 - Taxpayers are involuntary resource providers. They cannot choose whether to pay their taxes.
 - Taxes paid by an individual taxpayer generally are based on the value of property owned or income earned and seldom have a proportional relationship to the cost or value of the services received by the individual taxpayer.
 - There is no exchange relationship between resources provided and services received. Most individual taxes do not pay for specific services.
 - The government generally has a monopoly on the services that it provides.

- It is difficult to measure optimal quality or quantity for many of the services provided by governments. Those receiving the services cannot decide the quantity or quality of a particular service of the government.

Control Characteristics Resulting from a Government's Structure

- The budget as an expression of public policy and financial intent and a method of providing control—In the commercial world, revenues exceeding budget and expenses under budget would almost always be considered good things. In the governmental environment, higher revenues might indicate that taxes are set too high. Even more problematic, expenditures below budget might indicate that levels of spending for public purposes are not achieved because the budgeted funding level is a matter of public policy. Politically speaking, expenditures below budget might not be a good thing, unless the reductions were achieved by unanticipated efficiencies.
- The budget is a financial plan or expression of financial intent—This is a similar concept to the public policy question, but also brings into consideration the fact that the budgets of governments generally need to be balanced; for instance, revenues should equal expenditures, highlighting the concept that governments need to live within their means.
- The budget is a form of control that has the force of law—Since governments' budgets generally are subject to approval of both executive and legislative branches (similar to the process for other forms of legislation), violation of the budget's spending authority can be construed as a violation of the law.
- The budget may be used as a mechanism to evaluate performance—This characteristic is generally less useful in the government environment than in the commercial environment, since performance evaluation is not viewed as the primary purpose of the budget. To be effective, comparison of budgeted to actual results over time would have to be made, as well as consideration of the government's service efforts and accomplishments.

Use of fund accounting for control purposes. Most governments are required by law to use a fund accounting structure as a means to control use of resources. In some cases, bond indentures may require establishing and maintaining funds. In other cases, the government may decide to use fund accounting not because it is required, but simply because it can provide a useful control mechanism for distinguishing various components of its operation.

Regardless of the reason for the use of fund accounting, when examining the objectives of financial reporting for governments, the predominant use of fund accounting must be considered to properly recognize the potential needs of financial statement users.

Dissimilarities between similarly designated governments. GASBCS 1 concludes that the differences in the organization of governmental entities, the services they provide, and their sources of revenues all need to be considered when developing financial reporting objectives. For example, different governments at the same level (for example, county governments) may provide significantly different services to their constituents. The levels and types of services provided by county governments depend on the services provided by the cities, towns, villages, and so forth, within the county, as well as by the state government under which the counties exist. In other unique examples, such as the city of New York, there are five county governments located within the city. Beyond boundary differences, the level of provision of services (such as human services and public safety) varies from county to county. In addition, counties also derive their primary revenues from different sources. Some counties may rely primarily on a county tax on real property within the county. Other counties may rely more heavily on a portion of a sales tax. The

important point is that there is a high degree of variability among governments that are at comparable levels.

NOTE: This dissimilarity, while an important characteristic to consider when determining financial reporting objectives, is not unlike that encountered in the commercial environment. A financial statement reader of commercial entities encounters many dissimilarities among the nature of the operations of companies in seemingly identical industries.

Significant investment in non-revenue-producing capital assets. Governments do not determine their capital spending plans based strictly upon return-on-investment criteria. In fact, governments invest in large, non-revenue-producing capital assets, such as government office buildings, highways, bridges, sidewalks, and other infrastructure assets. In many cases, these assets are built or purchased for public policy purposes. Along with this capital investment is a capital maintenance assumption that governments have an obligation to maintain their capital assets. A government's implicit commitment to maintain its assets and its ability to delay maintenance and rehabilitation expenditures (particularly for non-revenue-producing capital assets) were important considerations in GASBCS 1.

Certainly return on investment is considered. Where governments engage in fee-for-service activities, these considerations are not unlike those found in commercial company accounting. For example, should the public water utility invest in a new piece of equipment that will reduce its costs by \$XX or enable it to serve XX number of new customers and generate more revenue? In addition to the business-type decisions, however, governments also make cost/benefit decisions in other seemingly non-revenue-producing activities. For example, a town may decide to invest in new sidewalks and street lighting in its shopping district to raise property values of the businesses in this district, as well as the overall appeal of the town itself. While this investment is non-revenue-producing in the strictest sense, the long-term strategy of the town is the maintenance and enhancement of its property values, and accordingly, its property tax revenues. At the same time, the government may reduce its judgments and claims costs as the number of trip-and-fall lawsuits decreases because of the improved infrastructures.

Nature of the political process. Governments must reconcile the conflict between the services desired by the citizens and the citizens' desire to provide resources to pay for those services. The objectives of the citizenry are to obtain the maximum amount of service with a minimum amount of taxes. These conflicts are handled by politicians whose relatively short terms in public office encourage the use of short-term solutions to long-term problems. Accordingly, governments are susceptible to adopting the practices of satisfying some service needs by deferring others, paying for an increased level of services with nonrecurring revenues, and deferring the cash effect of events, transactions, and circumstances that occur in a particular period. GASBCS 1 concludes that to help fulfill a government's duty to be accountable, financial reporting should enable the user to assess the extent to which operations were funded by nonrecurring revenues or long-term liabilities were incurred to satisfy current operating needs.

Users of financial reporting. GASBCS 1 identifies three primary groups as the users of governmental financial reports:

- The citizenry (including taxpayers, voters, and service recipients), the media, advocate groups, and public finance researchers.
- Legislative and oversight officials, including members of state legislatures, county commissions, city councils, boards of trustees, school boards, and executive branch officials.