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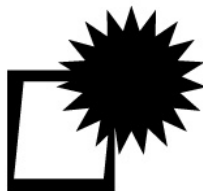
2012

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

Warren Ruppel

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GAAP for
Governments
2012



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Warren Ruppel



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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 philosophy of this book is to provide the reader with usable information in a useful 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 behind why technical requirements exist is an important ingredient in properly applying accounting standards.

The 2012 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 the book are greatly appreciated.

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
Woodcliff Lake, NJ
December 2011

ABOUT THE AUTHOR

Warren Ruppel, CPA, is a Partner at Marks Paneth & Shron LLP, New York, in the firm's Nonprofit and Government Services Group and also is a leader in its Professional Practices 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*.

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 Governmental Accounting and Auditing and Not-for-Profit Organizations Technical Committees and is the President of the Foundation for Accounting Education. He has also served as the Chair of the Society's Audit Committee. He is also a past president of the New York Chapter of the Institute of Management Accountants. Mr. Ruppel is a member of the Government Finance Officers Association and serves on its Special Review Committee. He also serves on the Executive Advisory Board to the Department of Accounting and Taxation of St. John's University.

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INTRODUCTION

The 2012 Governmental GAAP Guide incorporates all of the pronouncements issued by the Governmental Accounting Standards Board (GASB) through November 2010. 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><u>GASB Statement</u></i>	<i><u>Effective Date</u></i>	<i><u>Where in this book</u></i>
51 <i>Accounting and Reporting for Intangible Assets</i>	Periods beginning after 6/15/2009	Chapter 14
52 <i>Land and Other Real Estate Held as Investments by Endowments</i>	Periods beginning after 6/15/2008	Chapter 12
53 <i>Accounting and Financial Reporting for Derivative Instruments</i>	Periods beginning after 6/15/2009	Chapter 13
54 <i>Fund Balance Reporting and Governmental Fund Type Definitions</i>	Periods beginning after 6/15/2010	Chapter 4
55 <i>The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments</i>	Effective upon issuance	Chapter 2
56 <i>Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards</i>	Effective upon Issuance	Chapter 5
57 <i>OPEB Measurements by Agency Employers and Agent Multiple-Employer Plans</i>	Periods beginning after 6/15/2011 (provisions related to the use and reporting of the alternative measurement method are effective immediately)	Chapter 17
58 <i>Accounting and Financial Reporting for Chapter 9 Bankruptcies</i>	Periods beginning after 6/15/2009	Chapter 15
59 <i>Financial Instruments Omnibus</i>	Periods beginning after June 30, 2010	Chapters 12, 13, 22
60 <i>Accounting and Financial Reporting for Concession Agreements</i>	Periods beginning after December 15, 2011	Chapter 14
61 <i>The Financial Reporting Entity Omnibus—An Amendment of GASB Statements No. 14 and 34</i>	Periods beginning after June 15, 2012	Chapter 11
62 <i>Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements</i>	Periods beginning after December 15, 2011	Chapter 2

<u><i>GASB Statement</i></u>	<u><i>Effective Date</i></u>	<u><i>Where in this book</i></u>
63 <i>Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position</i>	Periods beginning after December 15, 2011	Chapter 9
64 <i>Derivative Instruments: Application of Hedge Accounting Termination Provisions—An Amendment of GASB Statement No. 53</i>	Periods beginning after June 15, 2011	Chapter 13

EXPOSURE DRAFTS

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

Exposure Draft—*Technical Corrections—An Amendment of GASB Statements No. 10 and 62*

The proposed statement resulting from this Exposure Draft would make limited technical corrections to GASB Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues* (GASBS 10), and GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements* (GASBS 62).

GASBS 10, paragraph 63, would be amended to delete the requirement that an entity's risk financing activities be accounted for either in the general fund or an internal service fund, if a single fund is used. Under GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions* (GASBS 54), the definition of a special revenue fund would allow for certain risk financing activities to be reported in a special revenue fund.

GASBS 62, paragraphs 222 and 227(b), would be amended to delete the guidance that that does not allow the use of the fair value method that is permitted in paragraph 6(b) of FASB Statement No. 13.

GASBS 62, paragraph 442, would be amended to clarify that the purchase of a loan or group of loans should be reported at its purchase price.

Effective Date

The Statement resulting from this Exposure Draft is expected to be effective for financial statements for periods ending after June 15, 2012.

Exposure Draft—*Reporting Items Previously Recognized as Assets and Liabilities*

The purpose of this Exposure Draft is to fully implement the provisions of GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources,*

Deferred Inflows of Resources, and Net Position (GASBS 63). There are currently a number of items on financial statements that are reported as assets and liabilities that would meet the definition of deferred outflows and deferred inflows of resources. In accordance with GASBS 63 only those items specifically identified in a GASB standard as a deferred outflow or inflow of resources should be reported as such. This Exposure Draft identifies all of the items currently reported as assets and liabilities that will need to be reported as deferred outflows and deferred inflows of resources.

The following are the items that would be impacted by a final statement issued as a result of this Exposure Draft.

Refundings of Debt

For current refundings and advance refundings resulting in defeasance of debt reported by governmental activities, business-type activities, and proprietary funds, the difference between the reacquisition price and the net carrying amount of the old debt should be reported as a deferred outflow of resources or a deferred inflow of resources and recognized as a component of interest expense in a systematic and rational manner over the remaining life of the old debt or the life of the new debt, whichever is shorter.

Prior to the expiration of the lease term, if a change in the provisions of a lease results from a refunding by the lessor of tax-exempt debt, including an advance refunding, in which (1) the perceived economic advantages of the refunding are passed through to the lessee and (2) the revised agreement is classified as a capital lease by the lessee, then the lessee should adjust the lease obligation to the present value of the future minimum lease payments under the revised lease. The adjustment of the lease obligation to present value should be made using the effective interest rate applicable to the revised agreement. The resulting difference should be reported as a deferred outflow of resources or a deferred inflow of resources. The deferred outflow of resources or the deferred inflow of resources should be recognized as a component of interest expense in a systematic and rational manner over the remaining life of the old debt or the life of the new debt, whichever is shorter.

Nonexchange Transactions

Imposed nonexchange revenue transactions. Deferred inflows of resources should be recognized when resources are received or recognized as a receivable before (1) the period for which property taxes are levied or (2) the period when resources are required to be used or when use is first permitted for all other imposed nonexchange revenues in which the enabling legislation includes time requirements.

Government-mandated nonexchange transactions and voluntary nonexchange transactions. Resources transmitted before the eligibility requirements are met (excluding time requirements) should be reported as assets by the provider and as liabilities by the recipient. Resources received or recognized as receivable before time requirements are met, but after all other eligibility requirements have been met, should be reported as a deferred outflow of resources by the provider and a deferred inflow of resources by the recipient.

Recognition of assets and revenues should not be delayed pending completion of purely routine requirements, such as the filing of claims for allowable costs under a reimbursement program or the filing of progress reports with the provider.

Sales of Future Revenues and Intra-Entity Transfers of Future Revenues

Sales of future revenues. In a sale of future revenues, the transferor government should report the proceeds as a deferred inflow of resources in both the government-wide and fund financial statements except for instances wherein recognition as revenue in the period of sale is appropriate.

Intra-entity transfers of future revenues. When accounting for intra-entity transfers of future revenues, a transferee government should not recognize an asset and related revenue until recognition criteria appropriate to that type of revenue are met. Instead, the transferee government should report the amount paid as a deferred outflow of resources to be recognized over the duration of the transfer agreement. The transferor government should report the amount received from the intra-entity transfer as a deferred inflow of resources in its government-wide and fund financial statements and recognize the amount as revenue over the duration of the transfer agreement.

Deferred inflows of resources and deferred outflows of resources resulting from intra-entity transfers of future revenues and the periodic recognition of those balances as revenue and expense/expenditure should be accounted for similarly to internal balances and intra-entity activity within the financial reporting entity.

Debt Issuance Costs

Debt issuance costs include all costs incurred to issue the bonds, including but not limited to insurance costs (net of rebates from the old debt, if any), financing costs (such as rating agency fees), and other related costs (such as printing, legal, administrative, and trustee expenses).

Debt issuance costs, except any portion related to prepaid insurance costs, should be recognized as expense in the period incurred. Prepaid insurance costs should be reported as an asset and recognized as expense in a systematic and rational manner.

Leases

Initial direct costs of operating leases. The lessor should recognize initial direct costs of an operating lease as expense/expenditure in the period incurred.

Sale-leaseback transactions. The gain or loss on the sale of property that is accompanied by a leaseback of all or any part of the property for all or part of its remaining economic life should be recorded as a deferred inflow of resources or a deferred outflow of resources, respectively, and recognized in a systematic and rational manner over the arrangement in proportion to the recognition of the leased asset, if a capital lease, or in proportion to the related gross rental charged to expense/expenditure over the lease term, if an operating lease, subject to certain exceptions.

Acquisition Costs Related to Insurance Activities

Acquisition costs related to insurance activities should be recognized as expense in the period incurred.

Lending Activities

Lending, committing to lend, refinancing or restructuring loans, arranging standby letters of credit, and leasing activities are lending activities for purposes of applying these requirements.

Loan origination fees and costs. Loan origination fees, except any portion related to points, should be recognized as revenue in the period received. Points received by a lender in relation to a loan origination should be reported as a deferred inflow of resources and recognized as revenue in a systematic and rational manner. Direct loan origination costs should be recognized as expense in the period incurred.

Commitment fees. Except as set forth in items 1. and 2. below, fees received for a commitment to originate or purchase a loan or group of loans should be recorded as a liability and, if the commitment is exercised, recognized as revenue in the period of exercise. If the commitment expires unexercised, the commitment fees should be recognized as revenue upon expiration of the commitment.

1. If the government's experience with similar arrangements indicates that the likelihood that the commitment will be exercised is remote, the commitment fee should be recognized as revenue in the period received.
2. If the amount of the commitment fee is determined retrospectively as a percentage of the line of credit available but unused in a previous period, and if that percentage is nominal in relation to the stated interest rate on any related borrowing, and, finally, if that borrowing will bear a market interest rate at the date the loan is made, the commitment fee should be recognized as revenue as of the determination date.

Purchase of a loan or group of loans. Any fees paid or any fees received related to this purchase should be recognized as expense or revenue, respectively, in the period that the loan(s) was purchased.

Mortgage Banking Activities

Similar to lending activities, mortgage banking activities may include the receipt or payment of nonrefundable loan and commitment fees representing compensation for a variety of services.

Loan origination fees and costs. If the loan is held for investment, loan origination fees, except any portion related to points, and the direct loan origination costs should be recognized as revenue or expense, respectively, in the period the loan is originated. Points received by a lender in relation to a loan held for investment should be reported as a deferred inflow of resources and recognized as revenue, in a systematic and rational manner. If the loan is held for sale, origination fees, including any portion related to points, and direct loan origination costs should be recorded as a deferred inflow of resources and a deferred outflow of resources, respectively, until the related loan is sold. Once the related loan is sold, the amount re-

ported as a deferred inflow of resources related to the loan origination fees, including any portion related to points, and the amount reported as a deferred outflow of resources related to the direct loan origination costs should be recognized as revenue and expense, respectively, in the period of sale.

Fees relating to loans held for sale. Fees received for guaranteeing the funding of mortgage loans to borrowers, builders, or developers should be accounted for as described above for commitment fees. Fees paid to permanent investors to ensure the ultimate sale of the loans (residential or commercial loan commitment fees) should be recognized as expense in the period when the loans are sold to permanent investors or when it becomes evident the commitment will not be used. Prior to the sale of the loans, the fees paid to permanent investors should be recorded as a deferred outflow of resources until the sale of the loan occurs.

Regulated Operations

General standards of accounting for the effects of regulation. The result of rate actions of a regulator can result in a liability or a deferred inflow of resources being imposed on a regulated business-type activity. Liabilities are usually obligations to the regulated business-type activity's customer and deferred inflows of resources represent an acquisition of net assets from the regulated business-type activity's customers that are applicable to a future reporting period. The usual ways in which a transaction results in a liability or a deferred inflow of resources and the resulting accounting are as follows:

1. A regulator may require refunds to customers. Refunds that meet the criteria for accrual of loss contingencies should be recorded as liabilities and as reductions of revenue or as expenses of the regulated business-type activity.
2. A regulator can establish current rates intended to recover costs that are expected to be incurred in the future with the understanding that if those costs are not incurred, future rates will be reduced by corresponding amounts. If current rates are intended to recover such costs and the regulator requires the regulated business-type activity to remain accountable for any amounts charged pursuant to such rates and not yet expended for the intended purpose, the regulated business-type activity should not recognize as revenues amounts charged pursuant to such rates. Those amounts should be recorded as a deferred inflow of resources and recognized as revenue when the associated costs are incurred.
3. A regulator can require that a gain or other reduction of net allowable costs be given to customers over future periods. That would be accomplished, for rate-making purposes, by allocating in a systematic and rational manner, the gain or other reduction of net allowable costs over those future periods and adjusting rates to reduce revenues in approximately the amount of the allocation. If a gain or other reduction of net allowable costs is to be allocated over future periods for rate-making purposes, the regulated business-type activity should not recognize that gain or other reduction of net allowable costs in the current period. Instead, it should be recorded as a deferred inflow of resources for future reductions of charges to customers that are expected to result.

Revenue Recognition in Governmental Funds

Revenues and other governmental fund financial resources should be recognized in the accounting period in which they become both measurable and available. When an asset is recorded in governmental fund financial statements but the revenue is not available, the government should report a deferred inflow of resources until such time as the revenue becomes available.

In addition to the guidance on specific items above, the Exposure Draft also provides the following more general guidance.

Use of the Term Deferred. The use of the term *deferred* should be limited to deferred outflows of resources or deferred inflows of resources.

Major Fund Criteria. Assets should be combined with deferred outflows of resources and liabilities should be combined with deferred inflows of resources for purposes of determining which elements meet the criteria for major fund determination as set forth in Statement 34, as amended.

Effective Date and Transition

The requirements of a final Statement are expected to be effective for financial statements for periods beginning after June 15, 2012, with earlier application encouraged. Accounting changes adopted to conform to the provisions of the final statement would be applied retroactively by restating financial statements, if practical, for all periods presented. If restatement is not practical, the cumulative effect of applying the final statement, if any, should be reported as a restatement of beginning net position or fund balance, as appropriate, for the earliest period restated. In the period the final statement is first applied, the financial statements should disclose the nature of any restatement and its effect. Also, the reason for not restating prior periods presented should be explained.

Exposure Draft—Accounting and Financial Reporting for Pensions—An Amendment of GASB Statement No. 25

After issuing an Invitation to Comment and a Preliminary Views Document regarding pension accounting and financial reporting, the GASB has issued two Exposure Drafts in this area. This Exposure Draft addresses pension plan accounting and financial reporting. The Exposure Draft discussed in the following section addresses employers' accounting for pensions.

Assuming that the matters provided in these Exposure Drafts make it to final GASB statements, the area of pension accounting and financial reporting will undergo significant changes.

The Exposure Draft that would significantly amend GASBS 25 is summarized below, based upon the GASB's summary of the important changes that would result. The Exposure Draft itself and the ultimate GASB statement that would result from it provides an even greater level of detail than is described below.

The proposed statement would amend the requirements of GASBS 25 and GASB Statement No. 50, *Pension Disclosures* (GASBS 50) as they relate to pension plans that are administered through trusts, or equivalent arrangements, that meet certain criteria. The requirements of GASBS 25 and 50 would remain applicable to

pension plans that are not covered by the scope of the proposed statement, and requirements applicable to defined contribution plans that provide postemployment benefits other than pensions would remain effective for those plans.

The proposed statement and the related proposed statement for employers would establish a definition of pension plan that reflects the primary activities of a fund that is used to provide pensions—the accumulation and management of assets dedicated for pensions and the payment of pensions to plan members as the benefits come due. A trust, or equivalent arrangement, that is used to administer a pension plan and that has the following characteristics is referred to by the Exposure Draft as a qualified trust:

1. Employer contributions to the plan, including contributions made on behalf of the employer(s) by a nonemployer contributing entity, and earnings on those contributions are irrevocable.
2. Plan assets are dedicated to providing pensions to plan members in accordance with the benefit terms.
3. Plan assets are legally protected from the creditors of the employer(s), non-employer contributing entities, and the plan administrator. If the plan is a defined benefit plan, plan assets also are legally protected from creditors of the plan members.

*NOTE: The criteria listed above are meant to make the criteria for a qualified trust essentially the same as those for a qualified trust under GASB Statement No. 43, **Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans** (GASBS 43). Basically, the GASB does not want to report as pension assets any assets over which the employer has discretionary control to redirect the resources for other uses.*

The proposed statement would establish standards for financial reporting by defined benefit pension plans administered through qualified trusts. These standards would outline the basic framework for the separately issued financial reports of defined benefit pension plans and specify the required approach to measuring employer obligations associated with pensions.

The Exposure Draft makes distinctions regarding the particular requirements depending upon the type of plan administered:

- Single-employer pension plans—those in which pensions are provided to the employees of one employer
- Agent multiple-employer pension plans—those in which plan assets are pooled for investment purposes but are legally segregated to pay the pensions of each employer’s employees
- Cost-sharing multiple-employer pension plans—those in which the participating employers pool or share their obligations to provide pensions to their employees, and plan assets can be used to pay the pensions of the employees of any participating employer.

The standards proposed by the Exposure Draft would also detail the note disclosure requirements for defined contribution pension plans administered through qualified trusts.

Defined Benefit Pension Plans

Financial statements. The standards proposed by the Exposure Draft would require defined benefit pension plans administered through qualified trusts to present two financial statements—a statement of plan net position and a statement of changes in plan net position. The statement of plan net position would present the following items as of the end of the plan’s reporting period:

- Assets, such as cash and cash equivalents, receivables from employers and plan members, the fair value of investments, and equipment and other assets used in plan operations
- Deferred outflows of resources
- Liabilities, such as benefit payments due to plan members
- Deferred inflows of resources
- Net position, which equals assets plus deferred outflows of resources minus liabilities minus deferred inflows of resources.

The statement of changes in plan net position would present the following items for the plan’s reporting period:

- Additions, such as contributions from employers (including those from non-employer contributing entities on behalf of employers), contributions from plan members, and net investment income
- Deductions, including benefit payments and administrative expenses
- Net increase (decrease) in plan net position, which equals the difference between additions and deductions.

Defined benefit pension plans also would continue to be required to follow all accounting and financial reporting requirements of other standards, as applicable.

*NOTE: The basic statements for pension plans remain unchanged except for the significant change to reflect deferred outflows and inflows of resources under GASB Statement No. 63, **Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position** (GASBS 63).*

Notes to financial statements. The notes to financial statements of defined benefit pension plans administered through qualified trusts would offer descriptive information, such as the types of benefits provided, the classes of plan members covered, and the composition of the plan’s board.

Notes regarding plan investments would present the plan’s investment policies, describe how it determines fair value, identify concentrations of investments with individual organizations equaling or exceeding 5% of plan net position, and disclose both time-weighted and money-weighted rates of return on plan investments. The notes also would provide information about contributions, reserves, and allocated insurance contracts.

Single-employer and cost-sharing pension plans also would disclose the following:

- As of the end of the plan's reporting period, (1) the total pension liability of the employer(s), (2) the amount of plan net position, (3) the net pension liability of the employer(s), and (4) the ratio of plan net position to the total pension liability of the employer(s)
- Significant assumptions used to calculate the total pension liability of the employer(s), including those about salary increases, inflation, mortality, cost-of-living adjustments (COLAs) and other postemployment benefit changes, and the discount rate, as well as the date(s) of the experience studies and published sources, such as mortality tables
- With respect to the discount rate, assumptions used in calculating the discount rate, including those related to contributions and other projected cash flows, the basis for selecting the long-term expected rate of return on plan investments and the municipal bond index rate (if applicable), the projection periods to which each rate was applied to determine the single rate that was used as the discount rate, and the sensitivity of the net pension liability of the employer(s) to the discount rate assumption.

NOTE: The proposed standard has a number of new disclosure requirements, with one of the most notable being those related to the investment performance of the trust's assets.

Required Supplementary Information

The standards proposed by the Exposure Draft would require single-employer and cost-sharing pension plans administered through qualified trusts to present the following schedules covering the past 10 fiscal years as required supplementary information:

- Changes in the net pension liability of the employer(s), including the beginning and ending balances of the total pension liability of the employer(s), the amount of plan net position, and the effects on those amounts of items such as service costs, benefit changes, changes of assumptions, contributions, net investment income, and benefits paid
- Information about the components of the net pension liability of the employer(s) and related ratios, including (1) the total pension liability of the employer(s), (2) the amount of plan net position, (3) the net pension liability of the employer(s), (4) the ratio of plan net position to the total pension liability of the employer(s), (5) the amount of covered-employee payroll, and (6) net pension liability of the employer(s) as a percentage of covered-employee payroll.

If the contributions of employer(s) to a single-employer or cost-sharing pension plan are actuarially determined, the plan would present in required supplementary information a schedule covering the past 10 fiscal years that includes (1) the actuarially calculated employer contribution, (2) the amount of employer contributions made, (3) the difference between 1 and 2, (4) the amount of covered-employee payroll, and (5) contributions made as a percentage of covered-employee payroll.

All defined benefit pension plans, including agent pension plans, would present in required supplementary information a schedule covering the past 10 fiscal years that includes (1) the actual annual time-weighted rate of return on plan investments, net of investment expenses, and (2) the actual annual money-weighted rate of return on plan investments, net of investment expenses.

Single-employer and cost-sharing pension plans also would identify significant methods and assumptions used in determining the actuarially calculated contributions as notes to the schedules, if not disclosed elsewhere, and all plans would explain factors that significantly affect the identification of trends in the amounts reported in the schedules, such as changes in benefit provisions, the size or composition of the population covered by the pensions provided through the plan, or assumptions used.

NOTE: The revised components of Required Supplementary Information reflect the fact that the GASB is moving away from actuarial liability calculation based on the funding calculations to a more standardized measure. In addition, previous requirements for display of historical information have been increased to ten years.

Measurement of the Net Pension Liability of the Employer(s)

NOTE: The changes discussed below to the inclusion of automatic COLAs in the liability calculation, the rules for selecting discount rates and the required use of the entry age normal actuarial method to calculate the pension liability are very significant changes to current standards. These changes are consistent with what will be required for employer's accounting and financial reporting that is discussed in the next Exposure Draft after this section. The resulting calculations will result in a standardized methodology for measuring net pension liability, rather than having this measurement dependent on the funding calculation methodologies permitted in current standards.

NOTE: While the GASB has reduced the acceptable number of actuarial attribution methods for calculating net pension liability from six to one (entry age normal), that does mean that governments are required to make any changes to the actual funding calculation methodologies that they currently utilize. However, as will be seen later, an employer's annual required contribution for financial reporting purposes will be calculated using the entry age normal attribution method.

The net pension liability of the employer(s) would equal the total pension liability of the employer(s) less plan net position restricted for pensions (plan net position). The total pension liability of the employer(s) would be the portion of the present value of projected benefit payments that is attributed to plan members' past service.

Actuarial valuations of the total pension liability of the employer(s) would be required of the employer(s) to be conducted at least every two years, with more frequent valuation encouraged. If a valuation is not conducted as of the end of the plan's reporting period, measurement of the total pension liability of the employer(s) would be based on update procedures to roll forward amounts from the most recent actuarial valuation conducted as of a date no more than 24 months prior to the plan's most recent year-end.

Projections of benefit payments. Projections of benefit payments to plan members would be based on the then-existing benefit terms and legal agreements and would incorporate projected salary increases (if the pension formula is based on compensation levels) and service credits (if the pension formula is based on periods of service), as well as projected automatic COLAs and other automatic postemployment benefit changes. Projections also would include ad hoc COLAs and other ad hoc postemployment benefit changes, if they are considered to be substantively automatic. All assumptions underlying the projections would be made in conformity with Actuarial Standards of Practice issued by the Actuarial Standards Board of the American Academy of Actuaries.

Discount rate. Projected benefit payments would be discounted to their present value using a single rate that would reflect (1) a long-term expected rate of return on plan investments to the extent that plan net position is projected to be sufficient to pay benefits and the net position projected to remain after each benefit payment can be invested long-term, and (2) a tax-exempt, high-quality municipal bond index rate to the extent that the conditions in (1) are not met.

Attribution method. The attribution of the actuarial present value of benefit payments would be accomplished using the entry age normal actuarial cost method as a level percentage of pay. The actuarial present value would be attributed to each plan member individually, from the period when the plan member first accrues pensions through the period when the employee retires.

Defined Contribution Pension Plans

Defined contribution pension plans would apply the existing reporting requirements for fiduciary funds when preparing their financial statements. In the notes to their financial statements, defined contribution plans would disclose the classes of employees covered, current membership, the number of participating employers and nonemployer contributing entities, and the fair value of plan investments (if they are not reported at fair value in the financial statements).

Effective Date and Transition

The resulting standard from this Exposure Draft is expected to have the following implementation schedule:

A single-employer pension plan with plan net position of \$1 billion or more in the first fiscal year ending after June 15, 2010, would be required to implement the requirements of the proposed Statement in periods beginning after June 15, 2012, if all of the following conditions are met:

- The participating employer does not have a special funding situation in which the nonemployer contributing entity has an unconditional legal requirement to make contributions, as described in paragraph 12 of the related proposed Statement.
- The plan is not included in the financial report of a public employee retirement system or other government that also reports (1) a single-employer pension plan in which a nonemployer contributing entity has an unconditional

legal requirement to make contributions, (2) an agent pension plan, or (3) a cost-sharing pension plan.

For all other pension plans, the proposed statement is expected to be effective for financial statements for periods beginning after June 15, 2013, with earlier application encouraged for all plans.

Exposure Draft—Accounting and Financial Reporting for Pensions—An Amendment of GASB Statement No. 27

After issuing an Invitation to Comment and a Preliminary Views Document regarding pension accounting and financial reporting, the GASB has issued two Exposure Drafts in this area. The Exposure Draft discussed above addresses pension plan accounting and financial reporting. The Exposure Draft discussed in this section addresses employers' accounting for pensions.

Assuming that the matters provided in these Exposure Drafts make it to final GASB statements, the area of pension accounting and financial reporting will undergo significant changes.

The Exposure Draft that would significantly amend GASBS 27 is summarized below, based upon the GASB's summary of the important changes that would result. The Exposure Draft itself and the ultimate GASB statement that would result from it provides an even greater level of detail than is described below.

The proposed statement and the related proposed statement for employers would establish a definition of pension plan that reflects the primary activities of a fund that is used to provide pensions—the accumulation and management of assets dedicated for pensions and the payment of pensions to plan members as the benefits come due. A trust, or equivalent arrangement, that is used to administer a pension plan and that has the following characteristics is referred to by the Exposure Draft as a qualified trust:

1. Employer contributions to the plan, including contributions made on behalf of the employer(s) by a nonemployer contributing entity, and earnings on those contributions are irrevocable.
2. Plan assets are dedicated to providing pensions to plan members in accordance with the benefit terms.
3. Plan assets are legally protected from the creditors of the employer(s), non-employer contributing entities, and the plan administrator. If the plan is a defined benefit plan, plan assets also are legally protected from creditors of the plan members.

*NOTE: The criteria listed above are meant to make the criteria for a qualified trust essentially the same as those for a qualified trust under GASB Statement No. 43, **Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans** (GASBS 43). Basically, the GASB does not want to report as pension assets any assets over which the employer has discretionary control to redirect the resources for other uses.*

The statement resulting from this Exposure Draft would establish standards for accounting and financial reporting by governments whose employees are provided

with defined benefit pensions through qualified trusts. These standards would establish the procedures for measuring and recognizing the obligations associated with pensions as liabilities and the costs of pensions as expenses, deferred outflows of resources, or deferred inflows of resources. The proposed statement identifies the methods and assumptions that would be used to project pension payments, discount projected payments to their present values, and attribute those present values to periods of employee service.

The note disclosure and required supplementary information requirements for employers whose employees are provided with defined benefit pensions through qualified trusts also are addressed. Distinctions are made regarding the particular requirements for employers based on the number of employers whose employees are provided with pensions through the plan and whether pension assets and obligations are shared.

Employers are classified in one of the following categories for purposes of applying the requirements of the proposed statement:

- Single employers are those whose employees are provided with defined benefit pensions through single-employer pension plans—plans in which pensions are provided to the employees of only one employer.
- Agent employers are those whose employees are provided with defined benefit pensions through agent multiple-employer pension plans—plans in which plan assets are pooled for investment purposes but are legally segregated to pay the pensions of each employer's employees.
- Cost-sharing employers are those whose employees are provided with defined benefit pensions through cost-sharing multiple-employer pension plans—plans in which the participating employers pool or share their obligations to provide pensions to their employees, and plan assets can be used to pay the pensions of any participating employer's employees.

NOTE: These definitions are consistent with those in current use. The accounting and financial reporting requirements of the statement proposed by the Exposure Draft vary by type of employer as categorized above, so it remains very important to pay particular attention to their proper classification.

In addition, the proposed Statement details the recognition and disclosure requirements for employers with liabilities to a pension plan administered through a qualified trust and those whose employees are provided with defined contribution pensions through a qualified trust. It also addresses special funding situations. Each of these areas is discussed below.

Defined Benefit Pensions

Single and agent employer liabilities to employees for defined benefit pensions. A single or agent employer whose employees are provided with defined benefit pensions through a qualified trust would be required to recognize a net pension liability in financial statements prepared using the economic resources measurement focus and accrual basis of accounting. The net pension liability would equal the em-

ployer's total pension liability less the amount of plan net position restricted for pensions (plan net position), as of the end of the employer's reporting period. The total pension liability would be the portion of the present value of projected benefit payments that is attributed to employees' past periods of service. Actuarial valuations of the total pension liability would be required to be conducted at least every two years under the proposed statement, with more frequent valuation encouraged. If a valuation is not conducted as of the end of the employer's reporting period, measurement of the total pension liability would be based on update procedures to roll forward amounts from the most recent actuarial valuation conducted as of a date no more than 24 months prior to the employer's most recent year-end.

*NOTE: This is a significant change in that single and agent employer liabilities will now actually **record** in their financial statements what essentially is their unfunded pension liability. Previously, this amount was only disclosed in the financial statements. The reporting of this liability in the financial statements would follow a similar requirement adopted for private sector (i.e., FASB reporting) entities several years ago, although the offsetting amounts recorded as deferred outflows of resources is definitely different in the proposed GASB reporting.*

Note also that this requirement only applies where the accrual basis of accounting and economic resources measurement focus is used—basically proprietary funds and the government-wide financial statements. Governmental funds (which use modified accrual accounting and the current financial resources measurement focus would **not record** this liability.

Selection of assumptions. Unless otherwise specified, all assumptions underlying measurements required by the proposed statement would be made in conformity with Actuarial Standards of Practice issued by the Actuarial Standards Board of the American Academy of Actuaries.

NOTE: The changes discussed below to the inclusion of automatic COLAs in the liability calculation, the rules for selecting discount rates and the required use of the entry age normal actuarial method to calculate the pension liability are very significant changes to current standards. These changes are consistent with what will be required for plan accounting and financial reporting that was discussed previously in the related Exposure Draft. The resulting calculations will result in a standardized methodology for measuring net pension liability, rather than having this measurement dependent on the funding calculation methodologies permitted in current standards.

Projections of benefit payments. Projections of benefit payments to employees would be based on the then-existing benefit terms and legal agreements and would incorporate projected salary increases (if the pension formula is based on compensation levels) and service credits (if the pension formula is based on periods of service), as well as projected automatic cost-of-living-adjustments (COLAs) and other automatic postemployment benefit changes. Projections also would include ad hoc COLAs and other ad hoc postemployment benefit changes, if they are considered to be substantively automatic.

Discount rate. Projected benefit payments would be discounted to their present value using the single rate that would reflect (1) a long-term expected rate of return on plan investments to the extent that plan net position is projected to be sufficient to pay pensions and the net position projected to remain after each benefit payment can be invested long-term and (2) a tax-exempt, high-quality municipal bond index rate to the extent that the conditions in (1) are not met.

NOTE: Since the long-term expected rate of return on plan assets is almost always earned from investments whose income would be taxable were it not held in a pension trust, this expected return is likely to be a higher rate than that of the municipal bond index. Accordingly, assuming that the plan assets will not be sufficient to be projected to cover the pension liability, factoring in the lower rate from the municipal bond index will generally result in a lower discount rate, which will result in a larger pension liability on a discounted basis.

Attribution method. The attribution of the actuarial present value of benefit payments would be accomplished using the entry age normal actuarial cost method as a level percentage of pay. The actuarial present value would be attributed for each employee individually, from the period when the employee first accrues pensions through the period when the employee retires.

NOTE: While the GASB has reduced the acceptable number of actuarial attribution methods for calculating net pension liability from six to one (entry age normal) that does mean that governments are required to make any changes to the actual funding calculation methodologies that they currently utilize. However, an employer's annual required contribution for financial reporting purposes will be calculated using the entry age normal attribution method.

Measurement of Pension Expense and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

The pension expense and deferred outflows of resources and deferred inflows of resources related to pensions that would be recognized in the financial statements of an employer whose employees are provided with defined benefit pensions through a qualified trust would result from changes in the net pension liability—that is, changes in the employer's total pension liability and the pension plan's net position.

Changes in the total pension liability relating to current period service cost, interest on the total pension liability, and benefit changes would be included in pension expense immediately. With regard to the effects on the total pension liability of changes of economic and demographic assumptions and of differences between expected and actual experience, the portion related to inactive employees would be included in pension expense immediately. The portion related to active employees would be recognized as deferred outflows of resources or deferred inflows of resources related to pensions and included in pension expense in a systematic and rational manner over a closed period that is representative of the expected remaining service lives of active employees, beginning with the current period.

Changes in plan net position resulting from projected earnings on the plan's investments would be included in pension expense immediately. The effect of differ-

ences between the projected earnings and actual experience would be recognized as deferred outflows of resources or deferred inflows of resources related to pensions and included in pension expense in a systematic and rational manner over a closed period of five years, beginning with the current period.

All other changes would be included in pension expense in the period in which they occur.

NOTE: The calculations of what is reported as pension expense and what is reported as a change in deferred outflow or inflows of resources is very specific (and somewhat complex and confusing.) What is important to keep in mind is that the distinctions are being made to determine what amounts are included in pension expense for a reporting period and what amounts are included as deferred outflows or inflows of resources, which do not affect pension expense but instead are reported on the "balance sheet" (i.e., the net position statement).

Financial Statements Prepared Using the Current Financial Resources Measurement Focus and Modified Accrual Basis of Accounting

In financial statements prepared using the current financial resources measurement focus and modified accrual basis of accounting, a net pension liability would be recognized to the extent the liability is normally expected to be liquidated with expendable available financial resources. Pension expenditures would be recognized equal to the total of amounts contributed to the pension plan and amounts normally expected to be liquidated with expendable available financial resources.

NOTE: In other words, pension accounting in the governmental funds remains essentially unchanged from current requirements.

Notes to Financial Statements of Single and Agent Employers

The notes to financial statements of single and agent employers whose employees are provided with pensions through a qualified trust would be required by the proposed statement to provide descriptive information, such as the types of benefits provided and the composition of the employees covered by the benefit terms. Single and agent employers also would disclose the following:

- For the current year, changes in the net pension liability
- Significant assumptions used to calculate the total pension liability, including assumptions used in calculating the discount rate
- The date of the underlying actuarial valuation, information about changes of assumptions and benefit terms, the basis for determining employer contributions to the plan, and information about the purchase of allocated insurance contracts, if any
- The individual components of the current period pension expense
- Explanations of the changes in the deferred outflows of resources and deferred inflows of resources related to pensions during the current period.