

## 100 Introduction

### Scope of the State and Local Governmental Sector

100.1 In 2012, the U.S. Bureau of the Census identified more than 89,000 units of local government, in addition to the 50 states, classified as follows:

a. Counties	3,031
	19,522
b. Municipalities	16,364
c. Townships	12,884
d. School districts	<u>37,203</u>
e. Special districts	89,004

Municipalities, counties and townships include cities, towns, villages, parishes, boroughs, etc. Special districts include port authorities, industrial development and housing agencies, water, park, and planning commissions, etc. In addition, there are thousands of subordinate agencies of these governments, including entities such as statutory authorities, commissions, corporations, etc., with governmental characteristics that are subject to administrative or fiscal control of independent local governments. Section 101 discusses the definition of governments in more detail.

100.2 States, counties, cities, towns, etc., provide a broad range of services to citizens, whereas special districts usually provide narrower, specialized services. In addition, governments may operate organizations such as hospitals, colleges, universities, employee benefit plans, or other

nonbusiness organizations to provide services.

100.3 By any measure, state and local governments play a significant role in the U.S. economy. The U.S. Department of Commerce Bureau of Economic Analysis reported that in the first quarter of 2015, state and local governments raised \$2.3 trillion in revenues, with 67% from taxes, including personal, production and imports, and corporate income tax. Spending totaled \$2.5 trillion, including \$1.6 trillion in consumption, \$.6 trillion in social benefits, and \$.2 trillion in interest payments. Compared to the U.S. Gross Domestic Product (GDP), state and local governments represent 11% of the U. S. economy. The U.S. Census Bureau 2012 Census of State and Local Governments reported that education was the largest component (32.2%) of state and local spending, followed by public welfare (18.0%), insurance trust (unemployment) (12.8%), and utilities (7.6%). While this breakdown varies significantly between state and local governments, local governments still spend 36.3% of their resources on education. Combined total debt outstanding for state and local governments in 2012 was \$2.9 trillion, with local governments holding 61% of that debt. Census employment reports for 2013 indicated that state governments employed 5.3 million people, while local governments employ 13.8 million people.

100.4 Besides their economic significance, local governments affect all individuals and organizations in the United States. They regulate aspects of daily and commercial life through laws, ordinances, regulations, etc. They provide services such as education, police and fire protection, court systems, transportation, water supply and other utilities, streets and highways, parks, libraries, etc.

100.5 The role of state and local governments, relative to that of the federal government, has expanded in the last few decades due, in part, to reduced federal spending at the state and local level along with growth of federally mandated programs imposed upon states and localities. In addition, there has been an increased demand by citizens for public services. One result has been an increase in the number of special districts created to provide specialized services—over 43 percent since 1977.

100.6 Financing methods have also changed, due, in part, to taxpayer resistance to new taxes and initiatives to limit tax increases, as well as to governments reaching their debt capacity limits. As a result, traditional financing sources such as property taxes have decreased while sales taxes and user fees have increased.

### **Scope of This Guide**

100.7 This *Guide* is concerned with the measurement, presentation, and disclosure of transactions and balances in accordance with GAAP in governmental financial statements. Thus, it focuses on the accounting and financial reporting standards for governmental entities as promulgated by the Governmental Accounting Standards Board (GASB). It is not a bookkeeping manual, that is, it is not concerned with preparation of books of original entry. However, it does provide journal entries to illustrate discussion of the accounting for various transactions, particularly complex ones or those that affect more than one fund.

100.8 **GASB Pronouncements Considered** This *Guide* includes relevant technical developments

as of September 2015. It is current as of:

- a. GASBS Statement No. 77, *Tax Abatement Disclosures*.
- b. GASB Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*.
- c. GASB Technical Bulletin No. 2008-1, *Determining the Annual Required Contribution Adjustment for Postemployment Benefits*.
- d. GASB Concepts Statement No. 6, *Measurement of Elements of Financial Statements*.
- e. GASB *Implementation Guide No. 2015-1*.

100.9 This *Guide* retains detailed discussions of GASBS No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and GASBS No. 27, *Accounting for Pensions by State and Local Governmental Employers*. These sections (809 and 803, respectively) remain in effect until GASBS No. 73, *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*, becomes effective for periods beginning after June 15, 2016, and provides guidance for those plans that are not administered through trusts that meet the criteria in GASBS No. 67 and 68. GASBS No. 67, *Financial Reporting for Pension Plans—an amendment of GASB Statement No. 25*, replaced the requirements of GASBS Nos. 25 and 50 for pension plans administered through trusts or equivalent arrangements that meet certain criteria effective for financial statements for fiscal years beginning after June 15, 2013. GASBS No. 68, *Accounting and Financial Reporting for Pensions—an amendment of GASB Statement No. 27*, replaced the requirements of GASBS Nos. 27 and 50 for pension plans administered through trusts or equivalent arrangements that meet certain criteria effective for financial statements for fiscal years beginning after June 15, 2014. GASBS Nos. 67 and 68 are discussed in sections 810 and 804, respectively. In addition, the disclosure checklist at Appendix B-1 includes disclosures required by GASBS Nos. 67 and 68, as well as by GASBS Nos. 25 and 27, and GASBS No.73.

100.10 **Nonspecialized Accounting Standards for Business-type Activities** As discussed in section 107, GASBS No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, codified several FASB pronouncements and added these provisions to the GASB Codification. Section 1 of Appendix 1B

summarizes these changes. However, certain pre-1989 FASB pronouncements were not added to the GASB Codification because state and local governments rarely use these provisions. This guidance may continue to be applied as “nonauthoritative accounting literature.” Section 2 of Appendix 1B outlines these FASB pronouncements issued prior to November 30, 1989.

**100.11 Specialized Accounting Standards Not Covered** This *Guide* does not cover the specialized accounting standards in the following documents and pronouncements:

- a. AICPA Audit and Accounting Guide, *Health Care Entities*. Section 1708 discusses the requirement for governmental healthcare entities that use enterprise fund accounting and financial reporting to follow the AICPA Health Care Guide. Although this *Guide* does not discuss the provisions of the AICPA Health Care Guide in any detail, it will be helpful to preparers of governmental healthcare entity financial statements to the extent that GASB requirements apply.
- b. Broadcasters, discussed in GASBS No. 62, paragraphs 385-388 (GASB Cod. Sec. Br10).
- c. Cable television systems, discussed in GASBS No. 62, paragraphs 389-399 (GASB Cod. Sec. Ca5).
- d. Foreign currency transactions, discussed in GASBS No. 62, paragraphs 165-172 (GASB Cod. Sec. F70).
- e. Insurance entities other than public entity risk pools, discussed in GASBS No. 62, paragraphs 400-430, as amended by GASBS No. 65, *Items Previously Reported as Assets and Liabilities*, para. 20 (GASB Cod. Sec. In3).
- f. Lending activities, discussed in GASBS No. 62, paragraphs 431-451, as amended by GASBS No. 65, paragraphs 21-24 and 31, effective for fiscal years beginning after December 15, 2012 (GASB Cod. Sec. L30).
- g. Mortgage banking activities, discussed in GASBS No. 62, paragraphs 452-475, as amended by GASBS No. 65, paragraphs 26-27, effective for fiscal years beginning after December 15, 2012 (GASB Cod. Sec. L30).

h. Regulated operations, discussed in GASBS No. 62, paragraphs 476-500, as amended by GASBS No. 65, paragraph 29, effective for fiscal years beginning after December 15, 2012 (GASB Cod. Sec. Re10).

i. Research and development arrangements, discussed in GASBS No. 62, paragraphs 374-384 (GASB Cod. Sec. R50).

j. Sales of real estate, discussed in GASBS No. 62, paragraphs 282-349 (GASB Cod. Sec. R30).

k. Costs and initial rental operations of real estate projects, discussed in GASBS No. 62, paragraphs 350-373 (GASB Cod. Sec. R30).

GASBS No. 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities*, requires public colleges and universities to follow the special-purpose government provisions of GASBS No. 34. Chapter 17 of this *Guide* discusses accounting and reporting by special purpose governments, including colleges and universities.

**100.12 Governmental Not-for-profits** Entities that are established as 501(c) organizations under the U.S. Internal Revenue Code but that meet the definition of a government (section 101) are required to report using the GASB standards as discussed in this *Guide*. SLG, paragraph 1.02, states that incorporation as a 501(c) not-for-profit organization is not a criterion in determining whether an entity is governmental or nongovernmental for accounting, financial reporting, and auditing purposes. Rather, an entity is assumed to be governmental or not based on the definition discussed in paragraph 101.5 of this *Guide*. Some governmental not-for-profits may be reported using enterprise fund accounting and financial reporting based on GASBS No. 34, paragraph 147, even if they do not meet the definition of an enterprise fund. See the discussion beginning in paragraph 1701.26 of this *Guide*.

**100.13 States and Special-purpose Governments** The focus of this *Guide* is on governmental accounting principles as they apply to general purpose governments—cities, other municipalities, and counties. However, the guidance is also generally applicable to states as well as school districts and many other special-purpose governments. Sections 1702 and 1703 discuss accounting issues unique, or particularly significant, to states and school districts. Chapter 17 of this *Guide* also discusses the accounting and financial reporting principles for public employee retirement systems (PERS) (section 1705), external investment pools (section 1706), and public entity risk pools (section 1704). Accounting and reporting guidance for federal entities is beyond the scope of this *Guide*.

**100.14 Performance and Reporting Standards Not Covered** This *Guide* covers financial statement preparation standards, that is, GAAP applicable to financial statements of governmental entities. Its guidance is useful to preparers of GAAP financial statements, whether those preparers are accountants in government or in public practice. Performance standards are the standards and procedures that a CPA in public practice must follow when associated with, and reporting on, the financial statements of a client. Performance and reporting standards include standards for the compilation, review, or audit of financial statements. Discussion of performance and reporting standards is beyond the scope of this *Guide*. Guidance on the performance and reporting for compilation and review engagements may be found in *PPC's Guide to Compilation and Review Engagements* and guidance on performance and reporting for audits of governmental financial statements may be found in *PPC's Guide to Audits of Local Governments*. In addition, guidance on performing Single Audits for entities receiving federal awards is provided in *PPC's Guide to Single Audits*.

**100.15 Quality Control Standards Not Covered** Quality control standards relate to the internal system that a CPA firm uses to provide itself with reasonable assurance of conforming to the professional standards (including performance and reporting standards) in financial statement engagements. Quality control standards apply to compilation, review, attestation, and audit engagements. Discussion of quality control standards is beyond the scope of this *Guide*. Guidance may be found in *PPC's Guide to Quality Control*.

**100.16 Ethics Standards Not Covered** Ethics standards relate to the performance of professional responsibilities by all members of the AICPA, whether they are in public practice, government, industry, or education. Those standards are codified in the AICPA *Code of Professional Conduct*. Discussion of ethics standards is beyond the scope of this *Guide*.

### **Organization of This Guide**

**100.17 Chapters** This *Guide* includes 17 chapters that discuss authoritative accounting literature pertinent to the chapter topic. Each chapter presents examples and journal entries when appropriate to help in the understanding and application of the accounting rule being discussed. Chapter 2 gives an overview of the basic fund accounting principles, for example, use of the modified accrual basis of accounting by governmental funds and brief descriptions of fund definitions, etc. Chapter 3 provides detailed descriptions of fund definitions and interfund activity. Chapters 4-9 discuss basic accounting requirements and are arranged by financial statement category, for example, revenues and receivables, cash and investments, debt, etc. Chapters 10 through 16 discuss financial reporting requirements, including the financial reporting entity, basic financial statements, notes, required supplementary information (RSI) and comprehensive annual financial reports (CAFRs). The following chapters make up this *Guide*:

Chapter 2—Fund Accounting Overview.

Chapter 3—Fund Definitions and Interfund Activity.

Chapter 4—Revenues and Receivables.

Chapter 5—Operating Expenditures/Expenses and Liabilities (Other Than Employee Benefits).

Chapter 6—Cash and Investments.

Chapter 7—Capital Assets, Including Intangibles and Infrastructure.

Chapter 8—Employee Benefits.

Chapter 9—Debt and Debt Service.

Chapter 10—Financial Reporting Overview.

Chapter 11—Presenting Fund Financial Statements.

Chapter 12—Deriving Government-wide Financial Statements from Fund Financial Statements.

Chapter 13—Notes to Basic Financial Statements.

Chapter 14—Budgetary Reporting.

Chapter 15—Management's Discussion and Analysis.

Chapter 16—Comprehensive Annual Financial Reports.

Chapter 17—States and Special-purpose Governments.

Each chapter includes a section discussing future accounting developments, where applicable, for example, GASB projects in progress or exposure drafts outstanding. The *Guide* is updated annually for accounting and financial reporting changes that result from the issuance of new GASB Statements or other pronouncements.

100.18 **Appendixes** Chapter appendixes follow many of the chapters listed at paragraph 100.17. Appendixes to selected chapters present checklists, worksheets, practice aids, cases, illustrative financial statements, and other information to aid in understanding or implementing the standards discussed in the *Guide*. The appendixes are referred to by a number letter combination where the number represents the chapter number and the letter represents the order of the appendix. For example, Appendix 1A is the first appendix following this chapter. Other more general appendixes are located at the end of the *Guide*. Those appendixes include the following:

- Appendix A—Comprehensive Annual Financial Reports.
- Appendix B-1—Governmental Disclosure Checklist.

Appendixes provided in this chapter include:

- Governmental entity determination checklist (Appendix 1A).

- Pre-November 30, 1989 FASB and AICPA Pronouncements Codified by GASBS No. 62 (Appendix 1B).

100.19 **Acronyms for Authoritative Pronouncements** This *Guide* uses the following acronyms to refer to authoritative pronouncements:

- a. GASBS No. X—Governmental Accounting Standards Board Statement No. X.
- b. GASBC No. X—Governmental Accounting Standards Board Concepts Statement No. X.
- c. GASBI No. X—Governmental Accounting Standards Board Interpretation No. X.
- d. GASBTB No. XX-X—Governmental Accounting Standards Board Technical Bulletin No. XX-X.
- e. GASB Cod. sec. xxxx.xxx—GASB Codification section xxxx.xxx (all references are to the June 30, 2014 edition).
- f. BFC—The Basis for Conclusions section of a referenced GASB Standard.
- g. *GASB Implementation Guide No. 2015-1*—this GASB publication contains all previously issued GASB Implementation Guides and Comprehensive Implementation Guides and updates them for the effects of new GASB pronouncements. (See the discussion beginning in paragraph 107.11.)
- h. SLG—The AICPA Audit and Accounting Guide, *State and Local Governments* (updated as of March 2015).
- i. NCGAS X—National Council on Governmental Accounting Statement No. X.

j. SAS No. X—Statement on Auditing Standards No. X.

k. AU-C XXX.XX—AICPA auditing standards section and paragraph XXX.XX.

l. FASBS No. X—FASB Statement of Financial Accounting Standards No. X.<sup>1</sup>

m. 2012 GAAFR—The GFOA *Governmental Accounting, Auditing, and Financial Reporting*, issued in 2012 (also called The Blue Book).

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<sup>1</sup> Effective September 15, 2009, FASBS No. 168 replaced the previous four part hierarchy of GAAP for nongovernmental entities with the FASB *Accounting Standards Codification* or “FASB ASC.” The FASB ASC took all sources of nongovernmental GAAP under the previous hierarchy and merged them into a codification, similar to the GASB Codification. The FASB ASC does not apply to governmental entities. As discussed in section 107, GASBS No. 62 codifies guidance contained in pre-November 30, 1989 FASB and AICPA pronouncements that is applicable to state and local governments. In certain instances, the *Guide* refers to a previous FASB standard to provide additional background relating to the accounting for an item.

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## 101 Definition of a Governmental Entity

### Definition of a Government—THE BASICS

- Any entity that meets the definition of a government must follow GASB pronouncements (other than the federal government). All others follow the *FASB Accounting Standards Codification*.
- All general purpose governments meet the definition of a government simply based on the fact that they are public corporations or

bodies corporate  
and politic.

- Other organizations may be governments based on one of the four characteristics discussed in paragraph 101.5.

101.1 What is a governmental entity? In some cases, the answer is obvious. A state or a city, for instance, obviously is a government. In other cases, however, it may not be obvious whether a particular entity should be considered governmental for the purpose of determining whether governmental accounting and reporting standards apply. The determination may be particularly difficult for special districts or entities created under general corporation or not-for-profit corporation laws and that perform some governmental functions, have some characteristics of government, or are controlled by a governmental entity. For example, is a community services center that provides youth recreation and job training services and is financed through government grants and city contracts a governmental entity or a nongovernmental entity? The answer depends on other specific circumstances discussed in the following paragraphs.

101.2 As discussed in section 107, the GASB has jurisdiction over accounting and financial reporting standards for state and local governmental entities, and the Financial Accounting Standards Board (FASB) has jurisdiction over standards for nongovernmental organizations. Thus, the determination of whether an entity is a governmental entity has important accounting consequences.

101.3 In March 1996, the GASB and the FASB met jointly to clear the proposed AICPA Audit and Accounting Guide, *Health Care Organizations*. During that meeting, the GASB and the FASB agreed on a definition of a governmental organization that should be used in determining whether an entity should follow GAAP for governments.

101.4 Rather than issue a Statement, the two Boards decided to clear AICPA audit and accounting guides containing the definition, which, at the time, ranked as a level “b” source of GAAP. Previous nonauthoritative guidance in this area consisted of a November 1993 GASB staff paper titled “Applicability of GASB Standards” (the GASB Staff Paper). Readers of this *Guide* should be aware that determining that an organization is governmental based on the definition does not supersede guidance in GASBS No. 14, *The Financial Reporting Entity*, as amended, regarding whether to include the organization in a particular governmental financial reporting entity. (See section 102.)

## Definition

101.5 The following definition of a *governmental entity* originally provided in paragraph 1.01 of SLG, has been incorporated into the GASB Category B authoritative GAAP with the issuance of GASBS No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*, as AICPA literature that has been cleared by the GASB (See GASBS No. 76, Appendix C, Paragraph C1 and the discussion of the GAAP hierarchy beginning at paragraph 107.17):

Public corporations and bodies corporate and politic are governmental entities. Other entities are governmental entities 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 of one or more state or local governments
  
- The potential for unilateral dissolution by a government with the net position reverting to a government
  
- The power to enact and enforce a tax levy

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.

### **Common Examples**

101.6 Most potential governmental organizations will clearly fit into the first sentence of the definition in paragraph 101.5. *Black's Law Dictionary* describes a public corporation as a municipality or a governmental corporation that has been created to administer public affairs or as an instrumentality of the state, founded and owned in the public interest. The following entities are common examples of governmental entities.

- a. States, territories of the United States, and the District of Columbia.
  
- b. Entities created by or under a state constitution, statute, statutory enabling legislation, or other local ordinance, including—

- (1) Cities.
- (2) Counties.
- (3) Towns.
- (4) Townships.
- (5) Villages.
- (6) Parishes.
- (7) Boroughs.
- (8) School districts.
- (9) Special districts.
- (10) Public authorities.

c. Entities are considered to be a “municipal corporation” because they are declared by statute to be a “public corporation” or a “body corporate and politic.” Legally separate special-purpose entities may be so designated so that they can avoid limitations or requirements placed on the general government, such as limitations on debt issuance or civil service requirements.

## Example of Determination as to Governmental Nature

101.7 As an example of the definition in paragraph 101.5, consider the question posed in paragraph 101.1 about the governmental nature of a community services center that provides youth recreation and job training services and is financed through government grants and city contracts. Presented below are two situations in which the center would be considered governmental and one in which it would not. Although these examples are based on Illustration 1 in the GASB Staff Paper, they remain applicable based on the revised definition of a governmental organization.

a. The center would be considered to be a governmental organization if it was created by a city ordinance pursuant to state enabling legislation as a “body corporate and politic” and its governing board was appointed by the city's mayor, and if the center could issue its own tax-exempt debt.

b. The center would be considered to be a governmental organization if it was incorporated as an IRC Sec. 501(c)(3) not-for-profit corporation under the state's not-for-profit corporation laws and if its governing board consisted entirely of city officials serving *ex officio*, that is, serving by virtue of their status as city officials. The status as governmental would apply even if the center could not issue its own tax-exempt debt.

c. The center would not be considered to be a governmental organization if it was organized by a private civic group and incorporated as a Section 501(c)(3) not-for-profit corporation under the state's not-for-profit corporation laws and if its governing board consisted entirely of private, nongovernmental individuals. It would be nongovernmental because it was not created by a governmental organization, no governmental organization has control over its operations, and it does not possess any characteristics of government, such as popularly elected officials or the power to tax. The status as nongovernmental would apply even if a governmental agency issued tax-exempt debt on the center's behalf.

In the first two situations, the center's accounting and financial reporting would be subject to the standards-setting authority of the GASB. In the third situation, the center would be subject to the standards-setting authority of the FASB. Note that this could result in different accounting and financial reporting by two entities that engage in the same activities and differ only with respect to their being governmental or nongovernmental organizations.

## Checklist for Determining Whether an Entity Is Governmental

101.8 Appendix 1A presents a checklist that can be used as an aid in determining whether an entity is a governmental entity based on the guidance discussed in the preceding paragraphs. Entities determined to be nonprofit organizations should consult *PPC's Guide to Preparing Nonprofit*

*Financial Statements.*

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## 102 Defining the Financial Reporting Entity

102.1 Governments, such as cities, provide services and engage in activities through a variety of organizations that may have differing degrees of autonomy from the city's elected officials and differing degrees of financial accountability to the city. Which of these entities should be included in the city's financial statements? The *financial reporting entity* refers to the units of government, organizations, and activities included in a particular set of financial statements.

102.2 GASBS No. 14, *The Financial Reporting Entity*, as amended, establishes the criteria for determining what makes up the financial reporting entity. The financial reporting entity is comprised of a primary government and organizations for which the primary government is financially accountable. A primary government is a state government, general purpose local government, or special-purpose government that meets certain criteria of GASBS No. 14 denoting its independence from other state or local governments. Those criteria include the ability to adopt its own budget, to set its own tax and other revenue rates, and to issue debt without substantive approval from another entity.

102.3 One should not confuse the definition of a governmental entity discussed in section 101 with the GASBS No. 14 criteria for a primary government. That is, an entity might meet the definition of a government but not meet the definition of a primary government. Similarly, an entity may not meet the definition of a government but may still be included as a component unit of a governmental entity, as discussed in paragraph 102.4.

### Definition of Component Unit

102.4 A component unit is a legally separate organization for which the primary government is financially accountable. GASBS No. 14 gives the indicators of financial accountability, such as ability to approve or modify the potential component unit's budget or service fee rates or being obligated for the unit's debt. A component unit may be a governmental entity, a nonprofit corporation, or a for-profit corporation. Only its relation to the primary government is important in determining whether it is part of a governmental reporting entity. GASBS No. 39, *Determining Whether Certain Organizations Are Component Units*, amended GASBS No. 14. It provides guidance on when certain legally separate

tax-exempt organizations for which the primary government is *not* financially accountable (often referred to as “affiliated organizations”) should, nonetheless, be included in a government's financial reporting entity.

**102.5 GASB Statement No. 61** GASBS No. 61, *The Financial Reporting Entity: Omnibus*, amended GASBS No. 14. As discussed in section 1006, GASBS No. 61 modifies the requirements for inclusion of component units in the financial reporting entity when there is fiscal dependence. An organization previously included based on meeting the fiscal dependency criterion would also need to have a financial benefit or burden relationship with the primary government for it to be included in the reporting entity as a component unit. GASBS No. 14, paragraph 55, as amended by GASBS No. 61, paragraph 10, also requires that a government include as a component unit any other organization in which it has a majority equity interest for the purpose of directly facilitating government services. This expands a GASBS No.14 requirement that applied only to equity interests in business enterprises. GASBS No. 61 provides additional guidance on reporting component units on the basis that it would be misleading to exclude them.

### **Discrete Presentation of Component Units**

102.6 There are two ways of reporting a nonfiduciary component unit in the financial statements of the reporting entity: discrete presentation and blending. These are not options; the method for which the unit qualifies must be used to report that component unit in the primary government's financial statements. Most component units are discretely presented. Discrete presentation refers to presentation of data for the component unit in a column to the right of the data columns for the primary government. Fiduciary component units are aggregated with the corresponding fiduciary funds of a primary government (GASBS No. 34, paragraph 106 and Question 7.77.4 of the *GASB Implementation Guide No. 2015-1*).

### **Blending of Component Units**

102.7 Blending means that the component unit is so closely related to the primary government that it is, in effect, the same as the primary government. In this case, the data for the component unit's funds are combined with the data for corresponding funds of the primary government. (As discussed in section 1006, GASBS No. 61 amends the criteria for blending component units.)

### **Guidance on the Financial Reporting Entity**

102.8 Sections 1005 and 1006 discuss the financial reporting entity in detail, and Appendix 10A presents a checklist for determining the financial reporting entity based on the reporting entity requirements established by GASBS No. 61.

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## 103 The Government Environment

103.1 Some aspects of the governmental sector are similar to the nongovernmental sector. For example, fees may be charged to users of some government services, and the governmental service activity may be operated on a cost-recovery basis. In general, the accounting and financial reporting for such “business-type” (proprietary) activities are similar to the accounting for similar activities provided by business enterprises in the private sector. Other aspects of the governmental sector, however, are quite different from the private sector, and the accounting and financial reporting for those aspects are unique. Thus, it is important to understand those unique environmental characteristics.

103.2 GASBC No. 1, *Objectives of Financial Reporting*, paragraph 13, identifies, among others, the following significant government environmental characteristics:

a. Government structure and services—

(1) The representative form of government and separation of powers.

(2) The relationship of taxpayers to services received.

b. Control characteristics—

(1) The budget as an expression of public policy and as a method of providing control.

(2) The use of fund accounting for control purposes.

c. Other—

(1) The political process.

(2) Significant investment in non-revenue-producing capital assets.

The following paragraphs discuss these characteristics and how they affect governmental accounting and financial reporting.

### **Governmental Structure and Budget**

103.3 State and local governments operate as representative forms of government in which elected officials and separate branches of government ultimately are accountable to the electorate. For example, the executive branch prepares a budget that, when approved by the legislative branch, authorizes expenditures and has the force of law. Citizens play a role in the budget-adoption process, for example, by commenting on a proposed budget at budget hearings. Thus, the adopted budget becomes an expression of public policy of service objectives and priorities. The legally adopted budget also serves as a form of control and a means of demonstrating accountability.

103.4 The governmental accounting model recognizes the annual budget's significance by focusing on the flows of current financial resources in the governmental fund financial statements. This measurement focus is the same as or similar to the measurement focus used in many governments' legally adopted budgets. Using this measurement focus, certain noncurrent, nonfinancial resources, liabilities, and expenditures are given unique treatment so that these assets and liabilities are reported in the same manner as they are in most legally adopted budgets. In addition, GAAP requires governments to present budget-to-actual comparisons for their general fund and each major special revenue fund that has a legally adopted annual or biennial budget to demonstrate whether government officials adhered to the spending authorizations and limitations inherent in the budget. (See section 1401.)

103.5 **Fund Accounting** Besides the budget, other legal and contractual provisions govern how governments may raise and spend resources. For example, a debt agreement may specify the use for which borrowed monies may be spent and may require the accumulation of resources for

repaying the debt. Or, enabling legislation authorizing a new tax or fee may restrict the revenues to use for a specific purpose. Or, a grant agreement may stipulate how grant resources received from another level of government may be used. Fund accounting is a way governments traditionally have controlled the use of resources designated for a specific purpose and have demonstrated compliance with the legal or contractual provisions governing specific resources. Even though computerized accounting systems may have diminished the need for fund-based accounting systems, fund-based financial reporting is still a way for governments to demonstrate that resources were used as authorized and the government was in compliance with other finance-related legal or contractual requirements.

### **Relationship of Taxpayers to Services Received**

103.6 In a representative democracy, the electorate as a whole authorizes, through actions of elected officials, the imposition of taxes to raise resources needed to provide basic government services. However, individual taxpayers must abide by that taxing decision and pay taxes whether they want to or not and whether they receive all the authorized services or not. Because taxes may be based on factors such as income or the value of property owned, the amount of taxes an individual citizen pays usually will not bear a direct relationship to the value of tax-supported services that the taxpayer receives. For example, property owners must pay property taxes to finance public education even though they do not have any children in public schools. The fact that individual taxpayers are involuntary resource providers increases the need for governmental financial reporting to demonstrate fiscal accountability to those resource providers.

### **Absence of Exchange Relationship, Profit Motive, and Competition**

103.7 There is not an exchange relationship between resources provided to governments and many general government services provided by governments. For example, the fire department generally does not bill a citizen for its services in fighting a fire on the citizen's property. Also, governments provide many services that the private sector would not find cost-effective or profitable to provide, for example, public transportation. The result is that, in some instances, the government is the only provider of a service.

103.8 This monopolistic quality and the lack of a profit-motive for providing services can result in difficulty in measuring the efficiency of many government operations. Unlike the private business sector, the government is not measured in terms of profit or loss or return on shareowners' investment. Instead, governmental financial reporting must provide other methods of evaluating the government's efficiency and effectiveness. The GASB's *Suggested Guidelines for Voluntary Reporting: SEA Performance Information*, on service efforts and accomplishments reporting is discussed in section 1014 of this *Guide*.

### **Political Nature of Government**

103.9 Government is by definition a political process. Elected officials attempt to balance competing claims for limited resources and conflicting taxpayer desires for more services without tax increases. Elected officials often serve for relatively short terms and thus have a short-term horizon for their

view of the value of public policy decisions. There is some incentive for elected officials to satisfy citizens' desires for current services by deferring other services or deferring necessary maintenance of infrastructure (such as streets and bridges) and other non-revenue-producing capital assets. Also, officials may pay for services with nonrecurring, short-term revenues or by deferring the cash effects of certain types of transactions to more remote periods. In the past, the focus on measuring and recognizing long-term or deferred commitments or liabilities had been given less emphasis than the focus on current resources and expenditures that correspond to the time frame of the annual budget. However, management's discussion and analysis (MD&A) and government-wide financial statements, required by GASBS No. 34, address the longer-term focus, that is, interperiod equity. (See additional discussion at paragraph 105.3.)

## **Business-type Activities of Governments**

103.10 Some of the unique characteristics of governmental activities discussed in the preceding paragraphs, and the related accounting and financial reporting implications, can be better understood by contrasting those characteristics with characteristics of business-type<sup>2</sup> (proprietary) activities that governments use for certain operations. Business-type activities have counterparts in the private sector and include activities such as water utilities, sanitation services, golf courses, parking lots and garages, etc. These activities provide the same types of services as are provided by private enterprises. Thus, often there is competition that may be absent from governmental activities. If there is competition, the customers have a choice whether to use the government's proprietary service or not (unless the activity is a monopoly of a necessary service, such as a water utility).

103.11 **Exchange Relationship and User Fees** Like private enterprises, government business-type activities charge user fees and thus have an exchange relationship with service recipients. The government-owned activity may charge user fees at a level that will recover all costs. However, the activity may be subsidized by the government to keep user fees at a level considered politically or economically sustainable. In either case, however, fund financial reporting for these activities focuses on measuring all costs of the activity, including, for example, depreciation and costs related to long-term commitments. It also focuses on reporting operating income, either to determine the necessary level of user fees or to determine the extent of subsidization necessary. This measurement focus concept is the same as for private-sector enterprises.

103.12 **Revenue-producing Assets** Business-type activities of governments usually are capital intensive. But because the capital assets are revenue-producing (unlike most capital assets associated with governmental activities), there may be less incentive to defer necessary maintenance. Maintenance will be performed as necessary to provide effective and efficient service that will generate revenue. Because the activity reports depreciation and other long-term costs, the related capital assets and long-term liabilities are included in the activity's statement of net position.

103.13 **Different Status of Budget** Because government business-type activities are fully or partially self-supporting from user fees (rather than from taxes), and because they have an exchange relationship with the customers and some relationship between user fees and services, there is less need for a legally adopted budget like that for governmental activities. Business-type activities use

budgets for internal planning and control, but the budgets generally do not have the legal status or political nature of governmental activity budgets. For instance, usually they are not subject to public comment and are not formally adopted by a legislature or governing body. However, it is important to review the applicable state laws for local government budgeting to determine if the business-type activities are exempt from the legal requirements to adopt budgets.

103.14 If the budget for proprietary activities is not a legal requirement for, or limitation on, spending, there is less need to demonstrate compliance with those budgetary guidelines. Thus, GAAP financial reporting includes budgetary comparisons only for certain governmental funds (activities).

103.15 **Absence of Fund Accounting** For similar reasons, business-type activities generally do not use fund accounting in their financial reporting (although the entire activity may be reported in one separate enterprise fund when the activity is included in the financial report of the government as a whole). Business-type activities typically may decide how to spend their revenues and resources to provide the service in the most efficient and effective way. Because the resources usually are not restricted to specified uses, there is no need to segregate the resources and their expenditures into funds for financial reporting purposes. (Debt agreements may specify how debt proceeds are to be used and may require the maintenance of certain “funds,” but those funds are treated as accounts for financial reporting purposes and are not equivalent to fund accounting.)

103.16 The differences discussed in the preceding paragraphs are not absolute. For one thing, the organizational demarcation between governmental and business-type activities is not always clear. For example, one government may organize its parks as a department of the general government while another government may organize them as a separate business-type activity. State laws or regulations can also impose specific accounting and financial reporting on local government entities. As previously mentioned, business-type activities may be subsidized, and therefore subject to the same political process of obtaining tax-supported subsidies and to resulting heightened accountability to the taxpayers. The activities may be a monopoly of necessary service, which affects the relationship with the service recipients. Rates, particularly of utilities, may be subject to regulation, which also increases political considerations and affects the relationship with service recipients. The activity may receive government grants that have restrictions on their use and require demonstration of compliance with those restrictions.

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<sup>2</sup> Both GASBC No. 1 and GASBS No. 34 use the terms *governmental activities* (or *governmental-type*) and *business-type activities*. However, those terms are defined only in GASBS No. 34, paragraph 15. Governmental activities “generally are financed through taxes, intergovernmental revenues, and other nonexchange revenues.” Business-type activities “are financed in whole or in part by fees charged to external parties for goods and services.” Governments are required to report business-type activities separately in their government-wide financial statements. See paragraph 108.12.

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Preparing Governmental Financial Statements

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104 Uses and Users of Governmental Financial Reports

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## **104 Uses and Users of Governmental Financial Reports**

### **Users**

104.1 Who are the users of governmental external financial reports? GASBC No. 1, paragraphs 30-31, identifies the following user groups:

a. *Citizens*. The government is primarily accountable to the citizenry. This user group includes citizen voters, taxpayers, and service recipients, the media, and advocate groups.

b. *Legislative and Oversight Bodies*. These bodies represent the citizens and include members of state legislatures, county commissions, city councils, boards of trustees, school boards, and executive branch officials who have oversight responsibility for other levels of government or for separately organized business-type activities.

c. *Investors and Creditors*. Investors and creditors include individual and institutional investors and creditors, municipal security underwriters, bond rating agencies, bond insurers, and other financial institutions.

Internal government management officials use external financial statements, but they are not identified as a primary user because they have access to the information through internal financial reports.

### **Uses**

104.2 What use do the users identified in the preceding paragraph make of external governmental

financial statements? GASBC No. 1, paragraph 32, lists the following uses:

- a. Comparing actual financial results with the legally adopted budget.
- b. Assessing financial condition and results of operations.
- c. Assessing compliance with finance-related legal and contractual requirements.
- d. Assessing efficiency and effectiveness.

The accounting and financial reporting objectives and standards discussed in this *Guide* are influenced by the uses made of governmental financial statements. The following paragraphs briefly explain these uses.

**104.3 Comparing Actual and Budgeted Results** Paragraph 103.3 explains the special significance of governments' legally adopted budgets. All user groups use governmental financial reports to compare actual to budgeted results. Citizens and legislative and oversight bodies make the comparison to assess whether resources were used as authorized. Other groups assess whether deviations from the budget reflect management weaknesses, poor budgeting practices, or other circumstances. As explained in paragraph 103.13, the budget has less significance for business-type activities. Thus, users of financial statements of business-type activities typically are less interested in comparing actual and budgeted results.

**104.4 Assessing Financial Condition and Results of Operations** Citizens assess whether the reported financial condition and operating results indicate that the government can continue to provide the current level of services with the current level of resources and the likelihood of tax or service fee increases. Legislative and oversight bodies use reported information in planning budgets and programs and to determine the need for tax, fee, or subsidy changes. Investors and creditors use reported information on financial condition to assess the government's ability to meet its debt service obligations.

**104.5 Assessing Compliance with Finance-related Legal and Contractual Requirements** Legal and contractual provisions such as debt covenants, grant restrictions, and statutory taxing or debt limits may control government activities or expenditures. Grantors use governmental fund financial statements to assess compliance with grant requirements, and investors and creditors use them to assess compliance with debt covenants. Citizens, too, are concerned with the government's compliance with such legal and contractual provisions because of the possible consequence of noncompliance, such as loss of grant funds.

104.6 **Assessing Efficiency and Effectiveness** Citizens and legislative and oversight bodies are particularly concerned with the economy, efficiency, and effectiveness with which government uses resources provided through taxes or grants from other levels of government.

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105 Objectives of Governmental Financial Reporting

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# 105 Objectives of Governmental Financial Reporting

105.1 GASBC No. 1 provides the conceptual framework for accounting and financial reporting for state and local governments. In GASBC No. 1 (GASB Cod. Appendix B), the GASB articulated the broad external financial reporting objectives that underlie existing, or will influence future, accounting and financial reporting standards. Many, but not all, of the reporting objectives have been achieved in the GASBS No. 34 financial reporting model. Familiarity with the objectives can increase understanding of the nature and purpose of existing standards and the trend of future standards.

## Accountability

105.2 GASBC No. 1, paragraph 56, states that “accountability is the cornerstone of all financial reporting in government.” That paragraph describes “accountability” as:

Accountability is the cornerstone of all financial reporting in government. . . . The dictionary defines *accountable* as “being obliged to explain one's actions, to justify what one does.” Accountability requires governments to answer to the citizenry—to justify the raising of public resources and the purposes for which they are used.

Accountability implies stewardship. A government is accountable to citizens for its stewardship of resources because individual taxpayers provide the resources involuntarily. Many laws and constitutions reflect the concept of the accountability of government to the people. So should governmental accounting. In paragraph 58, the GASB expressed the conclusion that governmental financial reporting should demonstrate accountability by providing information that will assist in assessing whether a government was “operated within the legal constraints imposed by the citizenry.”

## Interperiod Equity

105.3 GASBC No. 1, paragraph 61, notes that “interperiod equity is a significant part of accountability and is fundamental to public administration.” Although the term “interperiod equity” is not defined in GASBC No. 1 or in other accounting literature, the Board does discuss the term in the context of

balanced budget laws in paragraph 60. It notes that the intent of those laws is that “the current generation of citizens should not be able to shift the burden of paying for current-year services to future-year taxpayers.” Paragraph 77 introduces other facets of interperiod equity, specifically, whether previously accumulated resources were used up in providing service in the current period or whether current-year revenues were not only sufficient but also increased accumulated resources. As far back as the 1920s, commentators noted that the ease of issuing public debt often led governments to finance unfair portions of expenditures through the sales of bonds and thus to unfairly shift the repayment burden to future years. Currently, there is not a perceived problem of capital debt being issued with a term that exceeds the life of the asset it finances; however, issues involving interperiod equity exist with respect to operating debt, unfunded pension liabilities, deferred maintenance, claims and judgments, compensated absences, and unfunded other postemployment benefits liabilities.

105.4 Many state and local laws and constitutions recognize the need for interperiod equity. For instance, most state and local governments have laws requiring balanced budgets and limiting debt to amounts that can be repaid over the life of the assets that are acquired with the debt. Because of the political nature of government and the resulting short-term outlook of elected officials discussed in paragraph 103.9, there is a temptation to ignore interperiod equity when providing services to the current electorate. Thus, as GASBC No. 1, paragraph 59, explains, these laws attempt to “achieve fairness from one year, one term of office, or one generation to another.”

105.5 GASBC No. 1, paragraph 61, states that an objective of financial reporting is to provide information to assess whether current-year revenues are sufficient to pay for current-year services or whether future-year taxpayers will have to assume the burden for those services.

105.6 The concept of interperiod equity is related to the concept of accountability in that government officials are accountable for compliance with balanced budget and debt limitation laws that seek to achieve interperiod equity. Thus, as mentioned in paragraph 105.2, financial reporting that demonstrates accountability by providing information that will assist in assessing whether a government was “operated within the legal constraints imposed by the citizenry” also demonstrates the extent of interperiod equity. The financial reporting objectives of GASBC No. 1 discussed in the following paragraphs reflect the primacy of accountability and interperiod equity.

### **Financial Reporting Objectives**

105.7 From this focus on accountability and interperiod equity, the GASB established three basic objectives of financial reporting by state and local governments. GASBC No. 1, paragraphs 77-79, presents the three main financial reporting objectives, each with three subobjectives. The objectives apply to both governmental and business-type activities because both types are part of a government and thus are accountable to the public. There may be, however, differences in emphasis in applying the objectives to each type of activity. The objectives are as follows:

- a. *Assist in Assessing Accountability.* Financial reporting should assist in fulfilling government's duty to be publicly accountable and should enable users to assess that accountability.

(1) Financial reporting should provide information to determine whether current-year revenues were sufficient to pay for current-year services. This objective implies that financial reporting should enable the assessment of interperiod equity.

(2) Financial reporting should demonstrate whether resources were obtained and used in accordance with the legally adopted budget and should demonstrate compliance with other finance-related legal or contractual requirements.

(3) Financial reporting should provide information to assist users in assessing the governmental entity's service efforts, costs, and accomplishments. Such information will help users assess government's efficiency and effectiveness.

*b. Assist in Assessing Operating Results.* Financial reporting should assist users in evaluating the governmental entity's operating results for the year.

(1) Financial reporting should provide information about sources and uses of financial resources.

(2) Financial reporting should provide information about how the governmental entity financed its activities and met its cash requirements.

(3) Financial reporting should provide information necessary to determine whether the entity's financial position improved or deteriorated as a result of the year's operations.

*c. Assist in Assessing Services and Obligations.* Financial reporting should assist users in assessing the level of services that the governmental entity can provide and its ability to meet its obligations as they become due.

(1) Financial reporting should provide information about the governmental entity's financial position and condition and about resources and obligations that are both actual and contingent, current and noncurrent.

Because the major sources of resources are taxes and debt issues, financial reporting should also provide information about tax sources, tax limitations, and debt limitations. (Some of this information is presented in the operating statement and some in statistical schedules required to be included in government CAFRs.)

(2) Financial reporting should provide information about physical and other nonfinancial resources having useful lives that extend beyond the current year, including information useful in assessing the service potential of those resources and long-term and short-term capital needs.

(3) Financial reporting should disclose legal or contractual restrictions on resources and risks of potential loss of resources.

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106 Financial Reporting Objectives and the Governmental Financial Reporting Model

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## 106 Financial Reporting Objectives and the Governmental Financial Reporting Model

106.1 GASBS No. 34, which established a new and very different financial reporting model for governments in 1999, provided the GASB with its first opportunity to explore exactly what it meant by making accountability (and interperiod equity) the cornerstone of governmental financial reporting. GASB No. 1 established a very diverse list of objectives of financial reporting (paragraph 105.7). To achieve as many objectives as possible (and meet as many user needs as possible), the GASB found itself in the position of having to distinguish between *types* of accountability. Paragraph 204 of the GASBS No. 34 Basis for Conclusions (BFC) cites both *fiscal* and *operational* accountability:

*Fiscal accountability* is the responsibility of governments to justify that their actions in the current period have complied with public decisions concerning the raising and spending of public moneys in the short term (usually one budgetary cycle or one year).

. . . [*O*] *operational accountability* is governments' responsibility to report the extent to which they have met their operating objectives efficiently and effectively, using all resources available for that purpose, and whether they can continue to meet their objectives for the foreseeable future. [Emphasis added.]

GASBS No. 34, BFC paragraph 207, notes that the use of fund accounting and financial statements that show the sources and uses of current financial resources (e.g., taxes, capital outlay, debt service) are accounting and reporting practices that help demonstrate *fiscal* accountability.

106.2 On the other hand, the use of the economic resources measurement focus and full accrual basis of accounting required in the government-wide financial statements puts users in a better position to assess *operational* accountability. By providing information about all operating costs (both financial and capital), users can assess the level of services that can be provided as well as the effect that current period operations have on future resource needs. As discussed in BFC paragraph 223, operating costs provide a consistent basis for evaluating whether revenues were sufficient to cover costs, both for the current period and over time.

106.3 The GASB's perceived need to provide information about *both* operational and fiscal accountability eventually caused it to require three different types of financial statements/schedules within a single set of basic financial statements and RSI, including:

- *Government-wide Financial Statements* —consisting of a statement of net position and a statement of activities. These statements provide aggregated information for the government as a whole prepared using the economic resources measurement focus and full accrual basis of accounting and meet the need for operational accountability.
  
- *Fund Financial Statements* —consisting of governmental fund financial statements, proprietary fund financial statements, and fiduciary fund financial statements. Governmental fund statements, including a balance sheet and statement of revenues, expenditures, and changes in fund balances, are prepared using the current financial resources measurement focus and modified accrual basis of accounting. Governmental fund statements provide information about fiscal accountability by focusing on current financial resources and using a measurement focus that is similar to most governments' legally adopted budgets.
  
- *Budgetary Comparison Schedules/Statements* —presented only for a government's general fund (or its equivalent) and each major special revenue fund that has a legally adopted budget. These schedules/statements provide fiscal accountability by comparing original and final budgeted revenues and expenditures to actual revenues and expenditures on the entity's own budgetary basis of accounting.

106.4 Section 108 provides an overview of the governmental financial reporting model. Paragraphs 1001.12 and 1001.18 discuss other, more specific GASBC No. 1 objectives met by government-wide financial statements and fund financial statements, respectively. Section 1501 discusses the GASBC No. 1 objectives met by management's discussion and analysis (MD&A).

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