SECTION I--GOVERNMENTAL ACCOUNTING

MEASUREMENT FOCUS BASIS OF ACCOUNTING (MFBA)

Traditionally, governments have used essentially the same accounting as private-sector businesses for their proprietary funds (enterprise and internal service funds) and similar trust funds (nonexpendable and pension trust funds). In both cases, the measurement focus of the operating statement has been on the *changes in economic resources* (changes in total net position). Such changes have been recognized as soon as the underlying event or transaction has occurred, regardless of the timing of the related cash flow – the accrual basis of accounting. Thus, under GASB 34, proprietary funds (enterprise and internal service funds) and fiduciary funds recognize revenues as soon as they are earned and expenses as soon as a liability is incurred, just like private-sector businesses.

Governments have always taken a very different approach, however, in accounting for their governmental funds and expendable trust funds. The measurement focus here has been on *changes in current financial resources*. Additionally, changes in current financial resources have only been recognized to the extent that they normally are expected to have an impact upon near-term cash flows (modified accrual basis of accounting). Therefore, in addition to being earned, the inflows of expendable financial resources must also be available to pay for current period liabilities before it can be recognized as revenue. Likewise, in several cases (interest payable, compensated absences) no expenditure is recognized in a governmental fund for future outflows of financial resources that does not represent a use of current financial resources. This unique MFBA for governmental funds is reminiscent of fund accounting's historical link with checkbook accounting (funds originally developed out of separate checking accounts) and is consistent with the near-term financing focus that typically characterizes a government's operating budget.

Private-sector businesses adopt budgets, as do state and local governments. However, the role of the budget in public sector is unique. In the private-sector a budget is simply a financial plan, whereas in the public sector it plays a critical role in the system of checks and balances between the executive and legislative branches of government. Indeed, so important is the budget in the world of public-sector finance that demonstrating compliance with the appropriated budget has traditionally been an integral part of governmental financial reporting in the form of a mandated budget-to-actual comparison statement. Additional details as to how the budgetary comparison statements should be presented will be discussed at a later point.

Governments, unlike businesses, do not ordinarily provide services as a means to an end (i.e., profit), but rather as an end in themselves. In principle then, governments make their financial plans by first determining the types and levels of services they need or wish to provide, and then determining how these services are to be financed. Some services are partially financed from sources outside the government itself (i.e., charges for services, grants and contributions). In that case, a government will naturally wish to isolate and focus its attention on the portion of the cost of services that it will need to finance from its own resources. The "net program expense" format mandated by GASB 34 is designed precisely to reflect this unique governmental perspective.

PROGRAM REVENUES - Under the net program cost format, program expenses are netted against program revenues. Program revenues include the following:

- amounts received from those who purchase, use or directly benefit from a program; (extension, recreation, airports, etc)
  Charges for services should also include revenues from licenses

and permits (they directly benefit by paying for the privilege), liquor licenses and building permits.

- amounts received from parties outside the school's citizenry (e.g., grants and contributions) that are restricted to one or more specific programs.

- earnings on investments that are legally restricted for a specific program

Charges for services should be reported separately from grants and contributions. Likewise, operating grants and contributions should be reported separately from capital grants and contributions. A grant or contribution that may be used for either operating or capital purposes should be treated as an operating grant or contribution.

Fines and forfeitures should be reported as program revenues. As a rule, charges for services should be reported as a program revenue of the function that generates them. In the case of fines and forfeits, one function (e.g., police, health department) often will issue a citation for an alleged legal or regulatory infraction, which is then subject to adjudication by the courts. Another way to look at reporting fines with the police department is that if there were no police department there would be no fines.

To qualify as program revenue, a grant or contribution must be restricted to one or more specific functions. In the case of multi-purpose grants, the amount associated with each particular function must be specified either in the grant contract or in the underlying application form. However, multi-purpose grants of the reimbursement variety always will meet the test of restriction because such a grant, for accounting and financial reporting purposes, is only considered to occur when all eligibility requirements have been met (including the incurrence of qualifying expenditures in a particular function).

GENERAL REVENUES – All revenues that do not qualify as program revenues should be reported as general revenues. General revenues are to be presented immediately below the totals for "net (expense) revenue and changes in net position."

All taxes, even those that are levied for a specific purpose, are general revenues and should be reported by type of tax –for example, property taxes and sales taxes. All other nontax revenues that do not meet the criteria to be reported as program revenues should also be reported as general revenues.

General revenues are not always discretionary revenues. For example, even though motor vehicle revenues cannot be used for other than "road" purposes, they are still general revenues. Program revenues derive directly from the program itself or from parties outside the school's taxpayers or citizenry, as a whole; they reduce the net cost of the function to be financed from the government's general revenues. Motor vehicle revenues do not derive directly from the public works program itself, but rather they are restricted general revenues provided by law to finance the cost of specific programs.

The gain or loss on the sale of a capital asset should be netted into general revenues as a miscellaneous revenue. Consideration should also be given to reporting the sale of a capital asset as a special or extraordinary item if it fits the relevant criteria.

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GASB 31 provides us with a minor change in how interest earned is to be reported. Currently under state law, interest earned is receipted DIRECTLY to the General Fund or to the respective funds.

GASB 31 states the following, "If, however, the investment income is assigned to another fund for … management decision – the income should be recognized in the fund that reports the investments. The transfer of the income to the recipient fund should be reported as an operating transfer." So if the governing body decides that investment income should all go to the General Fund, the interest earned must be first placed into the fund that earned the income and then transferred to the General Fund by operating transfer to meet the boards intent.

Interest earned by Agency Funds may be placed directly into the General Fund. This exception is allowed because Agency Funds do not record any revenues.

Contributions to permanent fund principal are to be reported as a separate revenue line in the general revenue section of the government-wide statement of activities. Contributions will be reported as revenues and should be reported separately, after nonoperating revenues and expenses, on the statement of revenues, expenses and changes in net position. As a result, capital contributions will no longer be displayed as a separate component of net position.

REPORTING EXPENSES BY FUNCTION – GASB 34 mandates that governments report their activities at least by function. That is to say, in the case of governmental activities, the level of detail required is that currently found in the governmental fund operating statement (e.g., "general government," "public safety," "public works"). For business-type activities, each segment (enterprise fund) is considered to be a function. (water, sewer, liquor, electric). Each function should report all expenses that are clearly identified with it (i.e., direct expenses). Direct expenses include <u>depreciation</u> related to capital assets that can be specifically identified with a given function. This means that equipment should be sorted by function with the respective depreciation expense coded to each related function.

<u>Interest</u> on long-term debt is NOT a direct expense and should be reported as a separate function.

<u>Depreciation expense</u> that does not qualify as a direct cost (primarily buildings) should be reported as a separate line item in its own right. If a separate line is used, it should be made clear on the face of the statement that only unallocated amounts are included in that line.

<u>Depreciation on infrastructure</u> assets should be reported as a direct expense of the function normally associated with the acquisition and maintenance of infrastructure, or alternatively, as a separate line item.

Depreciation expense will play a key role in the new government-wide statement of activities, consistent with the GASB's adoption of the economic resources measurement focus and the accrual basis of accounting for government-wide reporting.

Along with the change in reporting of the general capital asset account group comes another change required by GASB 34, that of capital asset depreciation and infrastructure reporting. Accountants have used the term "infrastructure" to refer to assets that are immovable and of value only to the government (roads, bridges, dams). Under the current financial reporting model, state or local governments have not been required to report general infrastructure assets in their financial statements. However, the economic resources measurement focus and the accrual basis of accounting will be used in the future to report governmental activities in the government-wide financial statements. Under GASB 34 governments are to capitalize general infrastructure at their historical cost or estimated historical cost. Governments are required to capitalize all future infrastructure acquisitions, renovations, restorations, or improvements from the date of implementation of GASB 34 (prospective reporting).

Although state and local governments traditionally have reported general capital assets in their financial statements, they have not depreciated those assets. Once again, the move to the economic resources measurement focus and the accrual basis of accounting will substantially change traditional practice. Governments will be required under the new financial reporting model to report depreciation expense for all of their capital assets, including general infrastructure assets discussed above.

Capital assets now reported in the general capital assets account group will henceforth be reported in the “governmental activities” column of the government-wide statement of net position. Governments also will be required to report general infrastructure assets in this same column, even though the reporting of general infrastructure assets is not required under current GAAP.

Just as the assets section for “governmental activities” of the new government-wide statement of net position is to include items currently reported in the general capital asset account group, so too, the liability section of the same statement will include all liabilities currently reported in the general long-term debt account group. This means that bond issues, sick and annual leave and other long-term liabilities will be pulled in and reported with governmental activities.

Another change, which will take place, is the term “quasi-external transactions” will no longer be used. Rather, GASB 34 refers to this form of internal activity as “reciprocal interfund activity”. There are two types of reciprocal interfund activity - interfund loans and interfund service provided and used. Items previously reported as quasi-external transactions meet the definition of “interfund services provided and used,” and are reported as if they were external transactions, as i.e., revenues and expenditures/expenses.

Previously, transfers were separately reported as either operating or residual equity. Under the provisions of GASB 34, there will be a single “transfers” category that will encompass both type of transfers.