GASB Refrain

GOVERNMENTAL ACCOUNTING'S "URBAN LEGENDS"

GFOAT

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Background

- What is a governmental accounting "urban legend"?
  - Perennial and widespread misunderstanding concerning the application of generally accepted accounting principles (GAAP)
    - "What we think we know, that just isn't so!"
- Most often the product of "half truths"
  - "Believability factor"

“Number of funds” principle

- Half truth:
  - The “number of funds principle” means “the fewer funds the better”
- Full truth:
  - Use all the funds and fund types needed, but only the funds and fund types needed—no more, no less
    - It is possible to report “too few” funds.

Blending and fiduciary-type units

- Half truth:
  - Data from fiduciary-type component units should be "blended"
- Full truth:
  - Technique is the same, but terminology is different
    - Term "blended" = method of including component unit data in the government-wide financial statements
      - Fiduciary funds are not included in government-wide financial statements

Liabilities in governmental funds

- Half truth:
  - Liabilities should be recognized in governmental funds only if they are due and payable
- Full truth:
  - Applicable only for liabilities not normally expected to be liquidated with expendable available financial resources
    - Salaries and wages are always reported in the period in which they earned
    - Vendor payables are recognized when goods and services are provided
    - Employer contributions to defined contribution pension plans are recognized as an expenditure and liability in the period to which they relate

Operating subsidies to component units

- Half truth:
  - Operating subsidies to component units should be reported as transfers
- Full truth:
  - True for blended component units, but not true for discretely presented component units
    - For discretely presented component units, treat like any other grant (expenditure/expense)

Criteria for *special items*

- Half truth:
  - A *special item* is a transaction or event that meets just one of the two criteria for an *extraordinary item*
- Full truth:
  - Must also be subject to management control
    - Exclude natural disasters that are not infrequent in occurrence
      - Hurricanes in Florida

Long-term internal borrowings

- Half truth:
  - A long-term borrowing within the government should be reported as a fund liability, rather than as an other financing source
- Full truth:
  - True within the primary government, but not for borrowings between the primary government and discretely presented component units
    - Borrowing from another fund = liability
    - Borrowing from a discretely presented component unit = other financing source

Transactions with discretely presented component units

- Half truth:
  - Transactions with discretely presented component units should be treated just like transactions with outside parties
- Full truth:
  - Capital assets cannot change value within the financial reporting entity
    - Difference between carrying value and consideration given <u>not</u> capitalized
      - Reported instead as expense/expenditure of purchaser

Option to classify a fund as “major”

- Half truth:
  - A government has the option to voluntarily classify a given fund as “major”
- Full truth:
  - Option available only for governmental funds and enterprise funds
    - Fiduciary funds can never be reported as major funds

Interest capitalization in proprietary funds

- Half truth:
  - Interest capitalization is required in proprietary funds
- Full truth:
  - Interest capitalization does not apply to internal service funds
    - Otherwise interest expense would be reported as a functional expense in governmental activities

Application of benefit/burden criterion

- Half truth:
  - A legally separate entity should be included as a component unit if there is an ongoing relationship of financial benefit or burden.
- Full truth:
  - Financial benefit/burden only relevant if either
    - Fiscal dependency
    - Board appointment

Availability criterion

- Half truth:
  - Revenue should be recognized in governmental funds as soon as amounts become available.
- Full truth:
  - Availability is only a consideration subsequent to earning/eligibility.
    - Cash received in advance is *not* revenue, even though it is available.

Revenue from expenditure-driven grants

- Half truth:
  - All legal requirements need to be met before revenue from an expenditure-driven grant can be recognized.
- Full truth:
  - Routine administrative requirements (filing grant reports) should not delay revenue recognition.

Difference between proprietary funds

- Half truth:
  - The difference between internal service funds and enterprise funds is that the former serve internal customers, whereas the latter serve external customers.
- Full truth:
  - Internal service funds assume cost recovery over time, whereas enterprise funds do not
    - Activities reported in enterprise funds may be subsidized

Netting capitalized interest

- Half truth:
  - Interest expense on tax-exempt debt should be capitalized net of interest revenue on the reinvested proceeds.
- Full truth:
  - Interest expense and interest revenue on the reinvested proceeds are netted only if the related debt is legally restricted to the acquisition or construction of specified qualifying assets.

Assets in governmental funds

- Half truth:
  - Governmental funds should not report land, buildings, equipment, and similar assets.
- Full truth:
  - Governmental funds should report such items if they are acquired with the intent of sale rather than use of operations
    - Used in operations = capital asset
      - Not reported in governmental funds
    - Acquired for sale = financial asset
      - Reported in governmental funds

Derivatives and fair value reporting

- Half truth:
  - Derivatives should be reported at fair value.
- Full truth:
  - Fair value reporting does <u>not</u> apply to derivatives reported in governmental funds
    - Hedge accounting is used only for financial statements prepared using the economic resources measurement focus and the accrual basis of accounting

Netting disaster losses against recoveries

- Half truth:
  - Disaster losses should be netted against recoveries.
- Full truth:
  - True of insurance recoveries
    - Netting based on prior transfer of risk to insurer
  - Not true of disaster assistance
    - No prior transfer of risk

Cash flows: public vs. private sector

- Half truth:
  - The essential difference in cash flows reporting between the public and private sectors is the use of two “financing” categories rather than just one.
- Full truth:
  - Categories are defined differently
    - Interest revenue/expense
      - Public sector = financing activities/investing activities
      - Private sector = operating activities
    - Capital outlays
      - Public sector = capital-related financing activities
      - Private sector = investing activities

Encumbrances and fund balance

- Half truth:
  - Encumbrances should be included in assigned fund balance.
- Full truth:
  - Not applicable to encumbrances that will be repaid from restricted or committed resources

Dedicated taxes as *program revenue*

- Half truth:
  - Revenues that must be used for a specific program or function are properly classified as “program revenues.”
- Full truth:
  - *Program revenues* must come from outside the government’s tax base
    - Dedicated taxes are <u>not</u> program revenues

Segment disclosure and condensed data

- Half truth:
  - Segment disclosure requires that condensed financial statements be provided in the notes to the financial statements for each segment.
- Full truth
  - Only necessary if information <u>not</u> provided in the financial statements
    - Unnecessary for segments reported as major enterprise funds

Deficits in individual funds

- Half truth:
  - Deficits in individual funds need to be disclosed in the notes to the financial statements.
- Full truth:
  - Not true of major funds, since the deficit would already be visible

Condensed data and cash flows

- Half truth:
  - Condensed financial statements should include a statement of cash flows.
- Full truth
  - Two situations where condensed financial statements must be included in the notes
    - Segment disclosure
    - Major discretely presented component units
      - Not presented as a separate column or in a combining statement
  - Data for discretely presented component units always drawn from government-wide financial statements
    - Statement of cash flows not part of basic government-wide financial statements
      - Statement of cash flows <u>not</u> required for discretely presented component units

Payments to a public-entity risk pool

- Half truth:
  - Payments to a public-entity risk pool should be treated like insurance premiums.
- Full truth:
  - Appropriate treatment depends on the characteristics of the pool
    - Participants transfer risk to pool?
      - Yes – treat like insurance premium
      - No – treat like deposit

MD&A and the letter of transmittal

- Half truth:
  - The same topic should not be addressed in both management’s discussion and analysis (MD&A) and the letter of transmittal.
- Full truth:
  - The letter of transmittal is properly used to provide more subjective information on topics treated in MD&A

Project-length budgets

- Half truth:
  - Budgetary comparisons are not required for governmental funds with project-length budgets
- Full truth:
  - Budgetary comparisons are required if a project-length budget is re-appropriated annually.
    - Annual reappropriation equivalent to annual budget

References to the notes

- Half truth:
  - Financial statements should include a reference to the notes to the financial statements
- Full truth
  - Combining and individual fund financial statements refer to the notes only if they are included within the scope of the financial statement audit
    - Not applicable to combining and individual fund financial statements that receive only an “in-relation to” opinion

10 percent and 5 percent tests

- Half truth:
  - Governmental funds should be classified as major if they meet both the 10 percent and 5 percent tests.
- Full truth:
  - Both the ten percent test and the five percent test must be met for the same element
    - Assets and deferred outflows of resources
    - Liabilities and deferred inflows of resources
    - Revenues
    - Expenditures/expense

Location of budgetary disclosures

- Half truth:
  - If budgets are presented as RSI, related disclosure should be in notes to RSI.
- Full truth:
  - An excess of expenditures over appropriations that constituted a legal violation would need to be disclosed in the notes to the financials statements
    - Disclosure of violations of finance-related legal or contractual provisions independent of “budgetary” disclosures.

Trust fund liabilities

- Half truth:
  - Trust funds do not report liabilities to beneficiaries.
- Full truth:
  - Liabilities are reported when due and payable to individual beneficiaries

Grant advances are reported by recipients as liabilities

- Half truth:
  - Advances are liabilities
- Full truth:
  - If all eligibility criteria have been met except for a time requirement a deferred inflow of resources is reported rather than a liability
    - There is no possibility of an outflow, thus no liability.

Condensed data are required for enterprise funds with revenue-supported debt

- Half truth:
  - Segment reporting is required in connection with revenue-supported debt
- Full truth:
  - Only if there is a requirement to separately maintain the data needed to present condensed financial statements
  - Only if the segment is not already separately reported as a major fund (or a single nonmajor enterprise fund)

Combining statements should always be accompanied by individual fund statements

- Half truth:
  - Individual funds support combining financial statements
- Full truth:
  - Only if additional information is provided in the individual fund statements