Governmental Accounting 101: A 30,000 Foot Overview of Governmental Accounting

Friday, November 7, 2019

City of Richardson Finance
Show of Hands

• How many Accounting majors in the room?

• How many took a class that focused on governmental accounting?
  – Undergraduate level?
  – Graduate level?

• How many took more than 3 hours of governmental accounting?
Lack of Formal Training

• Small to medium governments
  – Too many hats to wear
  – Limited training budgets

• Large governments
  – Limited government-specific CPE classes
  – Travel budgets often keyed to upper level employees who have little role in day to day transactions
GASB – 5 Years Ago

• 71 Standards to learn

• 6 Concept Statements to consider

• 6 Interpretations of Standards to be aware of

• 14 Technical Bulletins to remember
GASB – 5 Years Ago Today

- 71 Standards to learn
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- 14 Technical Bulletins to remember
- Implementation Guides to catch you off guard
USERS OF FINANCIAL STATEMENTS
Three Categories of Users

• Those to whom you are accountable
  – Citizens, media, and advocacy groups/public finance researchers*

• Those who represents the citizens
  – City councils, and other legislative/oversight bodies

• Those who lend you money
  – Creditors, individual/institutional investors, rating agencies/analysts*, underwriters
Basic Needs of Users

• Citizens/City Councils
  – How do you demonstrate accountability and interperiod equity?
    • How did actual results compare to budget?
    • What financial condition are you in – are tax/fee increases on the horizon?
    • Did you comply with all applicable rules/regulations?
    • Are services being provided efficiently?

• Creditors
  – Will you have the resources to repay them?
Limitations on Needs of Users

• Citizens
  – Want to obtain the maximum amount of service for the minimum amount of taxes
  – Amount of taxes paid (property taxes/sales tax) rarely relates to proportion of services received from government
  – Perceived value of services generally doesn’t match the cost of services
Limitations (cont.)

• City Councils
  – May try to satisfy service needs by deferring other services
  – Can delay cash impact of transactions to future periods
  – Can pay for increased level of services with non-recurring revenues
Limitations (cont.)

• Creditors
  – May not have a direct relationship with the government
  – Often hope for cookie-cutter approach to comparing individual governments
  – Want unlimited financial information about past performance and future potential performance
FRAMEWORK FOR FINANCIAL STATEMENTS
Financial Statement Characteristics

- Understandability
- Reliability
- Relevance
- Timeliness
- Consistency
- Comparability
Characteristics

• Understandability
  – Information should be expressed as simply as possible
  – Acknowledges that users have different levels of knowledge about governmental accounting
  – Don’t exclude information just because it is difficult, and seek to explain or interpret where possible
GASB – 5 Years Ago Today

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Characteristics (cont.)

• Reliability
  – Information should be verifiable and free from bias
  – Information should be comprehensive and cover all material transactions
  – Include narrative explanations about assumptions and methodology for obtaining estimates
Characteristics (cont.)

• Relevance
  – Encompasses many other characteristics
    • Won’t be relevant if not timely, etc.
  – Should be a logical relationship between information provided and the purpose for which it is needed
Characteristics (cont.)

• Timeliness
  – Reports have to be issued soon enough after reported events to affect decisions
  – Use of timely estimates may be more beneficial than waiting for precise information
  – GFOA Recommendation – legislative requirements should be the minimum standard rather than the ideal
GASB – 5 Years Ago Today

- 71 91 Standards to learn
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Characteristics (cont.)

• Consistency
  – Reports should be consistent over time
  – Once an accounting principle is adopted, it should be used for similar transactions
  – If accounting principles are changed, the nature of the change and reason for the change should be explained
GASB – 5 Years Ago Today

- 7191 Standards to learn
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Characteristics (cont.)

• Comparability
  – Reports should be similar across similar governments
  – Differences should be due to services offered or structure of governments rather than selection of differing accounting practices
Fund Accounting

• A fund is a fiscal and accounting entity with a self-balancing set of accounts
  – Records cash and other financial resources
  – Includes all related liabilities and residual balances (net position/fund balance)
  – Records the changes in these accounts
  – Is segregated for the purpose of carrying on specific activities
Fund Accounting (cont.)

• Governments should maintain the funds required by law and sound financial administration
  – Only the minimum number of funds consistent with legal and operating requirements should be used
  – Unnecessary funds result in undue complexity and inefficient administration
    • Smaller funds can be combined for presentation purposes
Fund Categories

• Governmental Funds
  – Activities primarily supported by taxes, grants, or similar revenue sources

• Proprietary Funds
  – Activities primarily supported by fees and charges for services

• Fiduciary Funds
  – Resources that a government controls which are not derived from its own activities, usually held in a trust or for the benefit of individuals or organizations outside the government
Governmental Fund Types

• General Fund
  – Chief operating fund of the government

• Special Revenue Funds
  – Revenues restricted or committed to a specific use (other than capital projects or debt service)
  – May include assigned amounts but restricted or committed should make up a substantial portion
Governmental Fund Types (cont.)

• Debt Service Funds
  – Resources *restricted, committed, or assigned* to expenditures for debt repayment

• Capital Project Funds
  – Resources that are *restricted, committed, or assigned* to expenditures for capital outlays and acquisition and construction of capital assets

• Permanent Funds
  – Resources that are *restricted* such that only earnings can be used for operations
Proprietary Fund Types

- **Enterprise Funds**
  - Activities for which a fee is charged to external parties
    - Required for activities for which debt backed solely by fees and charges has been issued
    - Required where laws or regulations mandate that all costs including capital be recovered through fees
    - Required when pricing policies are in place mandating that fees be set to recover costs including capital

- **Internal Service Funds**
  - Activities that benefit the government and are essentially break-even over time
Fiduciary Fund Types

• Pension (and OPEB) Trusts
  – Resources held in trust for members and beneficiaries for which the government has managerial responsibility

• Investment Trusts
  – Investment pools when reported by the sponsor

• Private-purpose Trusts
  – Principal and income benefit individuals, private organizations or other governments

• Custodial Funds
  – Fiduciary activities not held in trusts
REVENUES & EXPENSES/EXPENDITURES
Measurement Focus

• Measurement Focus – what you are looking to measure in a transaction

  – Current Financial Resources – assets and liabilities that affect near-term liquidity
    • Cash, accounts payable, etc.
    • Governmental funds

  – Economic Resources – all assets and liabilities
    • Cash, accounts payable, capital assets, long term debt
    • Proprietary funds, Fiduciary funds, Government-wide
Basis of Accounting

• Basis of Accounting – when the transaction should be recorded
  – Modified Accrual basis – transactions are recognized when they impact near-term liquidity
    • Revenues should be both measurable and available
      – Measurable – amount reasonably determined
      – Available – collectible within the current period or soon enough thereafter to finance current period expenditures
    • Expenditures are recognized when they are incurred
      – Except for – debt not currently payable, accrued interest payable, inventories & prepaids, accrued liabilities not expected to be liquidated with currently available resources
Basis of Accounting (cont.)

• Basis of Accounting – when the transaction should be recorded
  – Accrual basis – transactions are recognized when they occur or are incurred
    • Regardless of when cash is received or disbursed
  – Governmental funds use the modified accrual basis
  – Proprietary funds, Fiduciary funds, and Government-wide presentations use the accrual basis
## Measurement Focus/Basis

<table>
<thead>
<tr>
<th></th>
<th>Governmental Funds</th>
<th>Proprietary/Fiduciary Funds/ Government-wide presentation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Measurement Focus</strong></td>
<td>Current Resources</td>
<td>Economic Resources</td>
</tr>
<tr>
<td><strong>Basis of Accounting</strong></td>
<td>Modified Accrual</td>
<td>Full Accrual</td>
</tr>
</tbody>
</table>
Transaction Categories

• Exchange and exchange-like transactions
  – Each party gives and receives equal or nearly equal value
  – Example – facility rentals, entrance fees

• Nonexchange transactions
  – One party gives or receives value to another party without giving or receiving equal value in return
  – Four categories of nonexchange transactions
Nonexchange Transactions

• Derived tax revenues
  – Revenue generated from events unrelated to the government’s operation
  – Example – Sales tax receipts

• Imposed nonexchange transactions
  – Assessments made by a government that do not involve exchanges
  – Example – Property taxes, court fines
Nonexchange Transactions (cont.)

• Government-mandated nonexchange transactions
  – Services required by another level of government for which the other level will offer at least partial funding (funded mandates)
  – Not common in Texas

• Voluntary nonexchange transactions
  – All other nonexchange transactions
  – Example - grants
# Transaction Recognition

<table>
<thead>
<tr>
<th>Transaction</th>
<th>Receivable</th>
<th>Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exchange</td>
<td>At time of exchange</td>
<td>At time of exchange</td>
</tr>
<tr>
<td>Derived tax revenue</td>
<td>When sale takes place</td>
<td>When sale takes place</td>
</tr>
<tr>
<td>Imposed nonexchange</td>
<td>Assessment date</td>
<td>Start of period for which levied</td>
</tr>
<tr>
<td>Government-mandated</td>
<td>When qualifying expenditures incurred</td>
<td>When qualifying expenditures incurred</td>
</tr>
<tr>
<td>Voluntary nonexchange</td>
<td>When qualifying expenditures incurred or eligibility requirements met</td>
<td>When qualifying expenditures incurred or eligibility requirements met</td>
</tr>
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Revenue Rules for Modified Accrual

• Revenue recognition should be delayed until amounts are available
  – Offset receivable with a deferred inflow of resources

• If payment is received prior to an exchange, governments should record unearned revenue (liability) until eligible for recognition
Expenditure Rules for Modified Accrual

• Expenditures are recognized when they are incurred
  – Except for – debt not currently payable, accrued interest payable, inventories & prepaids, accrued liabilities not expected to be liquidated with currently available resources

• Debt and interest payable
  – Record as expenditure when due
Expenditure Rules (cont.)

• Accrued liabilities not expected to be liquidated with currently available resources
  – Record as expenditure when payment made
  – Except, record if amount was due at end of reporting period but not made due to timing of payables or payroll cycle
    • Compensated absences, pension contributions
Expenditure Rules (cont.)

- Inventories & prepaids
  - Can expense entire amount in current period (purchases method)
  - Can recognize portion over period of service (consumption method)
Other Financing Sources/Uses

• Governmental Funds report Other Financing Uses/Sources for transactions that are not based on operations
  – Issuance of long-term debt
  – Inception of capital leases
  – Sale of capital assets
  – Insurance recoveries
  – Transfers
FINANCIAL POSITION
Elements of Financial Position

• There are five elements of financial position
  – Assets
  – Liabilities
  – Deferred Outflows of Resources
  – Deferred Inflows of Resources
  – Fund Balance/Net Position
Assets/Liabilities

• Assets – resources with present service capacity that the government presently controls
  – Enables the government to provide services
  – The government has the right to determine how to use the capacity of the asset

• Liabilities – present obligations to sacrifice resources that the government has little to no discretion to avoid
  – Obligation created through a social, legal or moral requirement
  – Consequences for avoidance are more than insubstantial
Deferred Resources

- Deferred Outflows of Resources – consumption of net assets by the government that is applicable to a future reporting period
  - Positive impact on financial position

- Deferred Inflows of Resources – acquisition of net assets by the government that is applicable to a future reporting period
  - Negative impact on financial position
Fund Balance/Net Position

• Fund Balance/Net Position – the residual of all elements in the financial statement
  – Fund Balance – Governmental funds
  – Net Position – Proprietary funds, Fiduciary funds, and Government-wide presentations

• (Assets plus Deferred Outflows) less (Liabilities plus Deferred Inflows) equals Fund Balance/Net Position
Fund Balance Classifications

• Classifications
  – Non-spendable
  – Restricted
  – Committed
  – Assigned
  – Unassigned

• Hierarchy based on constraints on the specific purposes for which resources can be spent
Fund Balance Definitions

• Non-spendable
  – Resources that cannot be spent or must be maintained intact
  – Inventories, prepaid amounts, corpus of a permanent fund

• Restricted
  – Resources with external enforceable legal restrictions
  – Bond holders, grantors, constitutional, legislative
Fund Balance Definitions (cont.)

• Committed
  – Resources that have formal constraints imposed by governing body
  – Action such as ordinance or resolution occurs prior to year-end

• Assigned
  – Resources with an *intended* use set by governing body or management
  – Cannot exceed total fund balance less nonspendable, restricted, and committed balances
Fund Balance Definitions (cont.)

• Unassigned
  – All other resources
  – Positive balances only allowed in the General Fund
  – Negative balances allowed in any governmental fund
Net Position Classifications

• Classifications
  – Net investment in capital assets
  – Restricted
  – Unrestricted

• Previously called “net assets”
Net investment in capital assets

• Basically, capital assets net of depreciation, less the outstanding balance of capital-related debt
  – Debt shouldn’t include unspent proceeds
  – Include unamortized amounts for premiums, discounts, and deferred amounts on refundings in calculation
  – Debt shouldn’t include amounts not used to finance capital assets of your government
  – Can be negative
Restricted/Unrestricted Net Position

• Restricted
  – Parties outside the government
    • Creditors
    • Granting agencies
    • Enabling legislation
    • Constitutional

• Unrestricted
  – All other resources and obligations
  – Not a measure of current liquidity
  – Can be negative
FINANCIAL STATEMENTS
Major Fund Presentation

• Basic financial reporting emphasizes major funds by presenting them individually

• Nonmajor funds are presented in the aggregate

• General fund is always major

• Can promote fund to major based on other qualitative factors
Major Fund Criteria

<table>
<thead>
<tr>
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<th>10% Test – Like Funds</th>
<th>5% Test – All Funds</th>
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<tbody>
<tr>
<td>Assets + Deferred Outflows</td>
<td>≥ 10%</td>
<td>≥ 5%</td>
</tr>
<tr>
<td>Liabilities + Deferred Inflows</td>
<td>≥ 10%</td>
<td>≥ 5%</td>
</tr>
<tr>
<td>Revenues</td>
<td>≥ 10%</td>
<td>≥ 5%</td>
</tr>
<tr>
<td>Expenses</td>
<td>≥ 10%</td>
<td>≥ 5%</td>
</tr>
</tbody>
</table>

- Major fund if both 10% and 5% test positive for one of four groupings
Government-wide Presentation

• Governmental funds are converted to proprietary funds
  – Long-term liabilities and capital assets included
  – Revenues and expenses recognized using full accrual basis of accounting
Basic Financial Statements

- Management’s Discussion & Analysis
- Required Supplementary Information
  - Budgetary Comparisons
  - Trend Data for Pensions and OPEB

Financial Statements (Govt. Wide & Funds) + Notes
Management’s Discussion and Analysis ("MD&A")

• Provide an Objective and Easily Readable analysis of the government’s Financial Activities
  – Currently known facts (as of audit report date)
  – Focus on both short and long-term analysis
  – Serves as an introduction to the numbers
  – Avoid “boilerplate” language
• “The minimum is the maximum”
Location of MD&A

• Immediately following the Independent Auditor’s Report
  – Precedes the basic financial statements
• Contrast with location of other types of RSI
  – Following Notes
Comprehensive Annual Financial Report ("CAFR")

- Required Supplementary Information
  - Budgetary Comparisons
  - Trend Data for Pensions and OPEB

- Management’s Discussion & Analysis
- Combining Financial Statements
- Transmittal Letter
- Statistical Section

Financial Statements (Govt. Wide & Funds) + Notes
Upgrading to a CAFR

• Transmittal Letter
  – Basic description of government and chance to let users know positive things about your community

• Combining financial statements
  – Detail of nonmajor funds that were aggregated on fund financial statements

• Statistical Section
  – History of key facts and figures about your community
CAFR Stats

• For FY 2017, GFOA’s Certificate of Achievement program awarded 433 Certificates to Texas governments
  – Second only to California (544)
  – 4,328 Certificates awarded nationally

• This represents 16% of cities and 20% of counties in the state
CAFR Best Practices

• If you only prepare basic financial statements, work towards upgrading to a CAFR

• If your auditor prepares your financial statements, work towards preparing them in-house

• If you prepare a CAFR but don’t submit to GFOA, do so
Next Steps

• If you survived this presentation and found it interesting...

• Sign up for a future GFOAT Governmental Accounting Academy
  – 3 days of more in-depth accounting topics, taken from GFOA National material

• Join the GFOAT FRRR Committee
  – Stay on top of the next 20 GASB Standards
NO DEBITS OR CREDITS WERE HARMED IN THIS PRESENTATION
QUESTIONS?