

2011

GOVERNMENTAL  
GAAP  
PRACTICE MANUAL

ERIC S. BERMAN



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# Governmental GAAP Practice Manual

By Eric S. Berman

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Financial professionals who work with state and local governments must stay current with emerging governmental standards, understand how accounting transactions should be reported, and prepare accurate and complete financial statements or face some unfortunate consequences. This one-of-a-kind hands-on tool shows state and local government accountants and auditors how to apply generally accepted accounting principles (GAAP) to state and local governments in a practical step-by-step approach. The approach in CCH's *Governmental GAAP Practice Manual* is explained in plain English and supported by practical, straightforward journal entries and examples common in the everyday government environment.

CCH's *Governmental GAAP Practice Manual* is organized sequentially so that readers can start at the beginning and follow how a typical governmental entity posts accounting transactions and ultimately creates its financial statements in accordance with generally accepted accounting principles. Readers can focus on a particular topic, read the relevant material, determine the appropriate journal entries, and follow the remaining chapters as they show in a step-by-step manner the preparation of the annual financial statements. For example, readers interested in how the information accounted for in Internal Service Funds is presented in a governmental entity's financial statements, can start with Chapter 8 (Internal Service Funds), go to Chapter 13 (Developing Information for Fund Financial Statements), proceed to Chapter 14 (Developing Information for Government-Wide Financial Statements), and see the end result in Chapter 16 (Basic Financial Statements).

## 2011 Edition

The 2011 edition has been updated with the very latest information on

- GASB-59 (Financial Instruments Omnibus)
- GASB-58 (Accounting and Financial Reporting for Chapter 9 Bankruptcies)
- GASB-57 (OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans)

Other pronouncements that are being implemented in fiscal years beginning after June 15, 2009, that are also discussed in this edition include the following:

- GASB-54 (Codification of Accounting Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards)
- GASB-53 (Accounting and Financial Reporting for Derivative Instruments)

The *Governmental GAAP Practice Manual* is designed to serve as a practical tool for applying the basic requirements of GAAP in the preparation of state and local government financial statements. The accounting and financial reporting

illustrations included here show how to apply the most common transactions encountered by a general-purpose government. The focus of this publication is on the conversion process necessary to take typical state and local government financial transactions and generate the financial statements required by GAAP. It is not intended to provide illustrations of the application of all GASB and applicable FASB pronouncements. A discussion of all GASB and applicable FASB pronouncements can be found in CCH's *Governmental GAAP Guide*.

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# Preface

Generally accepted accounting and financial reporting principles applicable to state and local governments are fundamentally different from those applicable to nongovernment entities. In its desire to establish accounting and reporting standards that make governmental financial reports more relevant to users, the Governmental Accounting Standards Board (GASB) established two sets of financial statements: fund financial statements, which focus on individually significant funds, and government-wide financial statements, which attempt to provide insight into the overall financial position and activities of the governmental reporting entity.

The dual presentation approach added a significant degree of complexity to an already challenging financial reporting model. This financial reporting model poses a variety of challenges to both those who prepare and those who read governmental financial statements; however, the major implementation problem facing preparers of governmental financial statements was to develop an approach that seamlessly produces the two distinct levels of financial statements.

Most governmental entities are expected to solve this problem by using a worksheet approach to convert fund financial statement information to the government-wide financial statements. The purpose of this book is to demonstrate in a detailed manner how a governmental entity can apply the complex standards established by GASB through a worksheet approach.

This practice manual is a companion to CCH's *Governmental GAAP Guide*, which provides current information on accounting and reporting standards.

## The Structure of This Book

The fundamental issue for understanding how to apply the accounting and financial reporting standards established by the GASB is the development of a clear understanding of the relationship between the modified accrual basis of accounting and current financial resources measurement focus (as used at the fund financial statement level for governmental funds) and the accrual basis of accounting and economic resources measurement focus (as used at the fund financial statement level for proprietary and fiduciary funds, and the government-wide financial statement level for governmental activities and business-type activities). Chapter 1 of the *Governmental GAAP Practice Manual* provides a detailed analysis of the interrelationship of the two bases of accounting and measurement focuses. Numerous transactions that governmental entities experience must first be recorded on the modified accrual basis and current financial resources focus (for presentation in the governmental fund financial statements) and then converted to the accrual basis and economic resources focus (for presentation in the government-wide financial statements). Included in Chapter 1 is a comprehensive checklist of transactions and events that typically require a worksheet conversion entry. An understanding of these entries will provide a governmental accountant with a basis for analyzing unique and complex transac-

tions and then converting their initial recording on the modified accrual basis to the accrual basis.

Starting in Chapter 2 is a comprehensive illustration that continues through the remaining chapters of the book. For governmental funds, a variety of transactions are illustrated and journalized in Chapter 2 through Chapter 6, which result in a year-end trial balance for each individual fund based on the modified accrual basis of accounting and current financial resources measurement focus. In Chapter 14 these trial balances are used as the basis for developing the information needed to prepare the fund financial statements. Chapter 16 illustrates the worksheet methodology for converting the information related to governmental funds (modified accrual basis and current financial resources focus) to information that is needed for the governmental activities column of the government-wide financial statements (accrual basis and economic resources focus).

A similar approach is used for proprietary funds (Chapter 7 and Chapter 8) and fiduciary funds (Chapter 9 through Chapter 13): Illustrative entries are developed for each of the funds, and the resulting trial balances become the basis for preparing fund financial statements (Chapter 13) and the business-type activities column of the government-wide financial statements (Chapter 14). However, because proprietary fund financial statements and the business-type activities column in the government-wide financial statements are presented on the same basis of accounting and measurement focus (accrual basis and economic resources focus), generally a conversion is not necessary for these funds and activities. In addition, because fiduciary funds are not presented in the government-wide financial statements, a conversion is not needed.

In Chapter 16 the basic financial statements (including the fund financial statements and government-wide statements) are prepared based on the information developed in Chapter 13 and Chapter 14.

Chapter 17, "Notes to the Financial Statements," provides a discussion of note disclosure concepts and a listing of the required note disclosures applicable to state and local government financial statements.

Chapter 18 discusses and develops information related to management's discussion and analysis and other required supplementary information. Chapter 19 illustrates combining financial statements that are presented as part of supplementary information included in a governmental entity's Comprehensive Annual Financial Report.

Chapter 20, "Statistical Section," provides the preparers of financial statements with an in-depth review of the statistical section of the CAFR.

Finally, in the 2011 edition of the *Governmental GAAP Practice Manual*, Practice Alerts have been added at key points throughout the book. This highlighted feature discusses matters that have not been finalized in the standard-setting process but are on the horizon and will impact your practice or your financial statement preparation practice.



## How to Use This Text

This text is structured so that it may be used in a number of ways. For a thorough understanding of how to implement the standards established by GASB, the reader can read the entire text beginning with the first chapter and ending with the final chapter. The sequential reading of all of the chapters serves as an excellent professional development course for new accounting professionals who have been hired by a governmental entity and need to be fully immersed in governmental financial reporting.

The text can also be read with an emphasis on a single chapter. Furthermore, a cluster of chapters can be read depending on the needs of the reader. Throughout the book, transactions are labeled with ID numbers so readers can refer from financial statements back to worksheet and journal entries (e.g. “JE02.51A” refers to worksheet entry “51A” in Chapter 2). For example: a governmental accountant interested in understanding how the accounts related to Internal Service Funds are to be integrated into both the fund financial statements and the government-wide financial statements will find that a careful study of Chapter 8, “Internal Service Funds,” provides a complete foundation for understanding this fund’s role in governmental financial reporting. A reader concerned with understanding the basis for the conversion from the modified accrual basis to the accrual basis will find a thorough reading of Chapter 1, “Overview,” to be an excellent foundation for understanding the issue. A reader confused about how specific governmental funds are tweaked in order to create the governmental activities column of the government-wide financial statement will find in the section on governmental funds (Chapter 2 through Chapter 6) and Chapter 14 (“Developing Information for Government-Wide Financial Statements”) a clear explanation of the interrelationship of accounts in governmental funds and amounts reported in the government-wide financial statements.

The emphasis of the *Governmental GAAP Practice Manual* is on the process of preparing financial statements. That is, the specific accounting transactions are straightforward—and there is a strategy to avoid getting bogged down in GASB standards that are complex in and of themselves. Once the conversion process, as clearly described in this text, is understood, more complicated accounting and reporting issues can easily be handled by referring to the GASB standards discussed in this text’s companion work, the *Governmental GAAP Guide*. In writing these two companion books, it is our desire to provide governmental accountants with a highly effective and efficient approach that can help them in their day-to-day responsibilities.

## Acknowledgments

The writing of this book was made possible by the efforts of a number of dedicated people. Tony Powell and many others at CCH provided the much-needed editorial support that makes any professional book an accurate and readable work. Jessie Powell, CPA, Powell & Spafford, LLP, provided thoughtful insights and reviews for this new edition. We would also like to say thanks to our

partners, co-workers, friends, and especially our families for the necessary support to complete this edition.

Although the individuals mentioned above played an important role in the preparation of the *Governmental GAAP Practice Manual*, any errors or omissions are the responsibility of the authors. The *Governmental GAAP Practice Manual* continues to evolve as new pronouncements are issued and as we strive to better explain governmental accounting and reporting standards. If you have suggestions for improving the quality of the material, please send them to the editor:

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**PART I.**  
**INTRODUCTION**

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# CHAPTER 1

## OVERVIEW

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## **INTRODUCTION**

The financial reporting model for a state or local government's annual financial statements established by GASB-34 (Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments), which requires that a governmental entity present in its general purpose external financial statements both fund financial statements and government-wide financial statements.

The purpose of this reporting model is, in part, to make governmental financial reporting more consistent with and responsive to the fundamental concepts adopted in GASB Concept Statement No. 1 (GASB:CS-1) (Objectives of Financial Reporting). GASB:CS-1 identifies the following primary user groups of governmental financial reports:



- Citizens of the governmental entity
- Direct representatives of the citizens (legislatures and oversight bodies)
- Investors, creditors, and others involved in the lending process

GASB:CS-1 identifies accountability as the paramount objective of financial reporting by state and local governments. Accountability is based on the transfer of responsibility for resources or actions from the citizenry to another party, such as the management of a governmental entity. Financial reporting should communicate adequate information to user groups to enable them to assess the performance of those parties empowered to act in the place of the citizenry.

The assessment of accountability is fulfilled in part when financial reporting enables user groups to determine to what extent current-period expenses are financed by current-period revenues. This reporting objective is based on the concept of interperiod equity, which is based on the idea that the citizenry, as a group, that benefits from an expense should pay for it. For this reason, financial reporting should provide a basis for determining whether, during a reporting period, (1) a surplus was created (a benefit to the future citizenry), (2) a deficit was incurred (a burden to the future citizenry), (3) a surplus from a previous reporting period was used to finance current expenses (a benefit to the current citizenry), (4) a deficit from a previous reporting period was satisfied with current revenues (a burden to the current citizenry), or (5) current, and only current, expenses were financed by using current and only current revenues (achievement of interperiod equity).

Financial reporting by a state or local government should also provide a basis for user groups to determine whether (1) the governmental entity obtained and used resources consistent with the legally adopted budget and (2) finance-related legal and contractual requirements have been met. A budget reflects a myriad of public policies adopted by a legislative body and generally has the force of law as its basis for authority. The legally adopted budget is an important document in establishing and assessing the accountability of those responsible for the management of a governmental entity. While finance-related legal and contractual requirements are not as fundamental as the legally adopted budget, they nonetheless provide a basis for accountability, and financial reporting should demonstrate that this accountability either has or has not been achieved with respect to the requirements.

The basis of accounting and measurement focus are fundamental to providing a financial reporting model that can help user groups to determine whether a governmental entity has demonstrated fiscal accountability. Governmental fund financial statements are presented on modified accrual accounting concepts and the flow of current financial resources. Generally, governmental accounting standards interpret the flow of current financial resources applied on a modified accrual basis to mean that revenues, and the resulting assets, are accrued at the end of the year only if the revenues are earned and the receivables are expected to be collected in time to pay for fund liabilities in existence at the end of the period. Expenditures and the related fund liabilities are accrued when they are expected to be paid out of revenues recognized during the current period. Proprietary and fiduciary funds are reported on the accrual basis of accounting