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GOVERNMENTAL
GAAP
PRACTICE MANUAL

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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 transactions 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 2010 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

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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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Contents

<i>Preface</i>	v
<i>About the Authors</i>	ix
Part I: Introduction	
Chapter 1: Overview	1-1
Part II: Governmental Funds	
Chapter 2: The General Fund	2-1
Chapter 3: Special Revenue Funds	3-1
Chapter 4: Capital Projects Funds	4-1
Chapter 5: Debt Service Funds	5-1
Chapter 6: Permanent Funds	6-1
Part III: Proprietary Funds	
Chapter 7: Enterprise Funds	7-1
Chapter 8: Internal Service Funds	8-1
Part IV: Fiduciary Funds	
Chapter 9: Pension (and Other Employee Benefits) Trust Funds	9-1
Chapter 10: Private-Purpose Trust Funds	10-1
Chapter 11: Investment Trust Funds and Individual Investment Accounts	11-1
Chapter 12: Agency Funds	12-1
Part V: The Consolidation and Conversion Process	
Chapter 13: Developing Information for Fund Financial Statements	13-1
Chapter 14: Developing Information for Government-Wide Financial Statements	14-1
Chapter 15: Component Units	15-1
Part VI: The Financial Statements and Related Disclosures	
Chapter 16: Basic Financial Statements	16-1
Chapter 17: Notes to the Financial Statements	17-1
Chapter 18: Management's Discussion and Analysis and Other Required Supplementary Information	18-1
Chapter 19: Combining and Individual Fund Financial Statement Presentations	19-1
Chapter 20: Statistical Section	20-1
<i>Accounting Resources on the Web</i>	WEB-1
<i>Index</i>	IND-1

CHAPTER 1

OVERVIEW

CONTENTS

Introduction	1-3
Application Issue	1-5
Modified Accrual Basis of Accounting and Current Financial Resources Measurement Focus	1-6
Accrual Basis of Accounting and Economic Resources Measurement Focus	1-8
Fund Financial Statements	1-9
Governmental Funds	1-9
Proprietary Funds	1-9
Fiduciary Funds and Similar Component Units	1-9
Government-Wide Financial Statements	1-10
Methodology for Preparing Governmental Financial Statements	1-12
Elements of Governmental Financial Statements and Recognition Measurement Attributes	1-13
Worksheet Conversion Entry Checklist	1-14
Long-Term Debt and Related Transactions	1-16
Capital Assets and Related Transactions	1-16
Noncurrent Monetary Assets	1-16
Operating and Other Transactions	1-16
Reclassification Entries	1-17
Analysis of Year Ended June 30, 20X1	1-17
Issuance of Debt	1-17
Issuance of Long-Term Debt: Previous Year's Balances	1-18
Debt Service Transactions	1-19
Interest Paid During the Year	1-19
Principal Repaid During the Year	1-20
Amortization of Discount/Premium	1-21
Deep-Discount Debt	1-21
Zero-Coupon Bonds	1-22
Discount Bonds (Less than 20%)	1-23

Advance Refundings of Debt	1-24
Early Extinguishments of Debt (Nonrefunding)	1-26
Capital Expenditures: Current Period Transactions	1-26
Capital Assets: Previous Year's Balances	1-27
Capital Leases: Current Period Transactions	1-28
Capital Leases: Previous Year's Balances	1-30
Leasehold Improvements	1-31
Gains and Losses Related to Capital Asset Dispositions	1-32
Nonmonetary Exchanges (Trade-Ins)	1-32
Exchange of Dissimilar Capital Assets	1-33
Exchange of Similar Capital Assets with a Loss	1-34
Exchange of Similar Capital Assets with a Gain (No Boot Involved)	1-34
Exchange of Similar Capital Assets with a Gain (Boot Involved)	1-35
Donations of Capital Assets from Outside Parties	1-37
Donations of Capital Assets to Outside Parties	1-37
Gains and Losses Related to Capital Asset Dispositions	1-38
Involuntary Conversions of Capital Assets	1-39
Maintenance and Preservation Costs	1-40
Changes in Accounting Principles	1-40
Changes in Accounting Estimates	1-42
Long-Term Noninterest Bearing Notes Receivable	1-43
Lease Payments Receivable	1-44
Sales-Type Lease	1-45
Direct Financing Lease	1-46
Accrual of Expenses: Current Period Transactions	1-47
Accrual of Expenses: Previous Year's Balances	1-48
Accrual of Revenues: Current Period Transactions	1-49
Accrual of Revenues: Previous Year's Balances	1-50
Extraordinary Items	1-51
Special Items	1-52
Merging Internal Service Funds	1-53
Eliminations of Transfers and the Identification of Internal Balances	1-56
Interfund Loans (Reciprocal Interfund Activity)	1-56
Interfund Service Provided and Used (Reciprocal Interfund Activity)	1-57

Interfund Transfers (Nonreciprocal Interfund Activity)	1-57
Interfund Reimbursements (Nonreciprocal Interfund Activity)	1-58
Terminology and Format	1-59
Governmental Funds Financial Statements	1-59
Government-Wide Financial Statements	1-60
Comprehensive Illustration	1-63
Governmental Funds	1-63
Proprietary Funds	1-64
Fiduciary Funds	1-65

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 and economic resources measurement focus. GASB-34 added accrual basis accounting and economic resources measurement focus for governmental funds activities on an entity-wide basis in the government-wide statement of net assets and statement of activities.

The standards established by GASB-34 apply to external financial reports prepared by state and local governments. The standards focus on general-purpose governments that are prepared by states, cities, counties, towns, and villages.

PRACTICE POINT: Public colleges and universities must follow the guidance established by GASB-35 (Basic Financial

Statements—and Management’s Discussion and Analysis—for Public Colleges and Universities). GASB-35 requires that, in general, public colleges and universities use the same accounting and financial reporting standards that are used by all other governmental entities under the standards established by GASB-34. Specifically, public colleges and universities that issue separate financial reports should observe the guidance established in GASB-34 (pars. 134–138) for special-purpose governmental entities.

The material in CCH’s *Governmental GAAP Practice Manual* is presented in a sequential fashion so that the reader can start from Chapter 2 and follow how a typical governmental entity can post typical accounting transactions and ultimately create its financial statements based on generally accepted accounting principles (GAAP) applicable to state and local governments. However, readers can also focus on a particular topic, read that material, determine the appropriate journal entries, and then follow the remaining chapters that result in the preparation of the financial statements. For example, if a reader is interested in how the information accounted for in Internal Service Funds is presented in a governmental entity’s annual financial statements, he or she can start with Chapter 8 “Internal Service Funds,” then go to Chapter 13, “Developing Information for Fund Financial Statements,” then proceed to Chapter 14, “Developing Information for Government-Wide Financial Statements,” and, review detailed financial statements in Chapter 16, “Basic Financial Statements.”

Application Issue

One of the more complex application issues in governmental accounting and financial reporting is the development of procedures that facilitate the presentation of the two levels of financial statements (the fund financial statements and the government-wide financial statements). Many governmental entities address this application issue by using a worksheet approach to convert fund financial statement information into government-wide financial statements. The purpose of this book is to demonstrate in a detailed step-by-step manner how an accountant or auditor can apply GAAP for state and local governments using a worksheet approach in the development of these financial statements.

One of the unique aspects of GAAP for state and local governmental entities is the presentation of two levels of reporting:

1. Fund financial statements
2. Government-wide financial statements

Fund-based financial statements must be included in a governmental entity’s financial report in order to demonstrate

that restrictions imposed by statutes, regulations, or contracts have been followed. Certain fund financial statements have a short-term emphasis, and in the case of governmental type funds they generally measure and account for cash and “other assets that can easily be converted to cash.” GAAP requires that fund financial reporting be focused on significant (or “major”) funds by reporting the entity’s General Fund and other *major* funds in separate columns in the fund financial statements and the remaining *nonmajor* funds aggregated in a single column. Governmental type funds are presented on the modified accrual basis of accounting and current financial resources measurement focus, and proprietary and fiduciary funds are reported on the accrual basis of accounting and economic resources measurement focus.

Government-wide financial statements were established by GASB-34 in order to provide a basis for determining (1) the extent to which current services provided by an entity were financed with current revenues and (2) the degree to which a governmental entity’s financial position has changed during the fiscal year. In order to achieve these objectives, government-wide financial statements include a statement of net assets and a statement of activities. Government-wide financial statements are based on a flow of all economic resources applied on the accrual basis of accounting. The flow of economic resources refers to all assets available to the governmental unit for the purpose of providing goods and services to the public. When the flow of economic resources and the accrual basis of accounting are combined, they provide the foundation for generally accepted accounting principles used by business enterprises in that essentially all assets and liabilities, both current and long-term, are reported in the government-wide financial statements.

Modified Accrual Basis of Accounting and Current Financial Resources Measurement Focus

Recognized as GAAP for governmental type funds, the modified accrual basis of accounting uses elements of both cash and accrual concepts. Revenues are recorded when they are both measurable and available to finance current expenditures of the government. Revenue is considered available when it is collectible during the current period, or the actual collection will occur either during the current period or after the end of the period but in time to pay current year expenditures and liabilities.

The flow of current financial resources measurement focus applied on a modified accrual basis is a narrow interpretation of what constitutes assets and liabilities for an accounting entity (a governmental fund). Assets comprise only current financial resources, such as cash and claims to cash, investments, receivables, inventory, and other, similar current financial assets. Liabilities comprise

governmental fund liabilities, which are normally expected to be liquidated with current financial resources.

Governmental funds generally record a liability when it is expected that the liability will be paid from revenues recognized during the current period. These definitions have been interpreted by many practitioners to mean that accruals can be made only when the related cash flow is collected or paid “shortly” after the end of the fiscal accounting period.

PRACTICE POINT: GASBI-6 was issued in March 2000 in order to address some of these issues. The GASB describes the Interpretation as exactly that—an interpretation. The Interpretation is not an attempt to change the standards that are the basis for the preparation of fund financial statements, but rather its purpose is “to improve the comparability, consistency and objectivity of financial reporting in governmental fund financial statements by providing a common, internally consistent interpretation of standards affecting the recognition of certain fund liability and expenditures, in areas where practice differences have occurred or could occur.”

The GASBI-6 Interpretation addresses what is meant by “shortly” in the context of the accrual of liabilities related to future expenditures. Liabilities that are normally expected to be paid with current financial resources should be presented as a fund liability, while liabilities that have been incurred but that will not be paid with current financial resources should be considered “general long-term liabilities.” General long-term liabilities are presented in the government-wide financial statements (statement of net assets) and not in a governmental fund balance sheet.

The basic guidance for determining when a governmental fund should accrue an expenditure/liability is found in NCGA-1 (par. 70), which states that “most expenditures and transfers out are measurable and should be recorded when the related liability is incurred.” GASBI-6 (par. 12) expands on this general guidance by noting the following:

Governmental fund liabilities and expenditures that should be accrued include liabilities that, once incurred, normally are paid in a timely manner and in full from current financial resources—for example, salaries, professional services, supplies, utilities, and travel.

These transactions give rise to fund liabilities that are considered mature liabilities because they are “normally due and payable in full when incurred.” However, GASBI-6 points out that there are several significant exceptions to this general guidance established in NCGA-1. Specifically, NCGA-1 (pars. 9–11) states that “unmatured long-term indebtedness” should not be reported as a fund liability

(except for debts that are related to proprietary and trust funds). Unmatured long-term indebtedness is defined as “the portion of general long-term indebtedness that is not yet due for payment,” and it includes debts such as the following:

1. Formal debt agreements such as bonds and notes
2. Liabilities not “normally expected to be liquidated with expendable available financial resources”
3. Other commitments that are not current liabilities properly recorded in governmental funds

GASBI-6 (par. 12) points out that the three specified categories listed above are exceptions to the general rule that a liability is recorded as a fund liability and “in the absence of an explicit requirement to do otherwise, a government should accrue a governmental fund liability and expenditure in the period in which the government incurs the liability.”

Unlike commercial enterprises, much of the revenue received by governments is not based on an exchange or exchange-like transaction (the selling of a product or service and receiving something of approximate equal value), but rather arises from the entity’s taxing powers or as grants from other governmental entities or individuals (nonexchange transactions). Nonexchange transactions are accounted for based on the standards established by GASB-33 (Accounting and Financial Reporting for Nonexchange Transactions).

Accrual Basis of Accounting and Economic Resources Measurement Focus

The accrual basis of accounting is used by commercial enterprises to prepare their financial statements. Generally, under this accounting basis, revenues are recognized when earned and expenses are recorded when incurred for activities related to exchange and exchange-like activities.

The flow of economic resources measurement focus refers to the reporting of all of the net assets available to the governmental unit for the purpose of providing goods and services to the public. When the flow of economic resources and the accrual basis of accounting are combined, they provide the foundation for generally accepted accounting principles used by proprietary and fiduciary funds and business-type activities. This approach recognizes the deferral and capitalization of certain expenditures and the deferral of certain revenues.

When the flow of economic resources is applied on an accrual basis for a fund, all assets and liabilities, both current and long-term, are presented in the fund’s balance sheet or statement of net assets.