FINANCIAL MANAGEMENT FOR
GEORGIA LOCAL UNITS
OF ADMINISTRATION

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10/21/92	07/01/92	I	GAAP Accounting and Financial Reporting Principles
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INTRODUCTION

Two important principles contained in the 2015-2016 Governmental Accounting Standards Board (GASB) Codification of Governmental Accounting and Financial Reporting Standards (2015-2016 Codification) is the basis of accounting and the measurement focus. The basis of accounting refers to the point in time when a Local Unit of Administration (LUA) recognizes revenues, expenditures or expenses (as appropriate), and the related assets and liabilities in the accounts and reported in the financial statements. In other words, the basis of accounting governs the time at which the accounting system recognizes transactions. The measurement focus tells the reader what types of transactions LUAs will report in their financial statements.

Three bases of accounting are commonly used in governments: cash, accrual and modified accrual. This chapter defines and compares each of these bases. Chapters I - 9 and I - 10 provide more specificity regarding the basis of accounting for specific transactions.

GASB STATEMENT NO. 34

Before the GASB's issuance of GASB Statement No. 34, Basic Financial Statements -- and Management's Discussion and Analysis -- for State and Local Governments (GASBS 34), Generally Accepted Accounting Principles (GAAP) required certain fund types to be reported using the accrual basis and certain fund types to be reported using the modified accrual basis.

GASBS 34 changes the fund structure (see chapter I - 6) and the basis of accounting for certain funds on certain financial statements. GASBS 34 introduces two financial reporting levels as follows:

- Governmental-wide reporting
- Fund level reporting

The governmental funds will report using a different basis of accounting for each of the two reporting levels. LUAs report this fund type on the accrual basis at the government-wide financial reporting level and on the modified accrual basis for fund level financial reporting. LUAs will report the proprietary funds using the accrual basis of accounting at both reporting levels and the fiduciary funds (i.e., they are reported only at the fund level) will use the accrual basis of accounting.

Chapter II -3 discusses these reporting levels in detail.

The adoption of GASB Statements No. 63 and 65 further clarified the treatment of certain assets and liabilities that are not considered available at fiscal year-end. Deferred Inflows/Outflows of Resources represent a consumption of resources that applies to a future period(s) and therefore will not be recognized as an outflow of resources (expense/expenditure) or inflow of resources (revenue) until the future period. Further detail of the change in the financial accounting equation are discussed in Chapter I-2 of the Financial Management Handbook.

In some instances, the GASB requires a government to delay recognition of decreases in the net current assets of a governmental fund as expenditures until a future period. Likewise, governments are required to delay recognition of increases in the net current assets of a governmental fund as revenues until a future period in other instances. Deferred outflows of resources and deferred inflows of resources, respectively, result from the delayed recognition of expenditures or revenues in these circumstances. Governments are only permitted to report deferred outflows of resources or deferred inflows of resources in governmental funds in circumstances specifically authorized by the GASB. GASBS No. 65, *Items Previously Reported as Assets and Liabilities*, identifies several deferred outflows of resources and deferred inflows of resources to be reported in governmental funds. The governmental fund deferred outflows of resources and deferred inflows of resources identified in GASBS No. 65 are discussed in Chapter I - 2.

CASH BASIS ACCOUNTING

Some LUAs still use cash basis accounting in their day-to-day operations. Cash basis accounting recognizes transactions only when an LUA has received or disbursed cash.

Cash basis financial statements do not include assets and liabilities not arising from cash transactions (i.e., they ignore the effects of accounts receivable, accounts payable and other accrued items). Since these items are commonly of significant dollar amounts, cash basis financial statements usually do not present financial position or results of operations in conformity with generally accepted accounting principles (GAAP). Because of an LUAs liability at fiscal year end, the cash basis will not agree with financial statements that are prepared on the GASB GAAP basis.

Cash basis accounting permits distortions in financial statement representations due to shifts in the timing of cash receipts and disbursements relative to underlying economic events near the end of a fiscal period. For example, a LUA may speed up and/or slow cash collections and payments near the end of the period. These cash flow changes would affect the LUA's financial position and results of operations.

LUAs are urged to follow GAAP during their daily accounting and financial reporting.

MEASUREMENT FOCUS

Before discussing the accrual and modified accrual basis of accounting, the concept of "measurement focus" must be reviewed. Although there is a relationship between the measurement focus and the basis of accounting, they are distinctly separate accounting conventions. Remember that the measurement focus determines what is measured in the financial statements (i.e., the types of transactions that might be found in a LUA's financial statements). The basis of accounting determines when LUAs recognize transactions in the financial statements despite the measurement focus applied. LUAs may use two types of measurement focus depending upon the fund category and financial reporting level:

> Current financial resources measurement focus. Commonly known as "flow of funds," the fund using this focus (e.g., the general fund) generally reports only current assets and current liabilities on their balance sheets. At the fund reporting level, the equity, which is the difference between current assets and current liabilities, is known as net current assets or fund balance. Funds using this focus only recognize revenue when the transaction will provide them with more resources to pay their bills in the near future. They would only report an expenditure when the transaction is going to use up current financial resources.
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> Economic resources measurement focus. A fund using this focus (e.g., an after-school fund) reports all assets and all liabilities on their statement of position. The difference between all assets and all liabilities is the classified as net position of the fund. The operating statements include all costs of providing a service and statement of net position includes total assets and total liabilities. In other words, LUAs would report on their operating statement transactions when they affect the LUA economically.

THE ACCRUAL BASIS OF ACCOUNTING

At the fund reporting level, all proprietary and fiduciary fund types use the accrual basis of accounting under GAAP. All governmental funds use the accrual basis of accounting when reporting at the government-wide level. Accrual basis accounting recognizes transactions when they occur, despite the timing of related cash flows. The use of accrual accounting techniques prevents distortions in financial statement representations due to shifts in the timing of cash flow and related underlying economic events near the end of a fiscal period. In other words, the receipt or disbursement of cash does not affect the reporting of revenues and expenses. Accrual accounting techniques enhance the comparability of financial statements from period to period and from one LUA to another.

Revenue Recognition

Under the accrual basis, revenue recognition occurs in the accounting period in which the revenue becomes objectively measurable and earned. "Objectively measurable" means the amount can be determined accurately. Obviously, LUAs cannot report a transaction unless they can determine the amount of the transaction. The LUA staff must either know the actual amount of a transaction or can estimate accurately this amount. This criterion is applicable to the recording of all financial transactions. For an LUA to earn revenue, it must have provided the goods or services. GASBS 33 provides guidance for revenue recognition on both the accrual and the modified accrual basis of accounting for non-exchange transactions, which is discussed in Chapter I-9.

Expense Recognition

When using the accrual basis of accounting, LUAs recognize expenses in the period incurred, if measurable. To incur an expense, the LUA must receive and consume the item purchased or the vendor or employee must have provided the service. For example, the purchase of a consumable supply in an enterprise fund must be received and consumed by the LUA before an expense can be reported. As another example, the monthly servicing of the lunchroom by the exterminator must be performed before an expense can be incurred and reported.

For an expense to be measurable, the amount must be determined. Normally this is when the LUA receives the invoice for the purchase of the service. However, the LUA could estimate this amount.

DISTINGUISHING BETWEEN EXPENSES AND EXPENDITURES

Note the use of the term expenses rather than expenditures when describing accrual accounting. Expenses and expenditures differ in several ways. An expenditure is a demand on current financial resources (e.g., cash, accounts receivable). For example, to report an expenditure, at some point in time, the LUA will write a check (i.e., a demand will occur on current financial resources).

For an LUA to incur an expense, they must be economically "worse off." For example, an LUA may incur an expense without a demand on current financial resources. The primary difference in the two terms is that expenses:

- Include various allocations of costs, such as depreciation
- Do not include the purchase of capital assets or the repayment of debt principal

Note that when an LUA incurs depreciation expense, it does not write a check (i.e., there is no demand on current financial resources). However, the LUA is economically "worse off" (i.e., their fund net position is reduced when depreciation expense is closed to the net position account at year end).

The opposite is true for expenditures. Expenditures:

- Include the purchase of capital assets
- Include the repayment of debt principal (i.e., a demand on current financial resources)
- Do not include allocations of costs such as depreciation or amortization of bond discounts (i.e., which would make the LUA economically "worse off")

MODIFIED ACCRUAL BASIS OF ACCOUNTING

All governmental fund types use the modified accrual basis of accounting at the fund level reporting.

Revenue Recognition

Under the modified accrual basis of accounting, a LUA recognizes revenues when they meet both the measurable and available criteria. As previously shown, a LUA recognizes transactions (e.g., revenues) when they are measurable under both the cash and the accrual bases of accounting. A LUA considers revenues objectively measurable if they can determine the amount accurately. Some revenues such as swimming pool user fees and daily lunch sales generally are not considered measurable until received in cash. However, this does not mean that the LUA recognizes these revenues on the cash basis. Rather, they become measurable when received (i.e., meeting one of the two revenue recognition criteria under the modified accrual basis of accounting).

The requirement that revenues be available before they are recognized, distinguishes the modified accrual basis revenue recognition from that of accrual basis. Available means that the revenue is collected in the current period or will be collected soon enough after the end of year to pay liabilities of the current period. In practice, LUAs interpret the term "available" in different ways. Alternative interpretations include:

- Collected within a period of time after year-end equal to the LUA's normal bill paying cycle.
- Collected within a specified standardized time period after year-end such as 30, 60, 90 or 120 days.
- Collected within 12 months after year-end (i.e., the transaction results in a current asset at year-end).

Under current GAAP, any of the above alternatives, are considered acceptable for revenue recognition. However, the 2015-2016 GASB Codification Section P70 clarifies revenue recognition for property taxes. LUAs recognize property taxes as revenue in the period for which the LUAs levy them (i.e., usually the period for which the taxes are budgeted) except that they will not recognize them unless:

- They are collected within the current year or expected to be collected within "60 days" after the end of the current year.

In other words, GAAP limits the available period to 60 days. Codification Section P70, Section 104 states, "when a property tax assessment is made, it is to finance the budget of a particular period, and the revenue produced from any property tax assessment should be recognized in the fiscal period for which it was levied, provided the "available" criteria are met. *Available* means collected within the current period or expected to be collected soon enough thereafter to be used to pay liabilities of the current period. Such time thereafter shall not exceed 60 days. Governments should disclose in their summary of significant accounting policies the length of time used to define available for purposes of revenue recognition in the governmental fund financial statements. If, because of unusual circumstances, the facts justify a period greater than 60 days, the governmental unit should disclose the period being used and the facts that justify it."

In summary, if a time period other than 60 days is determined to be the available period, the school district should provide justification for the use of a different measurement period.

Chapter I - 9 includes journal entries illustrating the recording of property tax revenue.

If a receivable is measurable but not available, the LUA reports the credit amount as a deferred inflow of resources, following the liability section of the balance sheet. Deferred inflow of resources for property taxes (i.e., those taxes collected after the 60-day period) and some grant revenues are the most common LUA deferrals.

Expenditure Recognition

LUA's recognize expenditures under the modified accrual basis:

- When measurable,
- And generally when the LUA incurs the liability,
- And the liability will be liquidated with current resources.

An expenditure normally is considered measurable when the LUA receives the invoice for the goods or services. If the expenditure was incurred as a result of a bid or the amount could be estimated, the LUA could consider the transaction measurable before it received the invoice.

To incur a liability, the LUA must receive the goods in satisfactory condition and/or the vendor or the employee must have performed the service. For example, a LUA records the expenditure when goods or services are received (note that it is not necessary that it uses the goods) or when repairs are completed (i.e., the liability is incurred) and the invoice is received (i.e., the transaction is measurable).

The third expenditure criteria, "the liability must be liquidated from current resources", is not as easily defined. Some consider current resources to be equal to fund balance. Therefore, when using this consideration, if there is a fund balance (i.e., no fund balance deficit), expenditures and liabilities outstanding can be recorded. However, this recording cannot exceed the amount of fund balance available. Alternatively, if the paying of the liability occurs after year-end but within the normal bill paying cycle, this criterion usually is considered met. As noted, GAAP allows flexibility when applying this criteria, however, a LUA should use a similar "available period" consistently from year to year. Most often, if a LUA has a liability at year-end, they should report this amount as an expenditure.

There are some exceptions or alternatives to this expenditure recognition criteria.

1. Principal and interest on general long-term debt generally are recognized when the payments for these purposes are due.

2. Inventory items such as consumable supplies may be considered as expenditures either when purchased or when used. Chapter I - 12 explain this option.

3. Expenditures that are prepaid for insurance and similar services extending over more than one accounting period (e.g., the fiscal year) may be allocated between accounting periods (i.e., one-third of a three-year insurance premium could be charged as an expenditure each year) or may be recognized in the period of acquisition. The latter alternative is most common.

4. At the fund reporting level, LUAs report expenditures for compensated absences (e.g., vacation, sick pay) in a governmental fund when they will liquidate them with expendable available current financial resources. Unfortunately, as with the revenue recognition "available" criteria, the term "expendable available current financial resources" is not defined clearly or applied consistently from LUA to LUA.

Chapters I-10 and III-4 explains detailed expenditure recognition.

Summary of the Bases of Accounting

The modified accrual basis of accounting falls somewhere between the cash basis of accounting and the accrual basis of accounting. A revenue is recognized on the modified accrual basis similar to revenue recognition under the accrual basis, since the cash is received soon enough after year-end (i.e., it is considered available). Generally, a LUA records an expenditure similar to recognition under the accrual basis, since the liability resulting from the expenditure is liquidated from current resources.

When the cash for a revenue transaction is collected, and when the liability resulting from an expenditure is liquidated, affects when a transaction is recorded under the modified accrual basis of accounting. When the LUA receives the cash from the transaction determines when the revenue is considered available. When the liability resulting from the expenditure is liquidated determines whether the liability was liquidated from current resources.

As indicated, there are major differences between the non-GAAP cash basis of accounting and the two GAAP methods of accrual accounting. The three bases discussed above can be compared as they relate to cash received and disbursed as follows:

1. Cash basis - Revenues and costs are reported only when cash is received or disbursed.

2. Accrual basis - Revenues and expenses are reported without regard to when cash is received or disbursed.

3. Modified accrual basis - Revenues and expenditures normally are reported before cash is received or disbursed, however, when cash changes hands does affect when the transactions are reported (i.e., when revenues are available or expenditures are liquidated from current recourses).

Exhibit I-7-1 summarizes the two acceptable bases of accounting explained above.

EXHIBIT I-7-1
COMPARISON OF THE BASES OF ACCOUNTING

	(1) Accrual Basis	(2) Modified Accrual Basis
A. Revenues are recorded on the operating statement when:	Measurable (the amount can be determined) and Earned (the service has been provided)	Measurable (the amount can be determined) and Available (the revenue was collected in the fiscal year or will be collected soon enough after the close of the fiscal year to pay liabilities of the current year)
B. Expenses/expenditures are recorded on the operating statement when:	(Expenses) Measurable (the amount can be determined) and Incurred (the goods or services have been received and consumed)	(Expenditures) Measurable (the amount can be determined) and Incurred (the goods or services have been received s) Payable from current financial resources
C. Capital Assets	An asset on the statement of net position.	An operating expenditure in the fund where the purchase is made (Note – the LUA also maintains a record of these assets in its capital asset system)
D. Depreciation is reported:	As an expense on the operating statement	Not reported
E. The issuance of debt is reported:	As an increase in the liability on the statement of net position	As an “other financing source” on the operating statement (Note – the LUA also maintains record of these liabilities)
F. The payment of debt is reported:	As a reduction of the liability	As an operating expenditure on the operating statement

RELATIONSHIP TO FUND ACCOUNTING

Under GAAP, all generic fund types must use either the accrual or the modified accrual basis of accounting as illustrated in Exhibit I-7-2. At the fund reporting level, governmental fund types use the modified accrual basis of accounting and current financial resources measurement focus and proprietary fund types and fiduciary fund types use the accrual basis of accounting and the economic resources measurement focus.

EXHIBIT I-7-2
FUND ACCOUNTING SUMMARY @ THE FUND REPORTING LEVEL

Fund Type	Fund Category	Measurement Focus	Basis of Accounting
General	Governmental	Flow of current financial resources	Modified accrual
Special Revenue	Governmental	Flow of current financial resources	Modified accrual
Debt Service	Governmental	Flow of current financial resources	Modified accrual
Capital Projects	Governmental	Flow of current financial resources	Modified accrual
Permanent	Governmental	Flow of current financial resources	Modified accrual
Enterprise	Proprietary	Flow of economic resources	Accrual
Internal Service	Proprietary	Flow of economic resources	Accrual
Pension Trust	Fiduciary	Flow of economic resources	Accrual
Private Purpose Trust	Fiduciary	Flow of economic resources	Accrual
Agency	Fiduciary	Not applicable	Accrual

At the government-wide financial reporting level, governmental and proprietary fund types use the accrual basis of accounting and the economic resources measurement focus.

EXHIBIT I-7-3
FUND ACCOUNTING SUMMARY @ THE GOVERNMENT-WIDE REPORTING LEVEL

Fund Type	Fund Category	Measurement Focus	Basis of Accounting
General	Governmental	Flow of economic resources	Accrual
Special Revenue	Governmental	Flow of economic resources	Accrual
Debt Service	Governmental	Flow of economic resources	Accrual
Capital Projects	Governmental	Flow of economic resources	Accrual
Permanent	Governmental	Flow of economic resources	Accrual
Enterprise	Proprietary	Flow of economic resources	Accrual
Internal Service	Proprietary	Flow of economic resources	Accrual
Trust and Agency:			
Pension Trust	Fiduciary	Not applicable	Not applicable
Private Purpose Trust	Fiduciary	Not applicable	Not applicable
Agency	Fiduciary	Not applicable	Not applicable

SUMMARY

1. Cash basis accounting permits distortions in financial statement representations due to shifts in the timing of cash receipts and disbursements relative to underlying economic events near the end of a fiscal period. This method is not recommended for LUAs.

2. The measurement focus determines “what” LUAs measure in their financial statements.

3. The basis of accounting determines “when” LUAs record transactions in their financial statements.

4. Funds using the current financial resources measurement focus generally report only current assets and current liabilities on their balance sheets.

5. Governmental fund types use the current financial resources measurement focus at the fund reporting level.

6. Funds using the economic resources measurement focus report all assets and all liabilities on their balance sheets.

7. Proprietary fund types and fiduciary fund types (except agency funds) use the economic resources measurement focus at the fund reporting level.

8. Under the accrual basis of accounting, revenues are recognized in the accounting period in which they become measurable and are earned.

9. Under the accrual basis of accounting, expenses are recognized in the accounting period incurred, if measurable.

10. Proprietary fund types and fiduciary fund types use the accrual basis of accounting at the fund reporting level.

11. Expenses include the allocations of costs including depreciation, but do not include the purchase of capital assets or the repayment of debt principal.

12. Expenditures include the purchase of capital assets and the repayment of debt principal, but do not include allocations of cost such as depreciation.

13. Under the modified accrual basis of accounting, LUAs recognize revenues in the accounting period when they become susceptible to accrual, that is, when they become measurable and available (i.e., collected soon enough after year end to pay liabilities of the current period).

14. LUAs recognize property taxes as revenue in the period for which they are levied except that they will not be recognized unless they collected within the current year or expected to be collected within 60 days after the current year.

15. Under the modified accrual basis of accounting, LUAs recognize expenditures in the accounting period when measurable and generally when they incur the liability and they will liquidate it with current resources.

16. Governmental fund types use the modified accrual basis of accounting at the fund reporting level and use the accrual basis of accounting at the government-wide financial reporting level.