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Governmental Accounting Standards Series

Interpretation No. 6 of the Governmental Accounting Standards Board

Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements

an interpretation of NCGA Statements 1, 4, and 5; NCGA Interpretation 8; and GASB Statements No. 10, 16, and 18

GASB

Governmental Accounting Standards Board
of the Financial Accounting Foundation

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Summary

The purpose of modified accrual accounting is to measure flows of current financial resources in governmental fund financial statements. This Interpretation clarifies the application of standards for modified accrual recognition of certain liabilities and expenditures in areas where differences have arisen, or potentially could arise, in interpretation and practice. Key points of clarification include the following:

- In the absence of an applicable accrual modification, governmental fund liabilities and expenditures should be accrued. Liabilities that governments normally pay in a timely manner and in full from expendable available financial resources (for example, salaries and utilities) should be recognized when incurred, without regard to the extent to which resources are currently available to liquidate the liability.
- A government's *unmatured long-term indebtedness* (other than "specific fund debt" of proprietary and trust funds) should be reported as general long-term liabilities, rather than governmental fund liabilities. This requirement applies not only to formal debt issues, such as bonds, but also to other forms of general long-term indebtedness, including compensated absences, claims and judgments, special termination benefits, landfill closure and postclosure care costs, and "other obligations" that are not due for payment in the current period.
- A government may accrue an additional governmental fund liability and expenditure for debt service on general long-term debt, beyond the amounts matured, if it has provided financial resources to a debt service fund for payment of liabilities that will mature early in the following year. This Interpretation clarifies that the application of the term *provided* is limited and that the term *early in the following year* refers to a short time period—usually one to several days and not more than one month.
- Liabilities for compensated absences, claims and judgments, special termination benefits, and landfill closure and postclosure care costs are "normally expected to be liquidated with expendable available financial resources," and should be recognized as governmental fund liabilities, to the extent that they *mature* each period. The accumulation of financial resources in a governmental fund for eventual payment of unmatured liabilities (for example, compensated absences) does not constitute an outflow of current financial resources or result in the recognition of an additional governmental fund liability or expenditure.

The effective date of this Interpretation coincides with the effective date of Statement 34 for the reporting government. Earlier application is encouraged, provided that this Interpretation and Statement 34 are implemented simultaneously.

Unless otherwise specified, pronouncements of the GASB apply to financial reports of all state and local governmental entities, including general purpose governments, public benefit corporations and authorities, public employee retirement systems, and public utilities, hospitals and other healthcare providers, and colleges and universities. Paragraph 5 discusses the applicability of this Interpretation.

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an interpretation of NCGA Statements 1, 4, and 5;
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March 2000

Governmental Accounting Standards Board
of the Financial Accounting Foundation
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March 2000

INTRODUCTION

1. Governmental fund financial statements are prepared using a *modified accrual basis of accounting* that is defined by a series of Statements and Interpretations of the National Council on Governmental Accounting (NCGA) and the Governmental Accounting Standards Board (GASB). The general purpose of these standards is to adapt accrual-basis recognition and measurement of the effects of certain types of transactions and events as necessary to measure and report *flows of current financial resources*—the measurement focus of governmental fund financial statements.

2. GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments,* carries forward the requirement that governmental fund financial statements be prepared using the current financial resources measurement focus and the modified accrual basis of accounting. This traditional measurement focus and basis of accounting (MFBA) provides useful information related to a government's *fiscal accountability,*[1] as part of the new financial reporting model. The new model also provides useful information related to a government's *operational accountability,*[2] including government-wide financial statements prepared on the accrual basis of accounting.

3. Concerns have been raised about the *interpretation* and *application* of existing modified accrual standards. These include (a) lack of comparability in the application of standards for recognition of certain fund liabilities and expenditures, (b) the perceived

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[1] "Fiscal accountability is the responsibility of governments to justify that their actions in the current period have complied with public decisions concerning the raising and spending of public moneys in the short term (usually one budgetary cycle or one year)" (GASB Statement 34, paragraph 203).

[2] "In contrast, operational accountability is governments' responsibility to report the extent to which they have met their operating objectives efficiently and effectively, using all resources available for that purpose, and whether they can continue to meet their objectives for the foreseeable future" (Ibid.).

subjectivity of some interpretations and applications, and (c) the potential circularity of the criteria for recognition of revenues and expenditures.

4. This Interpretation clarifies the application of existing standards for distinguishing the respective portions of certain types of liabilities that should be reported as (a) *governmental fund liabilities* and expenditures and (b) *general long-term liabilities* of the government. The objective of this Interpretation 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 liabilities and expenditures, in areas where practice differences have occurred or could occur.

INTERPRETATION

Scope and Applicability of This Interpretation

5. This Interpretation applies to state and local governmental entities that use the current financial resources measurement focus and the modified accrual basis of accounting. The scope of this Interpretation includes the financial reporting of certain governmental fund liabilities within the following categories:

- Those that generally are required to be recognized *when due*—debt service on formal debt issues, such as bonds and capital leases
- Those that are required to be recognized to the extent they are *normally expected to be liquidated with expendable available financial resources*—compensated absences, claims and judgments, landfill closure and postclosure care obligations, and special termination benefits
- Those for which no specific accrual modification has been established.

6. This Interpretation clarifies the application of portions of the following pronouncements: NCGA Statement 1, *Governmental Accounting and Financial Reporting Principles,* paragraphs 43, 57, 70, and 72; NCGA Statement 4, *Accounting and Financial Reporting Principles for Claims and Judgments and Compensated Absences*, paragraphs 16 and 17; NCGA Statement 5, *Accounting and Financial Reporting Principles for Lease Agreements of State and Local Governments,* paragraph 13; NCGA Interpretation 8, *Certain Pension Matters*, paragraph 12; GASB Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, paragraph 82; GASB Statement No. 16, *Accounting for Compensated Absences*, paragraph 13; and

GASB Statement No. 18, *Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Costs,* paragraph 10.

7. The scope of this Interpretation *does not* include whether, when, or at what amount a *government* should recognize a liability, but is limited to clarification of standards for distinguishing the parts of certain liabilities that should be reported as governmental fund liabilities and as general long-term liabilities. Nor does the scope of the Interpretation include standards for the financial reporting of fund liabilities and expenditures for:

- Operating leases with scheduled rent increases, which should be recognized in accordance with the requirements of Statement No. 13, *Accounting for Operating Leases with Scheduled Rent Increases,* as amended
- Employer contributions to (a) pension plans, which should be recognized in accordance with the requirements of Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers,* or (b) postemployment healthcare plans, if a government elects to measure and recognize its employer contributions in accordance with Statement 27.[3]

Modified Accrual Recognition of Liabilities and Expenditures

8. Consistent with the flow of current financial resources measurement focus required for *governmental fund* financial statements, governmental financial reporting standards include criteria for distinguishing the portions of liabilities incurred by the government that should be reported as:

a. Governmental fund liabilities (claims against current financial resources)
b. General long-term liabilities of the government.

9. NCGA Statement 1, paragraph 70, requires that a government *accrue* a governmental fund liability and expenditure for most expenditures and transfers in the period in which the government incurs the liability. However, NCGA Statement 1, paragraphs 43 and 44, requires that *unmatured long-term indebtedness*[4] (the portion of general long-term indebtedness that is not yet due for payment) be reported as general long-term liabilities of the government, rather than as governmental fund liabilities. That requirement applies not only to formal debt issues such as bonds, but also to other forms of general long-term indebtedness, including capital leases, compensated absences, claims

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[3]Paragraph 24 of Statement 27 permits, but does not require, governments to recognize their employer contributions to postemployment healthcare benefits in accordance with that Statement.

[4]Other than "specific fund liabilities" of proprietary and trust funds.

and judgments, pensions, special termination benefits, landfill closure and postclosure obligations, and "other commitments that are not current liabilities properly recorded in governmental funds."

10. *Matured liabilities* (other than those associated with proprietary or fiduciary funds) should be reported as governmental fund liabilities. Matured liabilities include:

a. Liabilities that normally are due and payable in full when incurred
b. The matured portion of general long-term indebtedness (the portion that has come due for payment).

11. In addition to the preceding criteria for classification of liabilities, a series of specific accrual modifications have been established pertaining to the reporting of certain forms of long-term indebtedness. For example:

- Debt service on formal debt issues (such as bonds and capital leases) generally should be recognized as a governmental fund liability and expenditure when due (matured)—with optional additional accrual under certain conditions, as interpreted in paragraph 13.
- Compensated absences, claims and judgments, special termination benefits, and landfill closure and postclosure care costs should be recognized as governmental fund liabilities and expenditures to the extent the liabilities are "normally expected to be liquidated with expendable available financial resources," as interpreted in paragraph 14.

Accrual in the Absence of an Applicable Modification

12. 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. 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. To the extent not paid, such liabilities generally represent claims against current financial resources and should be reported as governmental fund liabilities.

Additional Recognition of Debt Service Liabilities and Expenditures

13. Governmental fund liabilities and expenditures for debt service on general long-term debt, including capital leases, generally should be recognized *when due*—that is, to the extent that portions of the debt mature during the reporting period. However, NCGA

Statement 1, paragraph 72, *permits additional accrual* of debt service liabilities and expenditures *if* a government has provided financial resources to a debt service fund for payment of liabilities that will mature early in the following year (period). This explicitly applies to recognition in debt service funds. A government has "provided" financial resources to a debt service fund if it has deposited in or transferred to that fund financial resources that are dedicated for payment of debt service. "Early in the following year" refers to a short time period—usually one to several days and not more than one month. Accrual of an additional fund liability and expenditure is not permitted for (a) financial resources that are held in another governmental fund or (b) nondedicated financial resources transferred to a debt service fund at the discretion of management.[5]

Fund Liabilities "Normally Expected to Be Liquidated with Expendable Available Financial Resources"

14. Governmental fund liabilities and expenditures for claims and judgments, compensated absences, special termination benefits, and landfill closure and postclosure care costs should be recognized to the extent the liabilities are "normally expected to be liquidated with expendable available financial resources."[6] Governments, in general, are normally expected to liquidate liabilities with expendable available financial resources to the extent that the liabilities *mature* (come due for payment) each period. For example, *compensated absences* liabilities are normally liquidated with expendable available financial resources, and a governmental fund liability and expenditure should be recognized, as payments come due each period upon the occurrence of relevant events such as employee resignations and retirements. Similarly, *landfill closure and postclosure care costs* are normally liquidated with expendable available financial resources, and a governmental fund liability and expenditure should be recognized, as payments come due each period upon receipt of goods and services used in the closing and postclosure care processes. In all cases, the criterion for modified accrual recognition is whether and to what extent the liability has matured, independent of the method and timing of resource accumulation.

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[5]Accumulations of financial resources that do not meet the criterion for recognition of an additional debt service fund liability and expenditure should be reported as part of fund balance.

[6]Variations on this term are (a) *normally would be liquidated with expendable available financial resources* (in paragraph 17 of NCGA Statement 4 for certain claims and judgments and in paragraph 13 of GASB Statement 16 for compensated absences) and (b) *payable with expendable available financial resources* (in paragraph 6 of GASB Statement 17 for claims and judgments within the scope of Statement 10). These terms generally are synonymous with *normally expected to be liquidated with expendable available financial resources.*

Accumulation of Net Assets for Future Payments of Unmatured Liabilities

15. Some governments follow a policy of budgeting on the accrual basis for compensated absences, landfill closure and postclosure care costs, or other forms of long-term indebtedness covered by the “normally expected” criterion. Governments that follow that policy typically accumulate and earmark net assets for eventual payment of incurred but unmatured liabilities. Other governments do not budget for these forms of long-term indebtedness on the accrual basis but accumulate and earmark net assets for eventual payment of some of their unmatured liabilities.

16. The accumulation of earmarked net assets in a governmental fund for eventual payment of unmatured general long-term indebtedness does not constitute an outflow of current financial resources and should not result in the recognition of an additional governmental fund liability or expenditure. Paragraphs 43 and 44 of NCGA Statement 1 require that unmatured liabilities be reported as general long-term liabilities of the government. Accumulated net assets should be reported as a part of fund balance—for example, as unreserved–designated fund balance, if appropriate.[7]

“Other Commitments That Are Not Current Liabilities Properly Recorded in Governmental Funds”

17. *Unmatured long-term indebtedness* includes “other commitments that are not current liabilities properly recorded in governmental funds” (NCGA Statement 1, paragraph 43). The inclusion of “other commitments” acknowledges the possibility that new forms of general long-term indebtedness may be created from time to time, for which explicit recognition criteria have not yet been established. For such forms of liabilities, a fund liability and expenditure should be recognized when due, and the remainder should be reported as a general long-term liability.

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[7]This Interpretation clarifies standards for *modified accrual* recognition of certain liabilities and expenditures in governmental fund financial statements. It is not intended either to promote or to discourage funding policies followed by individual governments. The financial reporting model required by Statement 34 requires *accrual-basis* recognition of liabilities and expenses—including compensated absences, claims and judgments, special termination benefits, and landfill closure and postclosure care costs—in *government-wide* financial statements. Governments that would prefer accrual-basis reporting in *fund* financial statements, as well, might consider the possibility of, for example, reporting compensated absences or special termination benefits through a trust fund or an internal service fund.

EFFECTIVE DATE AND TRANSITION

18. The effective date of this Interpretation coincides with the effective date of Statement 34 for the reporting government. That is, the requirements of this Interpretation are effective in three phases based on a government's total annual revenues in the first fiscal year ending after June 15, 1999:

- Phase 1 governments—with annual revenues of $100 million or more—should apply the requirements of this Interpretation in financial statements for periods beginning after June 15, 2001.
- Phase 2 governments—with total annual revenues of $10 million or more but less than $100 million—should apply the requirements of this Interpretation in financial statements for periods beginning after June 15, 2002.
- Phase 3 governments—with total annual revenues of less than $10 million—should apply the requirements of this Interpretation in financial statements for periods beginning after June 15, 2003.

For purposes of identifying the appropriate implementation phase, *revenues* includes all revenues (not other financing sources) of the primary government's governmental and enterprise funds, except for extraordinary items as defined in Statement 34, paragraph 55. All component units should implement the requirements of this Interpretation no later than the same year as their primary government, regardless of the amount of each component unit's total revenues.

19. This Interpretation should be simultaneously implemented with Statement 34. Earlier application is encouraged, if done in conjunction with early adoption of Statement 34. Adjustments to governmental funds resulting from a change to comply with this Interpretation should be treated as adjustments of prior periods, and financial statements presented for the periods affected should be restated. If restatement of the financial statements for prior periods is not practical, the cumulative effect of applying this Interpretation should be reported as a restatement of beginning fund balance for the earliest period restated. In the first period that this Interpretation is applied, the financial statements should disclose the nature of the restatement and its effect.

The provisions of this Interpretation need not be applied to immaterial items.

This Interpretation was adopted by unanimous vote of the seven members of the Governmental Accounting Standards Board:

Tom L. Allen, *Chairman*
Robert J. Freeman, *Vice-chairman*
Cynthia B. Green
Edward M. Klasny
Edward J. Mazur
Paul R. Reilly
Richard C. Tracy

Appendix A

BACKGROUND

20. As discussed in the Basis for Conclusions of Statement 34, governmental fund financial statements provide information useful in demonstrating *fiscal accountability*.[8]

> 203. . . . Fiscal accountability is the responsibility of governments to justify that their actions in the current period have complied with public decisions concerning the raising and spending of public moneys in the short term (usually one budgetary cycle or one year). . . .
>
> 204. A primary objective of governmental activities is to provide services demanded and authorized by the citizenry within the constraints of available (current, spendable) financial resources. The resources needed to achieve this objective for the current period are obtained primarily from taxes, intergovernmental revenues, and other nonexchange revenues, rather than from charges specifically related to the cost of providing a service. In the absence of market mechanisms (such as cost and exchange price) to control the amount of services provided and consumed, governmental activities are governed by public decisions, including numerous laws and regulations that affect the sources and uses of public resources. . . .
>
> 205. Decisions about which services to provide, how much should be spent on them, and how resources should be raised to finance them are made collectively by interested parties outside as well as within the government—through the public budgetary process, voter referendums, and other control mechanisms. These decisions generally are incorporated into a legally adopted budget or spending plan, and into authorizations to raise specified amounts of taxes and other financial resources from identified sources to finance specific current-period activities. The financial statements for governmental activities traditionally have fulfilled the role of completing the budgetary cycle by reporting whether these duly authorized plans were achieved—whether resources were in fact raised and spent in the amounts and for the purposes intended. That information, together with information about fund balances, is important for decision makers involved in the future allocation of resources. Those decision makers include the financial community and the citizenry as well as legislative and oversight bodies.

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[8] A government's duty to be accountable includes both fiscal and operational accountability. Basic financial statements include statements designed to be useful in demonstrating both kinds of accountability. Governmental fund financial statements are useful primarily to demonstrate fiscal accountability. Government-wide and other financial statements are useful primarily to demonstrate operational accountability.

> 206. Key information for these purposes includes the inflows and outflows of current financial resources by source and use; whether aggregate inflows were sufficient to cover aggregate outflows; comparisons between budgeted and actual inflows and outflows; and year-end balances of current financial resources, outstanding claims against those resources (claims payable in the short term), and net current financial resources available for appropriation (or a net deficit requiring additional financing). . . .

21. To provide this information, governmental fund financial statements focus on reporting *flows of current financial resources,* and they are prepared using a *modified accrual* basis of accounting, which adapts accrual-basis recognition and measurement of certain types of transactions and events to fit that measurement focus. The modified accrual basis that should be used in governmental fund financial statements is defined by a particular set of "modifications" required or permitted by NCGA Statement 1 and by subsequent Statements and Interpretations issued by the NCGA and the GASB.

22. Initially, the NCGA expected that most liabilities and expenditures would be accrued in governmental fund financial statements. The only specific modification made in NCGA Statement 1 was for debt service on general long-term debt. However, that Statement also stated that general long-term liabilities were not necessarily limited to the unmatured principal of formal debt issues, such as bonds. They also could include noncurrent liabilities on lease–purchase agreements and unspecified "other commitments that are not current liabilities properly recorded in governmental funds." The NCGA thereby acknowledged the possibility that new forms of "debt," having both governmental fund liability and general long-term liability components, could be created or recognized from time to time.

23. Subsequent NCGA and GASB Statements and Interpretations have provided criteria for applying modified accrual recognition to additional specific types of liabilities and expenditures, including claims and judgments, compensated absences, special termination benefits, leases, landfill closure and postclosure care costs, and employer pension contributions.

24. NCGA Statement 4 introduced the notion that liabilities for claims and judgments and compensated absences should be reported as governmental fund liabilities and expenditures to the extent normally expected to be liquidated with expendable available financial resources. The same criterion was carried forward in Statement 10 on risk financing and Statement 16 on compensated absences, both of which superseded portions

of NCGA Statement 4, and was also applied to special termination benefits (NCGA Interpretation 8) and landfill closure and postclosure care costs (Statement 18).

25. The GASB's original technical agenda in 1984 included a project to reexamine the governmental financial reporting model as a whole. The scope of the project included the design and content of financial statements and the measurement focus and basis of accounting (MFBA) that should be used in preparing them. In this reexamination process—which resulted in the issuance of Statement 34 in June 1999—one of the most deliberated issues was the selection of a MFBA for governmental fund activities.

26. Prior to the June 1995 Preliminary Views (PV) document that led to Statement 34, some supported continuation of the current MFBA. Others argued that the current MFBA was fundamentally flawed and should be replaced by, for example, economic resources and accrual, total financial resources and accrual, or the government's budgetary basis. An underlying assumption of the discussion at that time was that the MFBA selected would be the only MFBA used to report governmental funds.

27. In the PV and later in the Exposure Draft (ED) (issued in January 1997), the Board changed the context of the discussion by proposing a dual-perspective model. Within that model, governmental fund financial statements would continue to be prepared using the current MFBA. In both documents, the Board stated its tentative conclusion that both entity-wide and fund financial statements were needed to address different groups of financial reporting objectives, which may be referred to as operational accountability and fiscal accountability. The Board affirmed that governmental fund financial statements prepared using the current MFBA continued to be useful in providing information relevant to a government's fiscal accountability.

28. In Statement 34, the Board replaced the notion of dual perspectives but continued to include fund information in the basic financial statements. After discussing ED responses and additional possibilities with regard to the governmental fund MFBA, the Board reaffirmed its decision to continue to require use of the current financial resources and modified accrual MFBA for financial statements of governmental funds.

29. The Board concluded that the requirement to include accrual-basis information in the basic financial statements effectively addressed some concerns expressed by ED respondents regarding the limitations of the governmental fund MFBA. For example, critics of that MFBA have long expressed concern that the issuance of long-term debt

results in reporting what they regard as a misleading increase in fund balance. This occurs because the assets, but not the liability that gave rise to them, are *current* and therefore are reportable in governmental funds. Under Statement 34, the reporting of long-term liability transactions in governmental fund financial statements remains unchanged, consistent with the Board's decision to carry forward the flow of current financial resources measurement focus for those statements. However, the government-wide financial statements, which are prepared using the accrual basis of accounting, make clear that the issuance of debt does not increase the financial position of the government.

30. Other concerns raised included:

a. *Lack of comparability in the application of standards for recognition of certain fund liabilities and expenditures.* Varied interpretations of existing standards for modified accrual recognition of governmental fund liabilities and expenditures have led to differing conclusions about whether and to what extent a governmental fund liability and expenditure should be recognized in specific situations. Existing standards have not defined key terms to assist preparers and auditors in reaching a conclusion in such situations—especially, the terms *normally expected to be liquidated with expendable available financial resources* and its variations (NCGA Statement 4, paragraph 17, and other Statements) and *other commitments that are not current liabilities properly recorded in governmental funds* (NCGA Statement 1, paragraph 43).

b. *The perceived subjectivity of some interpretations and applications.* Some observers believe that the MFBA has subjective qualities, because recognition of governmental fund liabilities and expenditures under the "normally expected" criterion, as sometimes interpreted, is associated with factors that can be controlled or influenced by management. For example, some have interpreted that recognition of such fund liabilities and expenditures should be based on the reporting government's budget policy, consistently applied. Others have interpreted that the effective criterion is whether and to what extent the government has sufficient unreserved financial resources that it can, and intends to, apply to liquidation of specific liabilities.

c. *The potential circularity of the criteria for recognition of revenues and expenditures.* In governmental fund financial statements, the recognition of revenues is limited by the extent to which related assets will become *available* in time to liquidate fund liabilities. However, the recognition of at least some types of expenditures depends on the extent to which the liabilities are "normally expected to be liquidated with expendable available resources." Depending on the interpretation of *normally expected,* the recognition of a governmental fund asset and revenue may be seen as depending on the recognition of a governmental fund liability and expenditure, and vice versa.

31. After months of discussions regarding the governmental fund MFBA, in September 1998 the Board approved a separate project to clarify the application of existing standards for modified accrual recognition of governmental fund liabilities and expenditures by means of an Interpretation. An ED was issued on June 30, 1999, to which 30 responses were received. That ED has resulted in this Interpretation.

Appendix B

BASIS FOR CONCLUSIONS

32. This appendix discusses factors considered significant by Board members in reaching the conclusions in this Interpretation. It includes discussion of the alternatives considered, views expressed by respondents to the Exposure Draft (ED), and the Board's reasons for accepting some alternatives and rejecting others. Individual Board members gave greater weight to some factors than to others.

Objectives of the Interpretation

33. The objectives of the proposed Interpretation included clarifying the application of existing standards; improving the consistency, comparability, and objectivity of reporting; and examining the apparent circularity of the criteria for recognition of revenues and expenditures. Virtually all ED respondents who commented expressed general agreement with regard to those objectives.

The Proposed Interpretation as a Whole

34. Most respondents who commented on the proposed Interpretation as a whole expressed general agreement. Some respondents, however, strongly disagreed for various reasons. Several significant themes in their comments relate primarily to disagreement with the proposed interpretation of *normally expected to be liquidated with expendable available financial resources* and are discussed under that caption. Additional broad objections are discussed in the following paragraphs.

35. As stated in paragraph 34 of the ED Basis for Conclusions, the Board's intent in this project has been to develop an *internally consistent interpretation* of existing modified accrual standards that could be *consistently and comparably applied*, rather than to increase or decrease accruals, as such, in governmental fund financial statements. Some respondents disagreed with the ED primarily because they believe that governmental financial reporting standards, including standards for governmental fund financial statements, should be moving in the direction of *greater accrual*—which they believe would also be moving in the direction of greater interperiod equity.

36. The Board discussed issues related to financial statements and the appropriate measurement focus and basis of accounting (MFBA) for each statement at length in

conjunction with Statement 34. In developing the new financial reporting model, the Board considered but rejected the notion that fund financial statements could reflect the financial position of the government—even if the Board were to require those statements to be prepared using the accrual basis of accounting. Rather, the Board concluded that reporting objectives having to do with financial position, changes in financial position, interperiod equity, and costs of services would more appropriately be addressed in government-wide statements. The model therefore includes both government-wide financial statements prepared using the accrual basis of accounting and fund financial statements—each of which provides useful information relevant to some of the objectives of financial reporting identified in Concepts Statement No. 1, *Objectives of Financial Reporting.* Governmental fund financial statements prepared using a modified accrual basis of accounting continue to be useful for some objectives precisely because they provide information about current financial resource flows.

37. Other reasons cited for disagreement with the ED proposal were that long-term liabilities would be "hidden" from financial statement users and that the proposal is not broad enough because, for example, it does not provide needed guidance regarding financial reporting of liabilities and expenditures related to other postemployment benefits (OPEB). With regard to the first objection, the Board disagrees that long-term liabilities will be hidden in the new model. All liabilities will be reported in the government-wide financial statements. Moreover, differences between the government-wide and governmental fund financial statements resulting from different MFBAs will be identified in reconciliations in the basic financial statements or the notes. With regard to the second objection, the Board agrees that improved guidance is needed for reporting OPEB, and those issues are being explored in a separate project.

The Interpretation of "Normally Expected to Be Liquidated with Expendable Available Financial Resources"

38. Although a majority of respondents expressed support for the ED as a whole, respondents who specifically commented on the proposed interpretation of *normally expected* were about evenly divided regarding the proposed interpretation and its application to compensated absences. For some respondents, this issue became the focal point for elaboration of their disagreement with the proposed Interpretation as a whole.

39. The ED proposed that *normally expected* be interpreted as referring to a broad assumption about governments in general. That is, because unmatured general long-term

indebtedness normally does not require outflows of current financial resources, governments are "normally expected" to liquidate general long-term indebtedness with current financial resources to the extent the liabilities mature. Several respondents advocated, instead, an alternative interpretation that *normally expected* relates to a government's budgeting policy consistently applied. Those responses reflect a particular understanding of the function and usefulness of modified accrual financial reporting which includes, explicitly or implicitly, notions regarding:

- The relationship between general purpose external financial reporting and public policy (discussed in paragraphs 40–43)
- The relationship between the modified accrual and budgetary bases of accounting (paragraphs 44–48)
- The notion that governmental fund liabilities and expenditures should be "matched" to assets and revenues in a flexible way based on the government's budgeting policy, and that the financial statements would otherwise be "distorted" (paragraphs 49–52)
- The notion that the accrual of an offsetting liability "protects" assets accumulated for payment of long-term liabilities, which otherwise would be "at risk" (paragraphs 53–57).

General Purpose External Financial Reporting and Public Policy

40. Some responses include, explicitly or implicitly, the notion that general purpose financial reporting[9] should encourage, support, and defend sound funding policies. For some respondents, consideration of a proposed change in the application of generally accepted accounting principles (GAAP) should focus on the projected effect on financial statement users' judgments and policy decisions. That is, given the choice, financial reporting should frame financial information to encourage governing bodies and other decision makers (users) to make decisions deemed sound and lessen the risk that they will make decisions deemed unsound.

41. Some believe it is appropriate from a policy standpoint for governments to move in the direction of more accrual in budgeting. For example, a government might choose to obtain and accumulate assets in amounts sufficient to fund compensated absences

[9]Especially governmental fund financial statements, which, prior to Statement 34, have been the primary focal point of governmental reporting standards and practice.

liabilities as they are incurred—or might accumulate assets according to some other policy to partially fund payments of unmatured liabilities as they come due in future periods. Some advocates of such budgeting policies favor an interpretation that *normally expected* refers to a specific government's policy consistently applied, because it would permit governments that follow accrual-oriented funding policies to accrue liabilities and expenditures in governmental fund financial statements to offset the assets accumulated. The financial statements would represent to governing bodies and others that there was no fund balance resulting from the accumulation of assets to fund compensated absences liabilities due in future periods. Reporting assets and liabilities, and revenues and expenditures, in this way is deemed, by some, to "protect" the assets accumulated; otherwise, these assets would be "at risk" of being reallocated to other governmental purposes.

42. This Interpretation reflects a different view of the relationship between general purpose external financial reporting and public policy. The Board has concluded that GAAP reporting should be consistent with the financial reporting concepts of *freedom from bias* and *representational faithfulness.* Concepts Statement 1 (paragraph 64) states:

> **Reliability**
>
> Financial reporting should be reliable; that is, the information presented should be verifiable and free from bias and should faithfully represent what it purports to represent. To be reliable, financial reporting needs to be comprehensive. Nothing material should be omitted from the information necessary to faithfully represent the underlying events and conditions, nor should anything be included that would cause the information to be misleading. . . .

43. The Board is not indifferent to public policy issues, unappreciative of those who work for sound policies, or unaware that information in general purpose financial statements, along with other sources of information, is used by decision makers to assist in making policy decisions regarding, for example, resource allocation. However, views frequently differ on matters of public policy. Underlying this Interpretation is the view that it is not within the Board's mission to promote any particular viewpoint regarding what is sound public policy. Rather, the Board believes that financial reporting standards, and this Interpretation in particular, should result in the reporting of information that is free from bias and that faithfully represents events and transactions that it purports to represent. In the context of this Interpretation, the application of standards for recognition

of fund liabilities and expenditures in governmental fund financial statements should result in financial reporting that faithfully represents *outflows of current financial resources*. The Board therefore reaffirms the conclusion originally expressed in paragraph 52 of the ED Basis for Conclusions that the accumulation of financial resources in excess of the amounts coming due in the current period does not constitute an additional outflow of current financial resources and, therefore, there is no additional expenditure to be reported. Underlying this interpretation is a clear distinction between two separate events: (a) the accumulation of current financial net assets (revenues) and (b) outflows of current financial resources (expenditures). Because the method and the timing of resource accumulation have no effect on the event that expenditures are intended to reflect—the outflows of current financial resources each period—the Board concluded that expenditure recognition should be independent of the method and timing of resource accumulation.

The Relationship between Modified Accrual (GAAP) and the Budgetary Basis

44. Respondents who disagreed with the ED on how *normally* should be interpreted did so, in part, based on their view of the relationship between the modified accrual basis of accounting and the government's budgetary basis. According to that view, information reported using the modified accrual basis of accounting completes and "disciplines" the budget cycle. Regardless of what a government's budgetary basis is, modified accrual reporting provides discipline by establishing a floor, or minimum standard, for liability and expenditure accrual in governmental fund financial statements.

45. According to several respondents, governments have worked to harmonize their application of the modified accrual basis and their budgetary basis by recognizing certain types of governmental fund liabilities and expenditures (those to which the *normally expected* criterion applies) based on their budgeting policy. For some, this has included recognizing liabilities to offset assets obtained and accumulated for future payment of unmatured liabilities. One respondent expressed concern about the effect of an Interpretation that would potentially move modified accrual farther from a government's budgetary basis and create larger differences to reconcile. From that respondent's point of view, modified accrual GAAP should remain as close to the budgetary basis as possible.

46. The Board concurs to the extent that clearly there is a relationship between modified accrual reporting and a government's budgetary basis. However, neither previous standards nor the discussions leading to Statement 34 indicate that minimization of

differences between the two is a criterion for interpreting how the modified accrual basis should be applied. In the Basis for Conclusions to Statement 34, the Board based its decision to continue requiring modified accrual reporting in governmental fund financial statements on two factors: the importance of the public budget and the continued usefulness of reporting information on flows of current financial resources. The essential common link between the two bases of accounting is that each measures flows of financial resources. Beyond that, neither the Standards section nor the Basis for Conclusions of Statement 34 provides further guidance regarding the interpretation or application of modified accrual reporting. That is the task of this Interpretation.

47. In choosing the modified accrual basis in Statement 34, the Board chose a basis for which standards exist (although needing clarification) and that would promote more consistent and comparable reporting of current financial resources flows than would a government's budgetary basis. In developing this Interpretation, the Board had no agenda either to increase or to decrease differences between the modified accrual and budgetary bases. Rather, the focus of the project has been to develop an internally consistent interpretation of existing modified accrual standards that could be consistently applied and that would result in faithful representation of outflows of current financial resources—for example, for compensated absences.

48. Although the GASB has generally taken the view that budgeting measurement standards are outside its scope and mission, some in the governmental field have supported the adoption of the modified accrual basis as governments' budgetary basis in order to simplify financial reporting or for other reasons. In addition, some governments have enacted GAAP budgeting laws. The Board acknowledges that in such cases the effects of changes in GAAP, or in the interpretation of the application of GAAP, can be complicated by the need to make corresponding adjustments in budgeting.

The Notion That Revenues and Expenditures Should Be "Matched"

49. Some respondents referred to the notion that revenues and expenditures should be "matched." That is, fund liabilities and expenditures should be recognized in the same period and to the same extent that "related" assets and revenues are recognized—as long as this is done in accordance with a consistently applied policy. One respondent stated that, by not permitting matching in this sense, the proposed Interpretation would "distort the fund financial statements." An implicit assumption seems to be that governmental fund financial statements should reflect matched recognition of inflows and outflows

based on a government's policies regarding inflows. However, the Board reaffirmed the conclusion expressed in the ED that governmental fund financial statements will more faithfully represent flows of current financial resources if inflows and outflows are measured independently.

50. The notion of matching arose in the context of accrual-basis accounting in the private sector. Without using the term *matching*, the Accounting Principles Board (APB) set forth three pervasive principles for recognizing costs as expenses in its Statement No. 4, *Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises*.

51. The APB's three pervasive principles for recognizing costs as expense are:

> *Associating cause and effect.* Some costs are recognized as expenses on the basis of a presumed direct association with specific revenue . . . and recognizing them as expenses accompanies recognition of the revenue. . . . [paragraph 157; footnote reference omitted]
>
> *Systematic and rational allocation.* . . . If an asset provides benefits for several periods its cost is allocated to the periods in a systematic and rational manner in the absence of a more direct basis for associating cause and effect. . . . [paragraph 159]
>
> *Immediate recognition.* Some costs are associated with the current accounting period as expenses because (1) costs incurred during the period provide no discernible future benefits, (2) costs recorded as assets in prior periods no longer provide discernible benefits or (3) allocating costs either on the basis of association with revenue or among several accounting periods is considered to serve no useful purpose. [paragraph 160]

The FASB later included essentially the same three principles in its Concepts Statement No. 6, *Elements of Financial Statements*.

52. Upon examination, these APB criteria do not support the notion that the accumulation of assets earmarked for future payment of compensated absences should be offset by recognition of an equivalent and offsetting liability, based on a government's funding policy, in financial statements prepared using the modified accrual basis of accounting.

a. In regard to the APB's first principle, *associating cause and effect*, matched (or linked) recognition of costs and revenues has been considered applicable where there is a direct cause-and-effect relationship between certain costs and revenues

(APB), or where those costs and revenues result jointly and directly from the same transactions or events (FASB).[10] (For example, matched recognition generally has been considered applicable to sales revenue and cost of goods sold.) The Board concluded that compensated absences costs generally *do not* meet these criteria for matched recognition with the predominantly nonexchange revenues (for example, taxes) reported in governmental funds. Rather, costs and revenues generally should be assigned to time periods independently, based on the occurrence of relevant transactions or other events in each case.[11]

b. The second principle, *systematic and rational allocation* (for example, capitalizing and depreciating the acquisition cost of a capital asset), does not fit the characteristics of compensated absences transactions.

c. The third principle, *immediate recognition*, appears applicable to the reporting of compensated absences in *accrual-basis* financial statements. However, in governmental fund financial statements prepared using the *modified accrual basis* of accounting, the recognition of liabilities and expenditures for compensated absences is based not on when the government incurs the liabilities, but on the extent to which the liabilities meet the criteria for inclusion as fund liabilities. Thus, the basic issue comes back to whether unmatured liabilities are admissible as fund liabilities. The Board concludes that they are not, based on the flow of current financial resources measurement focus and the matured-versus-unmatured criterion set forth in NCGA Statement 1, paragraph 43.

The Notion That Accrual of an Offsetting Liability "Protects" Assets and Demonstrates Funding of Liabilities

53. More than one respondent expressed the notion that recognition of an offsetting liability in governmental fund financial statements "protects" the assets that a government has accumulated to fund unmatured compensated absences liabilities, is necessary to demonstrate the extent to which the unmatured liabilities have been funded, or both.

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[10]In FASB Concepts Statement 6, paragraph 146, the FASB stated: "Matching of costs and revenues is simultaneous or combined recognition of the revenues and expenses that *result directly and jointly from the same transactions or other events.* In most entities, some transactions or events result simultaneously in both a revenue and one or more expenses. The revenue and expense(s) are *directly related to each other* and require recognition at the same time. In present practice, for example, a *sale of product or merchandise* involves both *revenue (sales revenue)* for receipt of cash or a receivable and *expense (cost of goods sold)* for sacrifice of the product or merchandise sold to customers. Other examples of expenses that may result from the same transaction and be directly related to sales revenues are transportation to customers, sales commissions, and perhaps certain other selling costs" [emphasis added].

[11]In FASB Concepts Statement 6, paragraph 151, the FASB discussed the relationship of "nonreciprocal transfers to an entity" (similar to nonexchange revenues as defined in GASB Statement 33) to expenses and concluded, similarly, that: "nonreciprocal transfers to an entity rarely result directly and jointly from the same transactions as expenses. Most contributions and expenses are much more closely related to time periods than to each other. For example, the receipt by a not-for-profit organization of contributed assets that involve donor stipulations restricting their use to particular types of services may be a cause of the expenses incurred in providing those services; however, the receipt of contributed assets—revenues or gains—and the subsequent incurring of liabilities or reduction of assets in providing services—expenses—are *separate events recognized in the period in which they occur*" [emphasis added].

- *Protecting assets.* Some respondents view the accrual of an offsetting liability as essential to keep the government on a sound path of (at least partially) funding unmatured compensated absences liabilities and to reduce the risk that the accumulated assets will be reallocated for other governmental purposes.[12] In their view, reporting the accumulated net assets as unreserved–designated fund balance might not be as effective for that purpose.
- *Demonstrating funding.* One respondent expressed concern that "the provisions of paragraph 10 of the ED, whereby fund liabilities for compensated absences only would be recognized as employees resign or retire, would seem to preclude governments from charging federal programs for leave as it is earned, unless the government contrives an internal service fund to fund the leave." According to that respondent, OMB Circular A-87 permits state and local governments to charge federal programs for the *lesser* of the liability incurred each period (as it would be recognized using the accrual basis of accounting) or the amount funded.

54. On both points, the Board believes that some respondents are assigning undue weight to the accounting recognition of fund liabilities, particularly within the context of the new financial reporting model. This Interpretation affects the recognition of compensated absences liabilities and expenditures in governmental fund financial statements prepared using the modified accrual basis of accounting. It *does not:*

- Require or constitute a change in a government's funding policies
- Preclude a governing body that was previously following a policy of accumulating assets for future payments of unmatured liabilities (for example, compensated absences) from continuing that policy (nor would the interpretation advocated by those respondents guarantee that result)
- Preclude a recipient government from demonstrating the extent to which it has funded unmatured compensated absences liabilities.

55. In the Basis for Conclusions to FASB Statement No. 5, *Accounting for Contingencies*, the FASB discussed the difference between accounting accruals and the accumulation of assets for a specific purpose:

> 61. . . . The Board believes that confusion exists between accounting accruals (sometimes referred to as "accounting reserves") and the reserving or setting aside of specific assets to be used for a particular purpose or contingency. Accounting accruals are simply a method of allocating costs among accounting periods and have no effect on an enterprise's cash flow. An enterprise may choose to maintain or have access to sufficient liquid assets to replace or repair lost or damaged property or to pay claims in case a loss occurs. Alternatively, it may transfer the risk to others by purchasing

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[12]This view begs the question of whether assets can be said to be placed "at risk" by potential decisions of the public officials entrusted with budgetary authority and responsibility.

> insurance. Those are financial decisions, and if enterprise management decides to do neither, the presence or absence of an accrued credit balance on the balance sheet will have no effect on the consequences of that decision. The accounting standards set forth in this Statement do not affect the fundamental business economics of that decision.
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> 62. In that regard, some respondents to the Discussion Memorandum and the Exposure Draft contended that an accounting standard that does not permit periodic accrual of so-called "self-insurance reserves" and, in the case of insurance companies, so-called "catastrophe reserves" will force enterprises to purchase insurance or reinsurance because the "protection" afforded by the accrual would no longer exist. Those accruals, however, in no way protect the assets available to replace or repair uninsured property that may be lost or damaged, or to satisfy claims that are not covered by insurance, or, in the case of insurance companies, to satisfy the claims of insured parties. Accrual, in and of itself, provides no financial protection that is not available in the absence of accrual.
>
> 63. The sole result of accrual, for financial accounting and reporting purposes, is allocation of costs among accounting periods. . . .

56. A significant part of some ED respondents' concern relates to how they anticipate that financial statement users may respond to changes in the presentation of financial information. The Board recognizes that under any set of standards, financial statement users may come to rely on certain markers, or reference points, for information relevant to them; therefore, any change in financial reporting standards or the application of standards will require some reorientation on the part of those users. For example, some users may be accustomed to looking at the fund liability for compensated absences as a marker that the government has "funded" compensated absences to that extent. Or they may be accustomed to looking at offsetting assets and liabilities related to compensated absences (a reported zero net effect on fund balance) as a marker suggesting that there are no unreserved net assets available for reallocation to other purposes. Although, for some governments, this Interpretation will eliminate those particular markers, the Board concludes that equivalent or better information will be available under Statement 34 and this Interpretation, including:

- Governmental fund balances designated for payment of compensated absences
- Accrual-basis information, including all liabilities and expenses, in government-wide financial statements.

57. Although this Interpretation precludes accrual-basis reporting in governmental fund financial statements, the Board notes that a government may report transactions such as

compensated absences liabilities on the accrual basis in fund financial statements, if it uses a fund type to which the accrual basis of accounting applies. For example, if a government wishes to report employee benefits such as compensated absences or special termination benefits on the accrual basis in fund financial statements, as well as in government-wide financial statements, it would not be precluded from reporting them through an employee benefit trust fund, if a proper trust is established.

Concerns about Basing Accounting Recognition on the Government's Consistently Applied Policy

58. In discussions prior to issuance of the ED, the Board considered but rejected the possibility of interpreting that *normally* depends on the reporting government's funding policy. The Board concluded that an individual government's funding policy, even if consistently applied, is too subjective to serve as a criterion on which to base a financial reporting standard. However, some ED respondents believe that sufficient discipline could be achieved by stressing the need for financial reporting of, for example, compensated absences based on the government's *consistently applied* policy. They would prefer that the Board modify the proposed interpretation of *normally expected* to emphasize that a government, once committed to a policy, should report according to that policy, even if the government does not abide by it in a given year. A change in policy would be treated as a change in accounting principle.

59. The Board concluded that the recommended alternative approach based on funding policy would raise a number of practice issues:

- *What would constitute a "funding policy"?* One of the concerns expressed by respondents is to support governments that partially fund their compensated absences liabilities. In some cases, a government may follow the practice of setting aside a portion of its residual net assets after other transactions for the year for future payments of compensated absences. The residual amounts might vary considerably from year to year. Would setting aside residual assets be a funding policy?
- *What would be considered "consistent"?* If a government consistently followed the practice just described, would that be deemed consistent, even though the amounts accrued from year to year might vary considerably as a result of transactions and events that have nothing to do with compensated absences?
- *What would be the financial reporting implications of failure to follow a funding policy consistently?* If a government failed to follow its policy in a given year, fund liabilities and expenditures would nevertheless be required to be recognized based on that policy, as if consistently applied—a condition contrary to fact. Amounts reported under that interpretation would not represent either outflows of current financial

resources or amounts paid and accumulated during the year, nor would they represent liabilities incurred during the period unless the funding policy was accrual based.

- *What would be the financial reporting implications of a change of funding policy?* If a government recognized compensated absences liabilities according to one funding policy and later changed to another funding policy that produced less accrual or no accrual, the change would be reported as a change of accounting principle. The effect of the change would be to reverse out liabilities and expenditures previously recognized. In subsequent periods, the same liabilities and expenditures would be recognized a second time in accordance with the new policy. The Board knows of no precedent where a change in funding policy would result in adjustment of expenditures/expense previously recognized[13] and believes that that approach could reduce the reliability of governmental fund financial statements.

60. More fundamentally, the Board found no persuasive evidence in the standards themselves to support the interpretation that *normally expected* refers to a recognition criterion *different from* the matured/unmatured criterion required by paragraphs 43 and 44 of NCGA Statement 1. To the contrary, paragraph 43, as amended, explicitly states:

> All other unmatured long-term indebtedness of the government, including certain special assessment debt, is *general long-term debt*. . . .[14]

Moreover, the preceding statement has not been amended as the NCGA and the GASB have established specific accrual modifications, as would have been necessary if the intent had been to establish new and different criteria. Rather, each new form of liability for which a specific modification has been established has been *added to* the list of examples of general long-term debt in paragraph 43—making clear that the matured/unmatured criterion should be applied universally.

Other Issues

Additional Accrual of Debt Service Liabilities and Expenditures

61. NCGA Statement 1, paragraph 72, permits additional accrual of debt service liabilities and expenditures if a government has "provided" financial resources for payments of liabilities that will mature early in the following year. If that condition has been met, "the expenditure and related liability may be recognized in the Debt Service Fund and the debt principal amount removed from [general long-term liabilities]."

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[13]In contrast, under Statement 27, a change in actuarial cost method is a change in estimate and would affect employer pension cost on a prospective basis.

[14]This statement refers to unmatured long-term indebtedness, other than specific fund debt of proprietary and fiduciary funds, as discussed in paragraph 42 of the same Statement.

62. The Board discussed whether this should apply only when a debt service fund is used, or whether it should also apply when financial resources have been "provided" in another governmental fund, such as the general fund. The Board noted that a debt service fund is not always legally required and does not encourage the creation and reporting of unnecessary funds. However, because this limited provision to accrue includes repeated references to recognition in a debt service fund, the Board concluded that extending the option to other governmental fund types would change the standard and, therefore, would not be within the scope of an Interpretation.

63. The Board reaffirmed that the purpose of the additional accrual option is a limited one—to recognize a debt service fund liability and expenditure in cases in which the government has provided dedicated financial resources to ensure timely payment of debt service requirements coming due shortly after year-end.[15] The Board concluded that the provision *does not* apply to discretionary transfers of nondedicated financial resources to a debt service fund, or to accrual for future debt service requirements coming due more than a short time after year-end. In those cases, the financial resources accumulated should be reported as part of fund balance (for example, unreserved–designated fund balance).

Accumulation of Net Assets for Future Payments of Unmatured Liabilities

64. The Board concluded that the accumulation of financial resources for future payments of unmatured general long-term indebtedness does not constitute an additional outflow of current financial resources; therefore, there is no additional fund liability or expenditure to be reported. Underlying this interpretation is the Board's view that a clear distinction should be maintained between two separate events: (a) the accumulation of current financial net assets (revenues) and (b) outflows of current financial resources (expenditures). Because the method and the timing of resource accumulation have no effect on the event that expenditures are intended to reflect—the outflows of current financial resources each period—the Board concluded that expenditure recognition should be independent of the method and timing of resource accumulation.

Other Commitments That Are Not Current Liabilities

65. In developing the ED, the Board considered but rejected an alternative interpretation that "other commitments" (in paragraph 43 of NCGA Statement 1) are the long-term

[15]In many cases, a government will already have transferred cash to its fiscal agent to ensure timely payment of debt service coming due within one to several days after year-end.

portion of *any* other liabilities, *provided that* the government has entered into a multilateral agreement to defer payment to a future period. The Board concluded that there is no accrual modification that would permit deferring to a future period the recognition of fund liabilities (such as salaries and utilities) that normally are paid in a timely manner and in full from current financial resources when incurred. Rather, the Board proposed that such transactions should be reported as governmental fund liabilities and expenditures when incurred. No ED respondent expressed disagreement with that proposal.

Effective Date and Transition

66. In the ED, the Board proposed to link the effective date of the Interpretation to the effective date of Statement 34, because Statement 34 will result in the reclassification of several funds and change the basis of accounting for certain trust funds. A few respondents disagreed. However, the Board concluded that to require implementation of this Interpretation prior to the implementation of Statement 34 would result in unnecessary problems for governments that have relied on alternative interpretations to, for example, support accrual-basis reimbursement of federal grant expenditures. Therefore, the Board reaffirms that this Interpretation should be implemented simultaneously with the implementation of that Statement. This Interpretation is effective at the same time that Statement 34 is effective for the reporting government as a whole. Earlier application is encouraged, if done in conjunction with early adoption of Statement 34.

Appendix C

CODIFICATION INSTRUCTIONS

67. The sections that follow update the June 30, 1999, *Codification of Governmental Accounting and Financial Reporting Standards* for the effects of this Interpretation. However, because Statement 34 also will make extensive revisions to the Codification at the same effective date as this Interpretation, these Codification instructions provide information on how the Statement 34 Codification instructions should be revised. Only the paragraph number of the Interpretation is listed if the paragraph will be cited in full in the Codification.

* * *

REPORTING LIABILITIES SECTION 1500

Sources: [Add the following:] GASB Interpretation 6

General Long-term Liabilities

.103 [Revise GASBS 34 Codification instructions paragraph .103 to change cross-reference.]

[Revise GASBS 34 Codification instructions to insert new paragraphs .105–.108, including footnote, following current Codification paragraph .104, and change cross-references; and renumber remaining paragraphs.]

.105–.108 [GASBI 6, paragraphs 8–11]

Long-term Debt Issue Expenditures

.111 [Revise GASBS 34 Codification instructions paragraph .107 as follows:] Section 1600, "Basis of Accounting," paragraph .118, indicates that most governmental fund expenditures are measurable and should be recorded when the related liability is incurred. The major exception to the general rule of expenditure accrual relates to unmatured principal and interest on general long-term debt. Governmental fund liabilities and expenditures for debt service on general long-term debt, including capital leases, generally should be recognized *when due*—that is, to the extent that portions of the debt mature during the reporting period. Financial resources usually are appropriated in other funds for transfer to a debt service fund in the period in which maturing debt principal and interest must be paid. Such amounts thus are not current liabilities of the debt service fund as their settlement will not require expenditure of existing fund assets. Further, to accrue the debt service fund expenditure and liability in one period but record the transfer of financial resources for debt service purposes in a later period would be confusing and would result in overstatement of debt service fund expenditures and liabilities and understatement of the fund balance. Thus, disclosure of subsequent-year debt service requirements is appropriate, but they usually are appropriately accounted for as expenditures in the year of payment. On the other hand, if debt service fund resources have been provided during the current year for payment of principal and interest due early in the following year, the expenditure and related liability may be recognized in the debt service fund. [NCGAS 1, ¶70 and ¶72, as amended by GASBS 34, ¶82; GASBS 6, ¶16; GASBI 6, ¶13]

[Insert new Codification paragraphs .112 and .113:]

Additional Recognition of Debt Service Liabilities and Expenditures

.112 The preceding paragraph explicitly applies to recognition in debt service funds. A government has "provided" financial resources to a debt service fund if it has deposited in or transferred to that fund financial resources that are dedicated for payment of debt service. "Early in the following year" refers to a short time period—usually one to several days and not more than one month. Accrual of an additional fund liability and expenditure is not permitted for (a) financial resources that are held in another governmental fund or (b) nondedicated financial resources transferred to a debt service fund at the discretion of management.[3] [GASBI 6, ¶13]

.113 For guidance on treatment of liabilities and expenditures for claims, judgments, compensated absences, special termination benefits, pensions, and operating leases, see Sections C50, "Claims and Judgments"; C60, "Compensated Absences"; T25, "Termination Benefits (Special)"; P20, "Pension Activities—Employer Reporting"; and L20, "Leases," respectively.

.114 [Insert GASBS 34 Codification instructions paragraph .108.]

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[3] [GASBI 6, fn5]

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Sources: [Add the following:] GASB Interpretation 6

Expenditure Recognition

.118 [Revise as follows:] The measurement focus of governmental fund financial statements is on *expenditures*—decreases in net financial resources—rather than expenses. Most expenditures and transfers out are measurable and should be recorded when the related liability is incurred. [NCGAS 1, ¶70, as amended by GASBI 6]

[Add new paragraphs .119–.121 and renumber subsequent paragraphs and footnotes.]

.119 [GASBI 6, ¶8]

.120 [GASBI 6, ¶9]

.121 [GASBI 6, ¶12]

.122 [Revise current Codification paragraph .123 as follows:] *Long-term Debt.*[5] The major exception to the general rule of expenditure accrual, stated in paragraph .118, relates to unmatured principal and interest on general long-term debt, which includes special assessment debt for which the government is obligated in some manner. Governmental fund liabilities and expenditures for debt service on general long-term debt, including capital leases, generally should be recognized *when due*—that is, to the extent that portions of the debt mature during the reporting period. Financial resources usually are appropriated in other funds for transfer to a debt service fund in the period in which maturing debt principal and interest must be paid. Such amounts thus are not current liabilities of the debt service fund as their settlement will not require expenditure of existing fund assets. Further, to accrue the debt service fund expenditure and liability in one period but record the transfer of financial resources for debt service purposes in a later period would be confusing and would result in overstatement of debt service fund expenditures and liabilities and understatement of the fund balance. Thus, disclosure of subsequent-year debt service requirements is appropriate, but they usually are appropriately accounted for as expenditures in the year of payment. On the other hand, if debt service fund resources have been provided during the current year for payment of

[5][Insert current Codification footnote 4.]

principal and interest due early in the following year, the expenditure and related liability may be recognized in the debt service fund. [NCGAS 1, ¶72; GASBI 6, ¶13]

Additional Recognition of Debt Service Liabilities and Expenditures

.123 The preceding paragraph explicitly applies to recognition in debt service funds. A government has "provided" financial resources to a debt service fund if it has deposited in or transferred to that fund financial resources that are dedicated for payment of debt service. "Early in the following year" refers to a short time period—usually one to several days and not more than one month. Accrual of an additional fund liability and expenditure is not permitted for (a) financial resources that are held in another governmental fund or (b) nondedicated financial resources transferred to a debt service fund at the discretion of management.[6] [GASBI 6, ¶13]

Fund Liabilities That Are "Normally Expected to Be Liquidated with Expendable Available Financial Resources"

.124 Governmental fund liabilities and expenditures for claims and judgments, compensated absences, special termination benefits, and landfill closure and postclosure care costs should be recognized to the extent the liabilities are "normally expected to be liquidated with expendable available financial resources."[7] Governments, in general, are normally expected to liquidate liabilities with expendable available financial resources to the extent that the liabilities *mature* (come due for payment) each period. For all types of expenditures to which this criterion applies, the criterion for modified accrual recognition is whether and to what extent the liability has matured, independent of the method and timing of resource accumulation. [GASBI 6, ¶14]

Accumulation of Net Assets for Future Payments of Unmatured Liabilities

.125–.126 [GASBI 6, ¶15 and ¶16]

.127 [Insert current Codification paragraph .119; add a cross-reference to paragraph .124 following the second paragraph.]

.128 [Insert current Codification paragraph .120.]

.129 [Insert current Codification paragraph .122.]

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[6][GASBI 6, fn5]

[7][GASBI 6, fn5] [Change cross-references.]

.130 [Insert current Codification paragraph .121.]

"Other Commitments That Are Not Current Liabilities Properly Recorded in Governmental Funds"

.131 [GASBI 6, ¶17] [Renumber subsequent paragraphs.]

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CLAIMS AND JUDGMENTS SECTION C50

.110 [Revise GASBS 34 Codification instructions for footnote 3 to add a cross-reference to Section 1600, "Basis of Accounting," paragraph .124.]

.124 [Revise GASBS 34 Codification instructions to add a cross-reference to Section 1600, paragraph .124, at the end of the second sentence.]

* * *

COMPENSATED ABSENCES SECTION C60

Sources: [Add the following:] GASB Interpretation 6

Reporting in Fund Financial Statements—Governmental Funds

.111 [Revise GASBS 34 Codification instructions paragraph .111 as follows:] Entities that report compensated absences in governmental funds should recognize compensated absences expenditures each period using the modified accrual basis of accounting. That is, the amount of the compensated absences recognized as expenditures in these funds should be the net amount accrued during the year that normally would be liquidated with expendable available financial resources. Compensated absences liabilities are normally liquidated with expendable available financial resources, and a governmental fund liability and expenditure should be recognized, as payments come due each period upon the occurrence of relevant events such as employee resignations and retirements. The accumulation of earmarked net assets in a governmental fund for eventual payment of unmatured general long-term indebtedness, including compensated absences, does not constitute an outflow of current financial resources and should not result in the recognition of an additional governmental fund liability or expenditure. [GASBS 16, ¶13, as amended by GASBS 34, ¶6 and ¶79; GASBI 6, ¶14 and ¶16]

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LANDFILL CLOSURE AND POSTCLOSURE CARE COSTS **SECTION L10**

Sources: [Add the following:] GASB Interpretation 6

Reporting MSWLFs in Governmental Fund Financial Statements

.109 [Revise GASBS 34 Codification instructions paragraph. 109 as follows:] For MSWLFs reported in governmental fund financial statements, the measurement of the liability for MSWLF closure and postclosure care costs should be consistent with paragraph .106 for proprietary funds. MSWLF expenditures and liabilities should be recognized in governmental funds using the modified accrual basis of accounting. Liabilities for landfill closure and postclosure care costs are normally liquidated with expendable available financial resources, and a governmental fund liability and expenditure should be recognized, as payments come due each period upon receipt of goods and services used in the closing and postclosure care processes. The accumulation of earmarked net assets in a governmental fund for eventual payment of unmatured general long-term indebtedness, including landfill closure and postclosure care costs, does not constitute an outflow of current financial resources and should not result in the recognition of an additional governmental fund liability or expenditure. Long-term liabilities for closure and postclosure care of MSWLFs reported in governmental funds are general long-term liabilities and should be reported in the governmental activities column in the government-wide statement of net assets. In the operating statement, facilities and equipment acquisitions included in estimated total current cost should be reported as closure and postclosure care expenditures. [GASBS 18, ¶10 and ¶11, as amended by GASBS 34, ¶119; GASBS 34, ¶82; GASBI 6, ¶14 and ¶16]

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LEASES **SECTION L20**

.112 [Revise GASBS 34 Codification instructions to add a cross-reference to Section 1600, "Basis of Accounting," paragraph .122.]

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TERMINATION BENEFITS (SPECIAL) **SECTION T25**

Sources: [Add the following:] GASB Interpretation 6

.102 [Revise GASBS 34 Codification instructions for paragraph .102 by adding a new footnote 1 to end of next-to-last sentence. Renumber subsequent footnote.][1] As discussed in Section 1600, "Basis of Accounting," paragraph .124, governments, in general, are normally expected to liquidate liabilities, including special termination benefit liabilities, with expendable available financial resources to the extent that the liabilities *mature* (come due for payment) each period. [GASBI 6, ¶14]