1. INTRODUCTION

Generally accepted accounting principles (GAAP) are uniform minimum standards of and guidelines to financial accounting and reporting. Adherence to GAAP assures that financial reports of all state and local governments contain the same types of financial statements and disclosures, for the same categories and types of funds and account groups, based on the same measurement and classification criteria. (CODIFICATION of GOVERNMENTAL ACCOUNTING AND FINANCIAL REPORTING STANDARDS, GOVERNMENTAL ACCOUNTING STANDARDS BOARD. Sec 1200.101)

The State of Arizona maintains its accounting system to ensure compliance with all legal and constitutional requirements. Legal provisions may conflict with GAAP. A variety of possible conflicts of this kind may be encountered. One type can arise from statutory specification of fund purpose and accounting requirements. Another type may be the preparation of the budget on a cash basis or another basis not consistent with GAAP. In cases of these conflicts, the Governmental Accounting Standards Board of the Financial Accounting Foundation recommends that if GAAP Financial Statements are prepared, then the provisions of GAAP should override the legal provisions. If necessary, two different sets of financial statements should be prepared; one on the GAAP basis, and the other on the Legal Budgetary Basis (LBB) of accounting. A reconciliation of the two is a required statement under GAAP. In accordance with ARS 35-131, the State of Arizona will prepare financial statements in accordance with the provisions of GAAP. (CODIFICATION Sec 1200.108 through .111)

2. FUND ACCOUNTING

Governmental Environment: The diverse nature of governmental operations and the necessity of assuring legal compliance preclude recording and summarizing all governmental financial transactions and balances in a single accounting entity. Unlike a private business, which is accounted for as a single entity, a governmental unit is accounted for through several separate fund and account group entities, each accounting for designated assets, liabilities, and equity or other balances. Thus, from an accounting and financial management viewpoint, a governmental unit is a combination of several distinctly different fiscal and accounting entities, each having a separate set of accounts and functioning independently of other funds and account groups. (CODIFICATION Sec 1300.101)

Various types of legal provisions require establishment of funds. Funds may be created pursuant to constitutional provisions or Arizona Revised Statutes. In addition, funds may be created by the Department of Administration to achieve sound and expeditious financial administration and reporting and/or to comply with grant or contract accounting and financial reporting requirements. (CODIFICATION Sec 1300.105)

Each fund must be accounted for in a separate self-balancing set of accounts for its assets, liabilities, equity, revenues, expenditures or expenses (as appropriate), and transfers. This requirement of a complete set of accounts for each fund refers to identification of accounts in the accounting records, and does not necessarily extend to physical segregation of assets or liabilities. CODIFICATION Sec 1300.109

The funds of a governmental unit may have financial transactions and debtor-creditor relationships with other funds of the governmental unit. Interfund receivables and payables may result from services rendered by a department financed from one fund to a department financed from another fund, or from interfund loans. Interfund loans normally must be authorized by statute. Because each fund is a fiscal and accounting entity, the amounts due to one fund from other funds, as well as the amounts owed to other funds, should be reflected in the fund accounts and in fund financial statements. Where money is owed from one fund to another fund and money is also owed from the latter to the former, the amounts receivable and payable should not be offset in the accounts. However, for purposes of reporting, current amounts due from and due to the same funds may be offset and the net amounts shown in the respective fund balance sheets. (CODIFICATION Sec 1300.110)

3. FUND TYPES AND ACCOUNT GROUPS

Governmental Funds: These funds are often called "source and disposition," "expendable," or "government-type" funds. These funds are those through which most governmental functions typically are financed. The acquisition, use, and balances of the government's expendable financial resources and the related current liabilities--except those accounted for in proprietary funds--are accounted for through governmental funds.

Governmental funds are, in essence, accounting segregations of financial resources. Expendable assets are assigned to the various governmental funds according to the purposes for which they may or must be used; current liabilities are assigned to the fund from which they are to be paid; and the difference between governmental fund assets and liabilities, the fund equity, is referred to as "Fund Balance."

The governmental fund measurement focus is on determination of financial position and changes in financial position (sources, uses, and balances of financial resources), rather than on net income determination. The statement of revenues, expenditures, and changes in fund balance is the primary governmental fund operating statement. It may be supported or supplemented by more detailed schedules of revenues, expenditures, transfers, and other changes in fund balance. (CODIFICATION Sec 1300.102)

There are four governmental fund types:

a. The General Fund--to account for all financial resources except those required to be accounted for in another fund.

b. Special Revenue Funds--to account for the proceeds of specific revenue sources (other than expendable trusts or for major capital projects) that are legally restricted to expenditure for specified purposes.

c. Capital Projects Funds--to account for financial resources to be used for the acquisition or construction of major capital facilities (other than those financed by proprietary funds and trust funds).

d. Debt Services Funds--to account for the accumulation of resources for, and the payment of, general long-term debt principal and interest.

Proprietary Funds: These funds are sometimes referred to as "income determination," "nonexpendable," or "commercial-type" funds. These funds are used to account for a government's ongoing organizations and activities that are similar to those often found in the private sector (enterprise and internal service funds). All assets, liabilities, equities, revenues, expenses, and transfers relating to the government's business and quasi-business activities--where net income and capital maintenance are measured--are accounted for through proprietary funds. The generally accepted accounting principles here are those applicable to similar businesses in the private sector; and the measurement focus is on determination of net income, financial position, and changes in financial position. (CODIFICATION Sec 1300.102)

There are two proprietary fund types:

a. Enterprise Funds--to account for operations (a) that are financed and operated in a manner similar to private business enterprises--where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred, and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

b. Internal Service Funds--to account for the financing of goods or services provided by one department or agency to other departments or agencies of the governmental unit, or to other governmental units, on a cost-reimbursement basis.

Fiduciary Funds: These funds are often referred to as "Trust and Agency Funds." These funds are used to account for assets held by a governmental unit in a trustee capacity or as an agent for individuals, private organizations, other governmental units, and/or other funds. In addition, donations are accounted for in Fiduciary Funds. Each trust fund is classified for accounting measurement purposes like either a governmental fund or a proprietary fund. Expendable trust funds are accounted for in essentially the same manner as governmental funds. Nonexpendable trust funds and pension trust funds are accounted for in essentially the same manner as proprietary funds. Agency funds are purely custodial (assets equal liabilities) and thus do not involve measurement of results of operations. (CODIFICATION Sec 1300.102)

There are four fiduciary fund types:

a. Expendable Trust Funds--to account for trust assets in which both the principal and earnings may be expended.

c. Nonexpendable Trust Funds--to account for trust assets in which only the earnings may be expended.

d. Pension Trust Funds--to account for the trust assets of retirement systems.

e. Agency Funds--to account for assets in which the governmental unit is acting in an agent capacity.

Account Groups--are used to establish accounting control and accountability for the government's general fixed assets and the unmatured principal of its general long-term debt.

The government's general fixed assets--all fixed assets (ie. all Land, Buildings, Improvements, Vehicles, Furniture and Equipment) except those accounted for in proprietary funds or trust funds--are not financial resources available for expenditure. The unmatured principal of its general long-term debt--long term liabilities not accounted for in proprietary funds or trust funds--does not require an appropriation or expenditure (use of financial resources) during the current accounting period. Long-Term Debt would include Right of Way Bonds, Certificates of Participation, University Bonds, etc. Hence, neither is accounted for in the governmental funds, but in self-balancing account groups. These account groups are not funds--they do not reflect available financial resources and related liabilities--but are accounting records of the general fixed assets and general long-term debt, respectively, and certain associated information. (CODIFICATION Sec 1300.103)

There are two account groups:

a. General Fixed Asset Account Group

b. General Long-Term Debt Account Group

Number of Funds

Number of General Funds - In accordance with National Council on Governmental Accounting Interpretation (NCGAI) 9, "Certain Fund Classifications and Balance Sheet Accounts", the definition of the general fund precludes multiple general funds. Therefore, governments should report only one general fund. (CODIFICATION Sec 1300.106)

Number of Other Funds - The general rule is to establish the minimum number of separate funds consistent with legal specifications, operational requirements, and the principles of fund classification discussed above. Using too many funds causes inflexibility and undue complexity in budgeting, accounting, and other phases of financial management, and is best avoided in the interest of efficient and economical financial administration. (CODIFICATION Sec 1300.108)

Other Matters

Classifications of Funds - Funds may be distinguished according to whether they are established constitutionally, statutorily, or by other governing body action. The basis for establishing funds is particularly important when considering the discretion the chief executive officer or the governing body (legislature) can exercise. (CODIFICATION Sec 1300.111)

Another classification of funds, by fund type, takes into account both the sources of fund financial resources and the nature of activities financed. This classification is valuable in managing and controlling current financial operations and for determining compliance with applicable legal provisions. (CODIFICATION Sec 1300.112)

Period versus Project-Orientation of Funds - The transactions of most of the fund types are planned and evaluated annually, and may be controlled by annual appropriations. To determine budgetary compliance and/or the results of financial operations, these funds must be accounted for on a fiscal year basis. Thus, the accounting and reporting for most governmental funds and all proprietary and fiduciary funds may be categorized as period-oriented.

On the other hand, capital outlay transactions financed through capital projects funds typically are planned and evaluated on a project basis. Capital outlay projects financed through these project-oriented funds often extend over two or more fiscal years. Thus, fund accounting records should reflect total project financial resources and expenditures to date as well as fund transactions of the current fiscal year and fund financial position at the end of the current fiscal year.(CODIFICATION Sec 1300.113 through .114)

4. MEASUREMENT FOCUS - BASIS OF ACCOUNTING

Statement of Principle - Accrual Basis in Governmental Accounting (NATIONAL COUNCIL OF GOVERNMENTAL ACCOUNTING STATEMENT 1, paragraph 57, as amended by GOVERNMENTAL ACCOUNTING STANDARDS BOARD STATEMENT 6, PARAGRAPH 16)

The modified accrual or accrual basis of accounting, as appropriate, should be used in measuring financial position and operating results.

a. Governmental fund revenues and expenditures should be recognized on the modified accrual basis. Revenues should be recognized in the accounting period in which they become available and measurable. Expenditures should be recognized in the accounting period in which the fund liability is incurred, if measurable, except for unmatured interest on general long-term debt, which should be recognized when due.

b. Proprietary fund revenues and expenses should be recognized on the accrual basis. Revenues should be recognized in the accounting period in which they are earned and become measurable; expenses should be recognized in the period incurred, if measurable.

c. Fiduciary fund revenues and expenses or expenditures (as appropriate) should be recognized on the basis consistent with the fund's accounting measurement objective. Nonexpendable trust and pension trust funds should be accounted for on the accrual basis; expendable trust funds should be accounted for on the modified accrual basis. Agency fund assets and liabilities should be accounted for on the modified accrual basis.

d. Transfers should be recognized in the accounting period in which the interfund receivable and payable arise.

"Basis of accounting" refers to when revenues, expenditures, expenses, and transfers--and the related assets and liabilities--are recognized in the accounts and reported in the financial statements. Specifically, it relates to the timing of the measurements made, regardless of the nature of the measurement, on either the cash or the accrual method. For example, whether depreciation is recognized depends on whether expenses or expenditures are being measured rather than on whether the cash or accrual basis is used. (CODIFICATION Sec 1600.101)

Cash and Accrual Bases - Under the cash basis of accounting, revenues and transfers in are not recorded in the accounts until the cash is received, and expenditures or expenses (as appropriate) and transfers out are recorded only when cash is disbursed. Under the accrual basis of accounting, most transactions are recorded when they occur, regardless of when cash is received or disbursed. Items not practicably measurable until cash is received or disbursed are accounted for at that time in both commercial and governmental accounting, as may be items whose measurement would be approximately the same under either basis or that are immaterial.

The accrual basis is the superior method of accounting for the economic resources of any organization. It results in accounting measurements based on the substance of transactions and events, rather than merely when cash is received or disbursed, and thus enhances their relevance, neutrality, timeliness, completeness, and comparability. Accordingly, use of the accrual basis to the fullest extent practicable is recommended. The accrual basis is necessarily applied somewhat differently in the proprietary funds (accrual basis) than in the governmental funds (modified accrual basis), however. The cash basis of accounting is not appropriate. (CODIFICATION Sec_ 1600.102 through .103)

Modified Accrual Basis in Governmental Funds - (CODIFICATION Sec 1600.105 through .124) - The major differences in applying the accrual concept in governmental fund accounting, as opposed to proprietary fund and commercial accounting, relate to differences in the environment and in the accounting measurement objectives. These modifications and adaptations for the practical and appropriate implementation of the accrual concept in governmental fund accounting are best referred to as the "modified accrual basis" and should be applied in all governmental fund accounting and reporting.

Revenue Recognition - Revenues and other governmental fund financial resource increments (for example, bond issue proceeds) are recognized in the accounting period in which they become susceptible to accrual--that is, when they become both measurable and available to finance expenditures of the fiscal period. "Available" means collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period. In Arizona, this is defined as monies deposited in the State Treasury during the 13th Month. Application of the "susceptibility to accrual" criteria requires judgement, consideration of the materiality of the item in question, and due regard for the practicality of accrual, as well as consistency in application.

In contemporary public finance, some revenues are assessed and collected in such a manner that they can appropr1ately be accrued, whereas others cannot. Revenues and other increases in governmental fund financial resources that usually can and should be recorded on the modified accrual basis include property taxes, regularly billed charges for inspection or other routinely provided services, most grants from other governments, interfund transfers and other transactions, and sales and income taxes where taxpayer liability has been established and collectibility is assured or losses can be reasonably estimated.

It is neither necessary nor practical to attempt to accrue taxpayer-assessed income and gross receipts taxes unless taxpayer liability and collectibility have been clearly established--as when tax returns have been filed but collection, while assured, is delayed beyond the normal time of receipt. Such items are best recognized as cash is received. However, known refunds of such taxes should be recorded as a liability and a reduction of revenue as of the time the refund claims are filed with the taxing authority (Department of Revenue).

Expenditure Recognition - The measurement focus of governmental fund accounting 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.

Accrual Basis in Proprietary Funds - Revenues earned and expenses incurred are recognized in essentially the same manner as in commercial accounting. Only minor adaptations are involved in applying the revenue realization and expense recognition principles in the government environment. (CODIFICATION Sec 1600.125)

Transfers - Transfers of financial resources among funds should be recognized in all funds affected in the period in which the interfund receivable(s) and payable(s) arise. (CODIFICATION Sec 1600.126)