## Recognizing Revenues inGovernmental Funds

**CHAPTER 4**

**LEARNING OBJECTIVES**

After studying this chapter you should understand:

1. Why governments focus on current financial resources and use the mod- ified accrual basis to account for their governmental funds
2. Why governments focus on all economic resources and use the full accrual basis in their government- wide financial statements
3. The key distinctions between the modified and full accrual bases of accounting
4. The distinction between exchange and nonexchange transactions
5. The main types of nonexchange transactions
6. The impact of the “available” criterion on revenue recognition
7. How each of the following types of revenues are accounted for:
   1. Property taxes
   2. Sales taxes
   3. Income taxes
   4. Licenses and permits
   5. Fines
   6. Grants and donations
   7. Sales of capital assets
   8. On-behalf payments

**WHY AND HOW DO GOVERNMENTS USE THE MODIFIED ACCRUAL BASIS?**

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| ***RATIONALE FOR THE MODIFIED ACCRUAL BASIS***  *The foundation for our discussion of revenue and expenditure recognition was laid in Chapter 1. In that chapter we pointed to two key* ***objectives of financial reporting:***   * *Indicating the extent to which the entity achieved interperiod equity (i.e., whether current-year revenues were sufficient to pay for current-year services)* * *Demonstrating whether the entity obtained and used its resources in accordance with its legally adopted budget* |

As suggested in Chapter 1, no set of financial statements prepared on a single basis of revenue and expenditure recognition can adequately fulfill both objectives. Therefore, GASB requires governments to prepare two separate sets of financial statements :

1. Fund financial statements : present governmental funds on a modified accrual basis to insure the budgetary compliance , proprietary and fiduciary funds statements are presented on a full accrual basis).
2. Government wide statements : presented on a full accrual basis

The modified accrual basis is far more budget-oriented than the full accrual basis in that the budgets of most governments focus on either cash or cash plus selected short-term financial resources. However, the budgetary principles of any individual government are determined by applicable state or local laws.

**OVERVIEW OF THE MODIFIED ACCRUAL BASIS**

Per today’s generally accepted practices, governmental funds are accounted for on a modified accrual basis. The measurement focus is on **current financial resources**. “Current financial resources” has been interpreted to mean “expendable financial resources”—cash and other items that can be expected to be transformed into cash in the normal course of operations (less current liabilities). The “other items” include investments and receivables but *not* capital assets.

As discussed in Chapter 5, inventories and prepaid items are also reported on the balance sheet, even though they do not fall within the conventional view of a financial resource. A frequently cited justification for this apparent inconsistency is that these assets will not ordinarily be transformed into cash (i.e., inventories will be consumed, not sold for cash), but they generally will result in short-term cash savings in that the entity will not have to expend additional cash to acquire them.

**RECOGNITION OF REVENUE**

**Under full accrual basis revenue is recognized when it is measurable.**

**Measurable means :** collection of cash must be reasonably ensured before revenue can be recognized)

**Under MODIFIED ACCRUAL BASIS:**

**revenue is recognized when it is measurable and available.**

However, when accounted for under the modified accrual basis, revenues are subject to an additional, extremely significant, stipulation. They cannot be recognized until

they are both *measurable and available to finance expenditures of the fiscal period*.

Governments (except those that engage primarily in business-type activities) derive their revenues mainly from nonexchange transactions—those in which one party gives or receives value without directly receiving or giving equivalent value in exchange.

**MEANING OF AND RATIONALE FOR “AVAILABLE TO FINANCE EXPENDITURES OF THE CURRENT PERIOD”**

The nonexchange revenues of governments are intrinsically associated with expenditures; they are generated solely to meet expenditures. Budgets are formulated so that each period’s estimated revenues are sufficient to cover appropriated expenditures. Expenditures of a current period may either require cash outlays during the period or create liabilities that must be satisfied shortly after the end of the period. For example, goods or services that a government receives toward the end of one year would ordinarily not be required to be paid for until early the next year.

*Available* therefore means “collected” within the current period or “expected to be collected soon enough thereafter to be used to pay liabilities of the current period.

Business accounting principles dictate that the collection of cash must be reasonably ensured before revenue can be recognized. The “available” stipulation ensures that, in addition, the cash has been collected or will be collected soon enough to pay the liabilities they are intended to cover.

**How many days after the close of the year must revenues be received to** satisfy the criteria of having been received soon enough to pay the liabilities of the current period?

With respect to *property taxes*—and only property taxes—existing standards provide that, in the absence of unusual circumstances, revenues should be recognized only if cash is expected to be collected within *60 days* of year-end.

Because existing standards provide no specific guidance as to time periods for recogni tion of other revenues, this “60-day rule” has become a widely used benchmark for all types of revenues, not just property taxes.

**WHAT ARE THE MAIN TYPES OF NONEXCHANGE REVENUES AND THE LIMITATIONS ON HOW AND WHEN THEY CAN BE USED?**

. There are four types of revenues resulting from nonexchange transactions.

1. **Imposed nonexchange revenues**. These are assessments imposed on individuals and business entities. The most prominent of these are property taxes and fines and are recognized in the year for which they are levied.

***The government imposes both tax rate and tax base***.

Tax base : the value to which tax rate is applied.

Tax levy : is a legal authorization to impose and collect property taxes

1. ***Derived tax revenues***. ايرادات ضريبيه مشتقه من عمليات تبادليهThese are taxes derived (i.e., that result) from assessments on exchange transactions carried on by taxpayers. They include sales taxes (derived from sales transactions) and income and other taxes on earnings or assets (derived from various income-producing commercial transactions) and are recognized in the period in which the income is earned.

**Government determines tax rate , tax base is determined as a result of exchange transactions between taxpayers**

1. ***Government-mandated nonexchange transactions (a mandated grants)***. These occur when a government at one level (e.g., the federal or a state government) provides resources to a government at another level (e.g., a local government or school district) and requires the recipient المستفيدto use the resources for a specific purpose. For example, a state may grant funds to a county stipulating that the resources be used for road improvements. Acceptance and use of the resources are mandatory الزاميand are recognized when all eligibility requirements are met.

***Under this type*** : the recipient is required to accept resources and comply with imposed restrictions (the recipient doesn’t have the option to accept or reject the grant)

***Grantor*** : is a government on a top level

1. ***Voluntary nonexchange transactions***. These result from legislative or contractual agreements entered into willingly by two or more parties. They include grants given by one government to another and contributions from individuals (e.g., gifts to public universities). Often the provider imposes eligibility requirements or restrictions as to how the funds may be used. **These types of transactions are similar to the government-mandated nonexchange transactions but differ in that the recipient government is not required to accept the awards. However, if the government accepts the awards it must observe the accompanying require- ments on how they may be spent. Like the government-mandated nonexchange transactions, they too are recognized when all eligibility requirements are met.**

Grantor : may be another government ,individual ,NFP or business org.

Recipient : has the option to accept or reject the grant ,but when he accepts he is required to comply with imposed restrictions.

Statement No. 33 establishes standards, discussed in the next sections, for each of the four types of transactions. The standards for government-mandated and voluntary nonexchange transactions apply to both revenues and expenditures. Thus, payments from one government to another are expected to be accounted for symmetrically.

Two types of limitations on nonexchange revenues :

Statement No. 33 also identifies two types of limitations that constrain when and how a government may use the resources it receives in nonexchange transactions:

1. ***Time requirements***. These specify the period during which resources must be used or **when use may begin**. For example, local governments typically levy property taxes designated for a particular fiscal year. Similarly, state governments that grant funds to local school districts may require that the funds be used during the state’s fiscal year.
2. ***Purpose restrictions***. **These specify the purpose for which the resources must be used**. For example, certain sales taxes must be used for road improvements, certain property taxes must be used to repay debt, and certain grants or private donations must be used to acquire specific goods or services.

governments should not recognize revenue or expenditures on nonexchange transactions until time requirements have been met (e.g., until the start of the specific time period during which resources may be used). By contrast, however, they need not delay recognition of revenue until they have satisfied the purpose restrictions

* + - time limitations are required to recognize revenues under both modified and accrual basis.
    - **Purpose restrictions** are nor required to recognize revenues