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Accrual of revenues and expenditures by state and local governmental units : proposal to Financial Accounting Standards Board to amend AICPA Industry audit guide on audits of state and local governmental units; Statement of position 75-3;

American Institute of Certified Public Accountants. Subcommittee on State and Local Governmental Auditing

Statement of Position 75-3

on

Accrual of Revenues and Expenditures by State and Local Governmental Units

July 31, 1975

Proposal to Financial Accounting Standards Board
to Amend AICPA Industry Audit Guide on
Audits of State and Local Governmental Units

Issued by
Accounting Standards Division

American Institute of
Certified Public Accountants

AICPA

NOTES

The American Institute of Certified Public Accountants has issued a series of industry-oriented Audit Guides that present recommendations on auditing procedures and auditors' reports and in some instances on accounting principles, and a series of Accounting Guides that present recommendations on accounting principles. Based on experience in the application of these Guides, AICPA Task Forces or Subcommittees may from time to time conclude that it is desirable to change a Guide. A Statement of Position is used to revise or clarify certain of the recommendations in the Guide to which it relates. A Statement of Position represents the considered judgment of the responsible AICPA Task Force or Subcommittee.

To the extent that a Statement of Position is concerned with auditing procedures and auditors' reports, its degree of authority is the same as that of the Audit Guide to which it relates. As to such matters, members should be aware that they may be called upon to justify departures from the recommendations of the Subcommittee.

To the extent that a Statement of Position relates to standards of financial accounting or reporting (accounting principles), the recommendations of the Subcommittee are subject to ultimate disposition by the Financial Accounting Standards Board. The recommendations are made for the purpose of urging the FASB to promulgate standards that the Subcommittee believes would be in the public interest.

AICPA American Institute of Certified Public Accountants
1211 Avenue of the Americas, New York, N.Y.10036 (212) 575-6200

July 31, 1975

Marshall S. Armstrong, CPA
Chairman
Financial Accounting Standards Board
High Ridge Park
Stamford, Connecticut 06905

Dear Mr. Armstrong:

The accompanying Statement of Position, prepared by the AICPA Subcommittee on State and Local Governmental Auditing, proposes amendments to the AICPA Industry Audit Guide on _Audits of State and Local Governmental Units_ which will clarify that part of Chapter 2 of the Guide which deals with accruals of revenues and expenditures by state and local governmental units.

While issuance of this Statement of Position will be helpful to independent auditors, we urge that FASB advise the accounting profession at an early date as to whether it believes the proposed amendments are appropriate and should be regarded as having the same authoritative support as the Audit Guide itself.

Members of the Subcommittee will be glad to meet with you or your representatives to discuss this proposal. The Subcommittee would also appreciate being advised as to the Board's proposed action on its recommendations.

Sincerely yours,

AICPA SUBCOMMITTEE ON
STATE AND LOCAL GOVERNMENTAL AUDITING

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cc: Securities and Exchange Commission

Audits of State and Local Governmental Units

Proposed Amendment to Industry Audit Guide

Background Information

The accrual basis of accounting is followed (with minor exceptions) by all funds other than budgetary funds of state and local governmental units. Budgetary funds (general, special revenue, and debt service funds) use the modified accrual basis of accounting. The AICPA Industry Audit Guide, *Audits of State and Local Governmental Units,* summarizes the modified accrual basis as follows:

1. Revenues are recorded as received in cash except for
   (a) revenues susceptible to accrual and
   (b) material revenues that are not received at the normal time of receipt.
2. Expenditures are recorded on an accrual basis except for
   (a) disbursements for inventory type items, which may be considered expenditures at the time of purchase or at the time the items are used;
   (b) prepaid expenses, which normally are not recorded;
   (c) interest on long-term debt, which should normally be an expenditure when due; and
   (d) the encumbrance method of accounting, which may be adopted as an additional modification.

Although the Guide contains a discussion of the application of both the accrual and modified accrual bases of accounting to revenues and expenditures, questions have arisen in practice with respect to four problem areas: sales taxes, revenue sharing, vacation and sick pay, and interest accruals in special assessment funds. Accordingly, this Statement of Position has been issued to revise or clarify that part of Chapter 2 of the Guide dealing (a) with the modified accrual basis, and (b) with the concept "fully matured and not paid" as it pertains to interest accruals in assessment funds.

Revenues Susceptible to Accrual

The Guide describes, on page 14, criteria to identify revenues susceptible to accrual, as follows:

> Revenues considered susceptible to accrual are those revenues that are both measurable and available. In substance, "available" means that the item is a resource that can be used to finance the governmental operations during the year.
>
> Few types of revenues in budgetary funds possess all of the characteristics essential to meet both criteria of being measurable and available, which are requisite to being considered susceptible to accrual.
>
> Revenue sources that generally are not considered susceptible to accrual include those generated on a self-assessed basis, such as income taxes, gross receipts taxes, and sales taxes. Normally, such taxes would be recorded as revenue when received.

The Subcommittee believes the Guide should be amended to clarify the application of these criteria to sales taxes and to revenue sharing entitlements.

Specifically, the Subcommittee believes that *Audits of State and Local Governmental Units* should be amended by inserting the following paragraphs immediately before the first full paragraph (beginning "Normally, when an item is billable. . . .") on page 15:

> The following paragraphs illustrate the application of these criteria.
>
> Sales taxes collected by merchants but not yet required to be remitted to the taxing authority at the end of the fiscal year should not be accrued. However, taxes collected and held by one government agency for another at year end should be accrued if they are to be remitted in time to be used as a resource for payment of obligations incurred during the preceding fiscal year. To illustrate, when a state collects all sales taxes and within 60 days remits to cities and counties the amounts collected for them, amounts held by the state for allocation on June 30 should be

accrued by cities and counties with a June 30 fiscal year end. However, taxes collected by merchants during June and prior months but not required to be remitted until after June 30 should not be accrued by the state, counties, or cities.

Revenue sharing entitlements are for the period from July 1 to June 30 and are received in four installments, the last of which is not received until July. This final installment, which is both measurable and available, should be accrued at June 30 as a resource of the fund accounting for the initial receipt of revenue sharing entitlements.

Vacation Pay and Sick Pay

The Guide states, on page 16, that "Expenditures are recorded on the accrual basis. . . ." and goes on to discuss certain exceptions to that statement. The Subcommittee believes the Guide should be amended to permit state and local governmental units not to record the costs of vacation and sick leave at the time the benefits are accumulated.

Specifically, the Subcommittee believes that *Audits of State and Local Governmental Units* should be amended by inserting the following paragraphs immediately before the last full paragraph (beginning "A summary of the modifications. . . .") on page 16:

Governmental units, like commercial and other organizations, provide vacation and sick pay benefits to their employees. However, governmental units often have policies or contractual agreements which permit employees to accumulate unused vacation and sick pay over their working careers and to redeem such unused leave time in cash upon death or retirement or by extended absence immediately preceding retirement. Portions of amounts accumulated at any point in time can be expected to be redeemed before termination of employment. While such accumulations may be material in total, the effect on the financial statements of any one year may be immaterial. However, the effect on any one year may become material if the governmental unit is required to liquidate the accrued amounts, e.g., because of a court action by employees.

Although governmental units generally should record expenditures on the accrual basis, the accounting for unused vacation and sick pay needs to be considered in light of the unique environment of governmental units. Budgetary funds of governmental units, unlike business entities, are not concerned with the principle of matching costs against associated revenues. Rather, a major interest of governmental financial statement users is the fiduciary responsibility of the governmental body for the revenues appropriated. Further, long-term debts of budgetary funds are not recorded as debts in the fund which will be making the requisite payments but rather in the long-term debt group of accounts.

Considering these factors and the nature of the accumulated unused vacation and sick leave, it is appropriate to disclose the estimated amount of such commitments in a footnote, if material, and not record the costs as expenditures at the time the leave is accumulated. If accumulated unused vacation and sick pay at the end of a fiscal year does not exceed a normal year's accumulation, footnote disclosure is not required.

Interest Accruals in Assessment Funds

The Guide states, on page 13, that "In special assessment funds, interest income on assessments receivable and interest expense on offsetting bonds payable or other long-term debt should not be accrued unless fully matured and not paid." The Subcommittee believes this statement should be clarified by a footnote, as set forth below:

This principle applies whether or not the date for payments to bondholders coincides with the date for collections from property owners; for example, if interest from property owners is due on March 1 and the corresponding payment to bondholders is payable on June 1, the entity would report as interest receivable on June 30 only the amounts still uncollected from property owners for the preceding March 1 and prior interest dates. The interest payable reported at June 30 should be only the amounts still payable to bondholders for the preceding June 1 and prior interest dates.