

CHAPTER 1 – Principles of Accounting

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PRINCIPLES OF ACCOUNTING

Several characteristics associated with government have influenced the development of governmental accounting principles and practices:

- State law usually dictates the local government accounting policies and systems, may specify the type and frequency of financial statements, and usually defines the type and frequency of audits. In Washington this guidance is found in RCW 28A.505.020.
- Governments receive substantial financial inflows for both operating and capital purposes that are frequently subject to restrictions that prohibit or limit the use of the resources for other than the intended purpose.
- A government's authority to raise and expend money is based on the adoption of a budget that, by law, must balance. (The estimated revenues plus prior year's surpluses are sufficient to cover the projected expenditures.)
- The power to raise revenues and issue debt are restricted and generally defined by law.

Accounting requirements for school districts in the state of Washington are in significant compliance with generally accepted accounting principles (GAAP). Where legal requirements are in conflict with GAAP, legal requirements prevail. Sufficient additional records should exist to satisfy GAAP reporting requirements.

Governmental accounting principles are not a complete and separate body of accounting principles, but are part of the whole body of GAAP. The hierarchy of specific sources of GAAP that are applicable to state and local governments are:

- Statements and interpretations issued by the Governmental Accounting Standards Board (GASB), plus statements and interpretations issued by the American Institute of Certified Public Accountants (AICPA), or the Financial Accounting Standards Board (FASB) if they have been made applicable to state and local governments by a GASB statement or interpretation.
- Technical bulletins issued by the GASB and AICPA pronouncements made specifically applicable to state and local governments and cleared by the GASB.
- Consensus positions of the GASB Emerging Issues Task Force and practice bulletins issued by the AICPA if they have been made specifically applicable to state and local governments and cleared by the GASB.
- Questions and answers published by the GASB staff and widely recognized and prevalent industry practices.
- GASB concept statements, pronouncements by FASB or the AICPA when not made applicable to state and local governments, FASB concept statements, AICPA issues papers, International Accounting Standards Committee statements, pronouncements of other professional associations or regulatory agencies, AICPA technical practice aids, and accounting textbooks and handbooks.

Following is a listing of the basic accounting principles set forth in the 2001 edition of *Governmental Accounting, Auditing, and Financial Reporting* from the Government Finance Officers' Association (GFOA). The principles are based on material published by the GASB in the *Codification of Governmental Accounting and Financial Reporting Standards* as of June 30, 2000. These are known as GAAP and are presented in **bold** print. Further discussion of

these principles and how they apply to school districts in the state of Washington is included in standard print. Guidance on shared services arrangements is also provided.

Accounting and Reporting Capabilities

A governmental accounting system must make it possible, both (a) to present fairly and with full disclosure the financial position and results of financial operations of the funds and account groups of the governmental unit in conformity with generally accepted accounting principles, and (b) to determine and demonstrate compliance with finance-related legal and contractual provisions. (GASB Cod. Sec. 1100.101. See also Sec. 1200, “Generally Accepted Accounting Principles and Legal Compliance.”)

Generally accepted accounting principles are uniform minimum standards of and guidelines to financial accounting and reporting. Adherence to GAAP ensures that financial reports of all state and local governments—regardless of jurisdictional legal provisions and customs—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. (GASB Cod. Sec. 1200.101.)

Local, state, and federal governments can impact the reporting requirements of school districts. Local ordinances providing specific requirements tend to be uncommon for school districts; the policies adopted by the school board generally act as a surrogate for such ordinances.

State laws and regulations govern the fiscal affairs of school districts. School districts must be in full compliance with all legal requirements. Fair presentation dictates that transactions be reported on a gross basis. Offsetting entries to accounts are not permitted, except for corrections of previous transactions. In Washington, school districts are required to file annual financial reports with the Office of Superintendent of Public Instruction (OSPI) and are required to use a particular chart of accounts. Also, school districts are often required to report specific data (for example, on such things as salaries and equipment purchased) to demonstrate compliance with funding provisions. In addition, the federal government provides various grants to school districts for special programs that may have spending limitations and require special documentation. Much of the state legal guidance for school districts is found in chapter 28A of the Revised Code of Washington (RCW) and chapters 392 and 180 of the Washington Administrative Code (WAC).

School districts must ensure that their accounting systems are capable of providing the information necessary to satisfy the requirements of the various governing agencies and funding sources. It is necessary for all school districts to provide comparable information to the Office of Superintendent of Public Instruction to enable generation of statewide reports. This information is needed by the state Legislature, the National Center for Education Statistics, various sections of OSPI, and other state and federal agencies.

Consequently, school districts might prepare two sets of financial statements—one that is in conformity with legal requirements as reported in the F-196 and one that is in conformity with GAAP. Financial statements prepared in conformity with legal requirements are considered to be “special reports” or “supplemental schedules” and are not basic financial statements. Districts electing to not prepare GAAP statements will receive an audit opinion based upon an

other comprehensive basis of accounting rather than one based on generally accepted accounting principles.

Financial statements of school districts in the state of Washington fall into the following categories:

GAAP Basis Financial Statements

➤ **Unqualified GAAP**

Districts issuing GAAP financial statements that include districtwide statements, fund statements, reconciliations between statements, a management discussion and analysis, and original budget for the General Fund and ASB Fund.

Other Comprehensive Basis of Accounting (OCBOA) Financial Statements

➤ **Cash Basis**

Districts with under one thousand full-time equivalent students for the preceding fiscal year, while encouraged to use accrual accounting, may report the F-196 on cash basis. (RCW 28A.505.020.)

➤ **Regulatory Basis**

Districts issuing required F-196 statements but not electing to prepare GAAP statements.

All districts must prepare and submit to OSPI financial reports on Form F-196.

Fund Accounting Systems

Governmental accounting systems should be organized and operated on a fund basis. A fund is defined as a fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with all related liabilities and residual equities or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations. (GASB Cod. Sec. 1100.102. See also Sec. 1300, "Fund Accounting.")

Because all governmental units receive financial resources that may be used only in accordance with restrictions established by law or by agreements with donors or grantors, their accounting systems must enable officials to demonstrate compliance with such restrictions. This need led to the development of the fund accounting concept as a control device.

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 refers to identification of accounts in the accounting records and does not necessarily extend to physical segregation of assets or liabilities. For example, it is not necessary to have a separate bank account for each fund unless required by law, bond indenture, or other reason. Likewise, governmental units using computerization and account coding techniques may treat these separate accounting entities as independent subcomponents of a unified governmental accounting system. (GASB Cod. Sec. 1300.109.)

When it is determined they are necessary, funds are established upon board resolution pursuant to legal authorization as further explained in this chapter and are terminated by board resolution when the purpose for which they were established no longer exists.

For example, the Capital Projects Fund (CPF) should not be established unless a capital project is planned. Once there is a firm commitment on the part of the board, the fund can be opened and revenue collected after the county treasurer is notified to establish the proper fund. Likewise, when all CPF projects are completed, the fund should be terminated and any remaining moneys transferred to another fund in accordance with legal provisions. When a fund is terminated, care should be taken to ensure that all claims on the fund have been cleared.

Government-Wide Reporting

In addition to fund statements, GASB Statement 34, *Basic Financial Statement—and Management’s Discussion and Analysis—for State and Local Governments*, requires government-wide financial statements. The GASB believes such statements are beneficial to financial statement users in assessing the government’s operational accountability. Districts preparing GAAP statements must include districtwide financial statements prepared on the accrual basis of accounting as well as a reconciliation with the fund statements prepared on the modified accrual basis of accounting.

Types of Funds

Three categories of funds are used in governmental accounting, which are then subdivided into eleven fund types for accounting and financial reporting purposes. (GASB Cod. Sec. 1100.103. See also Sec. 1300, “Fund Accounting.”)

Governmental Funds

➤ **General Fund**

The General Fund is used to account for all financial resources except those required to be accounted for in another fund. (GASB Cod. Sec. 1100.103a(1). RCW 28A.320.330. See also Sec. 1300, “Fund Accounting.”)

The General Fund is financed from local, county, state, and federal sources. These revenues are generally used for financing the current ordinary normal and recurring operations of the school district such as programs of instruction for the students, food services, maintenance, data processing, printing, and pupil transportation. All school districts must have a General Fund.

The General Fund cannot be used for those purposes for which funds have been established for specific activities. However, in the state of Washington, the General Fund may pay for Associated Student Body (ASB) expenditures even though there is an ASB Fund. (See also Chapter 9—ASB.)

➤ **Special Revenue Funds**

Special Revenue Funds account for the proceeds of specific revenue sources (other than trusts or for major capital projects) that are legally restricted to expenditures for specified purposes. (GASB Cod. Sec. 1100.103a(2). RCW 28A.320.330, RCW 28A.325.030. See also Sec. 1300, “Fund Accounting.”)

In many states, Special Revenue Funds are used to account for restricted grants. However, in the state of Washington, restricted grants are generally accounted for in the General Fund. In Washington school districts the only fund designated as a Special Revenue Fund is the ASB. This fund is financed, in part, by the establishment and collection of fees from students and nonstudents as a condition of their attendance at any optional noncredit extracurricular event of the district. As a Special Revenue Fund the ASB Fund is under the control, supervision, and approval of the board of directors, and the school district legally owns the resources accounted for in the ASB fund. (RCW 28A.320.330. RCW 28A.325.030.)

Saul Haas may be accounted for in the ASB if the funds are immaterial to the total ASB Fund revenue. For more information on Saul Haas funds see Chapter 9, Section 3, page 2.

➤ **Capital Projects Funds**

Capital Projects Funds 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). GASB Cod. Sec. 1100.103a[3]. See also Sec. 1300, “Fund Accounting.”)

Within the state of Washington, two funds are considered to be Capital Projects Funds: the Capital Projects Fund and the Transportation Vehicle Fund.

- The **Capital Projects Fund** can be used for the acquisition of land or existing facilities, construction of buildings, purchase of equipment, conducting energy audits, and making capital improvements that are cost effective as determined by energy audits. In addition, under certain conditions elaborated in Chapter 9—CPF, improvements to buildings and/or grounds, remodeling of buildings, and the replacement of roofs, carpets, service systems, and technology are included in the Capital Projects Fund. (RCW 28A.320.330.)

The Capital Projects Fund is generally financed from the proceeds from the sale of voted and/or non-voted bonds, state matching revenues, lease or sale of surplus real property, interest earnings, and special levies. In all instances where moneys are raised by voter-approved bond issues, the proposition must include a description of the projects for which the money is being raised.

- The **Transportation Vehicle Fund** is provided for the purchase and major repair of pupil transportation equipment. (RCW 28A.160.130.)

The Transportation Vehicle Fund is generally financed by the state reimbursement to school districts for depreciation of approved pupil transportation equipment although other revenue resources such as non-voted debt and levies can be used.

➤ **Debt Service Funds**

Debt service funds account for the accumulation of resources for, and the payment of, long-term debt principal and interest. (GASB Cod. Sec. 1100.103a[4]. See also Sec. 1300, "Fund Accounting.")

The use of a Debt Service Fund is required by GAAP under two circumstances:

- If legally mandated, or
- If financial resources are being accumulated for principal and interest payments maturing in future years (NCGA Statement 1, paragraph 30).

In the state of Washington one Debt Service Fund is used. This fund has been established to account for the payment of principal, interest, and other expenditures related to the redemption of outstanding bonds. The county treasurer or fiscal agent makes payment of interest and principal. (RCW 28A.320.330.)

Provision must be made annually for a levy sufficient to meet the payments of principal, interest, and related expenditures for voted debt. The state attorney general has ruled that it is improper to levy excessive taxes to retire bonds in advance of the redemption schedule.

Non-voted bonds are serviced in the Debt Service Fund rather than in the fund that received the debt proceeds. In order to provide the resources to retire the debt, a transfer is used by the General Fund, the Capital Projects Fund, or the Transportation Vehicle Fund to transfer resources to the Debt Service Fund.

The Debt Service Fund is also used in advance bond refundings to account for the proceeds from the sale of new bonds and the use of these proceeds to establish an escrow account with a bank. There are two methods to advance refund bonds—the regular method and the crossover method.

In the regular method of advance bond refunding the proceeds from the sale of new general obligation bonds are recorded as an "other financing source" and an "other financing use" in the Debt Service Fund. The cash from the proceeds of the sale of the new bonds is deposited in an escrow account with a bank and invested. The investments are selected so that the cash realized from maturing investments, together with interest earned, will be available to pay the principal and interest of the refunded (old) bonds as they mature and become callable. At the time the escrow account is established, an in-substance defeasance of the old bonds occurs. The cash deposited in the escrow account is not reported as an asset of the school district. The debt service on the new bonds is recorded in the Debt Service Fund and the principal amount is recorded as long-term debt. Taxes are no longer levied for the debt service requirements of the old bonds. Instead, taxes are levied for the debt service requirements of the new bonds together with any bonds that have not been refunded.

In the crossover method of advance bond refunding there is a delay in the defeasance date of the old bonds. The proceeds from the sale of the new bonds are held in escrow with a bank and invested until the crossover date. The investments provide interest earnings that are used to pay interest on the new bonds. After the crossover date, the proceeds from the sale of the new bonds are used to defease the old bonds. Until the crossover date, both the new bonds and the old bonds are reported as long-term debt, and the debt service on the old bonds is accounted for in the Debt Service Fund. After

the crossover date, only the new bonds are reported in the Schedule of Long-Term Debt, and the debt service on the new bonds is accounted for in the Debt Service Fund. Until the crossover date, taxes are levied for the debt service on the old bonds. After the crossover date, taxes are levied for the debt service requirements of the new bonds together with any bonds that have not been refunded.

Bond refunding escrow accounts are not reported through the County Treasurer's Report (F-197). School districts receiving bank escrow reports through the county treasurer may arrange to have those reports sent directly to the district. **It is the school district's responsibility to monitor the accuracy of the bank's escrow reports and compliance with the refunding escrow instructions.**

Since accounts/funds 5 and 6 are no longer used for escrow accounts, districts may, but are not required to, use them to account for long-term debt and capital assets. Although not reported in the fund statements, note disclosure requirements remain. Additionally, long-term debt is reported in the Schedule of Long-Term Debt, a required part of the F-196.

➤ **Permanent Funds**

Permanent Funds are used where resources are legally restricted such that **only** the earnings, not the principal, may be expended, and those resources can be used for the *support of the district*. Such moneys that benefit individuals or specific organizations should be accounted for as Private-Purpose Trust Funds. The determining factor is who may benefit, not the legal requirement that only earnings may be spent. Scholarship moneys, for example, benefit individuals and are accounted for as Private-Purpose Trust Funds whether or not the principal may be expended.

Proprietary Funds (Not permitted for school districts in Washington State)

➤ **Enterprise Funds**

Enterprise Funds 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. (GASB Cod. Sec. 1100.103b[1]). See also Sec. 1300, "Fund Accounting.")

Currently, the state of Washington does not allow use of Enterprise Funds by school districts. Activities that would typically be accounted for in Enterprise Funds (such as food services) are instead accounted for in the General Fund.

➤ **Internal Service Funds**

Internal Service Funds 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. (GASB Cod. Sec. 1100.103b[2]. See also Sec. 1300, "Fund Accounting.")

Currently, the state of Washington does not allow use of Internal Service Funds by school districts. Activities that would typically be accounted for in Internal Service Funds (such as printing, word processing, and motor pool) are accounted for in the General Fund instead.

Fiduciary Funds

➤ **Trust and Agency Funds**

Trust and Agency Funds 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. These include (a) Private-Purpose Trust Fund, (b) Investment Trust Fund, (c) Pension and Other Employee Benefit Trust Funds, and (d) Agency Fund. (GASB Cod. Sec. 1100.103c[1]. See also Sec. 1300, "Fund Accounting.")

- The purpose of the **Private-Purpose Trust Fund** is to account for moneys or other assets donated to school districts to benefit individuals or private organizations. Examples include moneys for scholarship, student aid, charitable, and other similar purposes, such as the Saul Haas funds (see Glossary for more information on Saul Haas). A Private-Purpose Trust Fund is established when principal and the earnings or only the earnings of the trust can be spent. The authority to use the resources comes from the donor who specifies a use or range of allowed uses for assets to be held in trust. The school board has the authority to determine the use of the assets only within the confines of the original trust agreement. Most school districts will have Private-Purpose Trust Funds. Donated moneys that are available for the general use of the district and permit **only** the earnings to be expended should be accounted for in the Permanent Fund.
- **Investment Trust Funds** are used to account for the external portion of investment pools reported by the sponsoring government. They are not permitted in Washington State.
- **Pension and Other Employee Benefit Trust Funds** are not reported by most school districts since Washington school districts contribute to a multi-employer, cost-sharing statewide retirement system managed by the state of Washington Department of Retirement Systems (DRS). Only districts that operate individual pension trust funds and *hold resources* in trust should report this type of trust. The DRS is a component of the state of Washington and, as such, its financial activities are included in the financial statements of the state of Washington.
- The purpose of the **Agency Fund** is to account for activities in which the district is acting in an agent capacity for some other organization, government, individual, or fund. Agency funds are purely custodial in nature (i.e., assets equal liabilities) and thus do not focus on the measurement of operations (i.e., there are no revenues, expenditures, or fund balance).

Number of Funds

Governmental units should establish and maintain those funds required by law and sound financial administration. Only the minimum number of funds consistent with

legal and operating requirements should be established, however, because unnecessary funds result in inflexibility, undue complexity, and inefficient financial administration. (GASB Cod. Sec. 1100.104. See also Section 1300, “Fund Accounting.”)

The eleven fund types defined above (General, Special Revenue, Capital Projects, Debt Service, Permanent, Enterprise, Internal Service, and four types of Fiduciary Funds) are to be used if needed by a governmental unit to demonstrate compliance with legal requirements or to facilitate sound financial administration. In the simplest possible situation, a governmental unit could be in conformity with GAAP if it used a single fund, the General Fund, to account for all events and transactions. As previously noted, school districts in the state of Washington do not use Enterprise, Internal Service, or Investment Trust Funds and rarely use Permanent Funds, Employee Pension and Other Employee Benefit Trust Funds, or Agency Funds.

Accounting for Capital Assets and Long-Term Liabilities

Capital Assets

Capital assets are land, buildings, machinery, vehicles, furniture, and other equipment that the school district intends to hold or continue to use over a long period of time. “Capital” denotes probability or intent to continue to use or possess and does not indicate immobility of an asset. School districts have a responsibility to safeguard and control their assets. Although capital assets are not reported in the F-196 financial statements for school districts, they are reported in the notes to the financial statements. (See Appendix B.)

Capital assets in Fiduciary and Proprietary Funds should be reported through those funds.

Capital assets for governmental funds are reported in the districtwide statements.

Long-Term Liabilities

Long-term debt includes the unmatured principal of bonds, warrants, notes, and other forms of noncurrent or long-term indebtedness that have a maturity of at least one year from the financial statement date and are otherwise not defined as “current debt.” While long-term debt is a legal obligation of the district funds, the long-term unmatured principal is not recorded in a fund because it does not require current appropriation or expenditure of a school district’s financial resources. It is important to account for long-term debt in the financial records of the district.

Although not reported as a part of the individual fund statements, long-term liabilities are reported in the Schedule of Long-Term Debt, a required part of the F-196 financial statements for school districts. Additionally, the notes to the financial statements require several debt disclosures. (See Appendix B.)

Debt that matures in less than one year must be reported in the districtwide statements in the long-term liabilities section titled “Due within one year.” The long-term portion is titled “Due in more than one year.”

Long-term debt in Fiduciary and Proprietary Funds should be reported through those funds.

Long-term debt for governmental funds is reported in the districtwide statements.

Valuation of Capital Assets

Capital assets should be accounted for at cost or, if the cost is not practicably determinable, at estimated cost. (GASB Cod. Sec. 1100.106. See also Sec. 1400, "Capital Assets.")

Donated Capital Assets

Governmental funds normally do not report *capital assets* or *donated capital assets* in the fund financial statements. If donated capital assets are material to a district's operations, the district should disclose the information in the Notes to the Financial Statement in the year the asset is donated. If a school district intends to sell rather than keep donated capital assets, revenues may be reported if either of the following conditions is met:

- the asset is sold prior to the end of the fiscal year, and the proceeds of the sale are available; or
- the asset is sold (or the district has entered into a contract to sell the asset) prior to the issuance of the financial statements, and the proceeds of the sale are considered available.

If the proceeds of the sale are not considered available, a *receivable* and a liability for *deferred revenue* would be recognized in the appropriate governmental fund only at the time the district finally entered into a sales contract. Otherwise, the donated asset should be treated like a capital asset used in the government's operations until a sale occurs.

Donated Non-Capital Assets (Voluntary Nonexchange Transactions)

School districts may receive donated cash or financial instruments. When this occurs, the recognition of revenue or deferred revenue is required when all eligibility requirements are met. If the donation is accepted in advance and the collection is measurable and available, a modified-accrual basis school district should recognize a receivable and a revenue. Eligibility requirements include conditions or criteria and time period imposed by donors.

Donated Services

Payments of salaries and benefits made on behalf of the district's employees for services rendered to the district are required to be recorded as *revenues* and *expenditures/expenses* in the fund receiving the services.

The Governmental Accounting, Auditing, and Financial Reporting (GAAFR) recommends that school districts follow FASB statement No. 116 for donated services by volunteers, because GASB is silent on this issue.

Per FASB statement No. 116, the recognition of revenue and expenditure/expense is limited to those services that are material to the district financial statements and meet one of the following criteria:

- The donated service creates or enhances nonfinancial assets (e.g., volunteer improvements to a capital asset); or
- The donated service requires specialized skills, and is provided by individuals possessing those skills, and would typically need to be purchased if not provided by donation (examples: accountants, architects, doctors, lawyers, etc.).

Depreciation of Capital Assets

GAAP requires depreciation be recorded in the accounts of governmental funds and reported in the districtwide Statement of Net Assets. Depreciation of capital assets may be recorded in cost accounting systems or calculated for cost finding analyses, and accumulated depreciation must be reported in the districtwide Statement of Net Assets.

Depreciation is not reported in the F-196 or required for those districts reporting on an other comprehensive basis of accounting (OCBOA).

Depreciation of Capital Assets Accounted for in Fiduciary Funds

Depreciation is recognized in those trust funds where expenses, net income, and/or capital maintenance are measured. (GASB Cod. Sec. 1100.107b. See also Sec. 1400, "Capital Assets.")

Accrual Basis in Governmental Accounting

The modified accrual or accrual basis of accounting, as appropriate, should be used in measuring financial position and operating results. (GASB Cod. Sec. 1100.108. See also Sec. 1600, "Basis of Accounting.")

Exception for Cash Basis

In the state of Washington, school districts with under 1,000 full-time equivalent students for the preceding fiscal year may make a uniform election for all funds to be on a cash basis of accounting (RCW 28A.505.020 and WAC 392-123-049). Under this basis of accounting, revenue means the receipt of cash or noncash donations and expenditure means the disbursement of cash or noncash donations, except that deferred compensation must be accrued.

Modified Accrual and Accrual Basis

Accrual accounting means that:

- Revenues should be recorded in the period in which the goods and/or services are provided, although payment is received in a prior or subsequent period.

- Expenses should be recorded in the period in which the benefit is received, although payment is made in a prior or subsequent period.

In business enterprise accounting, the accrual basis is employed to obtain a matching of costs against the revenue flowing from those costs, thereby producing a more useful income statement. In governmental entities, however, funds make use of revenue and expense accounts to promote efficiency of operation and to guard against impairment of ability to render the services desired.

Funds of other types (General, Special Revenue (ASB), Capital Projects, Debt Service, and Permanent Funds) are not concerned with income determination. They are, instead, concerned with matching expenditures of legal appropriations or legal authorizations with revenues available to finance those expenditures. Therefore, standards recommend that the “governmental” funds use the “modified accrual” basis of accounting for the governmental fund financial statements. The modified accrual basis recognizes that it is not practicable to account on an accrual basis for self-assessed revenues, such as income taxes, gross receipts taxes, sales taxes, and property taxes. For such taxes, recognition of revenue is ordinarily made at the time of collection (i.e., when it is measurable **and** available), thus placing the fund partially on a cash basis in respect to revenue recognition. In respect to expenditure recognition, however, the modified accrual basis is almost identical with the accrual basis. The primary exception to the general rule of expenditure accrual relates to unmatured principal and interest on long-term debt.

Districtwide statements use the accrual basis of accounting. Reconciliation between the modified accrual fund financial statements and accrual based districtwide statements is required. (See Chapter 8—Reporting.)

Identification of Modified Accrual or Accrual Basis by Fund or Transaction Type

Governmental Funds

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 long-term debt, which should be recognized when due. (GASB Cod. Sec. 1100.108a. See also Sec. 1600, “Basis of Accounting.”)

Proprietary Funds

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. (GASB Cod. Sec. 1100.108b. See also Sec. 1600, “Basis of Accounting.”)

The state of Washington does not currently allow use of Proprietary Funds by school districts.

Fiduciary Funds

Fiduciary Fund revenues and expenses or expenditures (as appropriate) should be recognized on the accrual basis. (GASB Cod. Sec. 1100.108c. See also Sec. 1600, “Basis of Accounting.”)

Transfers

Transfers should be recognized in the accounting period in which the interfund receivable and payable arise. (GASB Cod. Sec. 1100.108d. See also Sec. 1600, “Basis of Accounting.”)

Budgeting, Budgetary Control, and Budgetary Reporting

Annual Budget(s)

Every governmental unit should adopt budgets. (GASB Cod. Sec. 1100.109a. See also Sec. 1700, “The Budget and Budgetary Accounting,” and Sec. 2400, “Budgetary Reporting.”)

The standards do not require that a budget be adopted by governmental funds. It is recommended, however, as an essential element of the financial planning, control, and evaluation processes of governments. Many believe that the budget is the most important financial document produced by the governmental entity. A budget, when adopted according to procedures specified in state law, is binding upon the governmental unit and must be incorporated as a component of the accounting system.

In the state of Washington, school district budgets are required to be adopted in the General, Capital Projects, Transportation Vehicle, Debt Service, and ASB Funds on the same basis of accounting as the financial statement presentation.

The Accounting System

The accounting system provides the basis for appropriate budgetary control. (GASB Cod. Sec. 1100.109b. See also Sec. 1700, “The Budget and Budgetary Accounting,” and Sec. 2400, “Budgetary Reporting.”)

Accounting systems of funds for which budgets are required (General, Capital Projects, Transportation Vehicle, Debt Service, and ASB Funds) should incorporate budgetary accounts. Only three general ledger control accounts are needed—Estimated Revenues, Appropriations, and Encumbrances—to provide appropriate budgetary control. All three must be supported by subsidiary ledger detail.

Budgetary detail accounts for revenue are required in both the budget and accounting systems and reports.

An appropriation is an authorization for the district to incur expenditures in the amounts specified in the district’s budget for the fiscal year. In the state of Washington, by law, total appropriations may not exceed the sum of Estimated Revenues and the beginning Unreserved, Undesignated Fund Balance. The resulting Unreserved, Undesignated Fund

Balance account, after recording Estimated Revenues and Appropriations, must have a zero or credit balance.

The use of an encumbrance accounting system as an element of control in formal budgetary integration is widespread in governments. Such a system acts as an early warning device by controlling expenditure commitments; the government thereby significantly reduces the opportunity to over-expend an appropriation. Encumbrances are defined in the 1987 GASB Cod. Sec. 1700.129 as “commitments related to unperformed (executory) contracts for goods or services.” They are not GAAP expenditures or liabilities, but represent the estimated amount of expenditures ultimately to result if unperformed contracts in process are completed. When these commitments are realized, a liability is recognized for the goods and services received.

Notwithstanding its control advantages, encumbrances are not recorded for all expenditures. See Chapter 7—Journal Entries for more information on the use of budgetary accounts.

Budgetary Comparisons

Budgetary comparisons should be included in the appropriate financial statements and schedules for governmental funds for which an annual budget has been adopted. (GASB Cod. Sec. 1100.109c. See also Sec. 1700, “The Budget and Budgetary Accounting,” and Sec. 2400, “Budgetary Reporting.”)

OSPI requires presentation of the final budget and comparison with actual amounts for each governmental fund, except the Permanent Fund, which is not budgeted. The final budget is defined as the original budget adjusted by all reserves, transfers, allocations, supplemental appropriations, and other legally authorized legislative and executive changes applicable to the fiscal year, **as filed with OSPI**.

GAAP requires budgetary comparison schedules that include original (i.e., first complete appropriated) budget as well as the final appropriated budget for the General Fund and the ASB Fund, a major Special Revenue Fund. Actual inflows, outflows, and balances must be shown. A separate column to report the variance between the final budget and actual amounts is encouraged, but not required. If presented, the terms “favorable” and “unfavorable” should be avoided. The district has the option of presenting the budgetary comparison statement as required supplementary information (RSI), or as a part of the basic financial statements. Note disclosure of excesses of expenditures over appropriations in individual funds is required. If the budgetary comparison information is included in the basic financial statements, disclosure in the notes to the financial statements is appropriate. If, however, the district supplies the budgetary information as part of RSI, the note disclosure should follow and be a part of RSI.

For additional budgeting information see Chapter 2—Budgeting.

Transfer, Revenue, Expenditure, and Expense Account Classification

Interfund Transfers

Interfund transfers should be classified separately from fund revenues and expenditures/expenses. (GASB Cod. Sec. 1100.110a. See also Sec. 1800, "Classification and Terminology.")

Governmental fund revenues should be classified by fund and source.

GAAP establish two classes of interfund activity:

- **Reciprocal interfund activity** is the interfund equivalent of exchange and exchange-like transactions.
 - *Interfund loans* are amounts for which repayment is expected. They should be reported as interfund receivables to the lending fund and as interfund payables to the receiving fund. They should **not** be reported as other financing sources or uses in the fund financial statements. After adoption of board resolution, WAC 392-123-140 allows loans to the General Fund, Transportation Vehicle Fund, Capital Projects Fund, and Debt Service Fund. Loans are permitted from the General Fund or Capital Projects Fund only. Interfund loans do not increase budget capacity. Appropriate interest shall be charged.

Reference: WAC 392-123-135 through WAC 392-123-160, RCW 28A.320.320.

- *Interfund services provided and used* are sales and purchases of goods and services between funds for a price comparable to their external exchange value. They are reported as revenues in the providing fund and expenditures in the receiving fund. Unpaid amounts are treated as interfund receivables or payables.
- **Nonreciprocal interfund activity** is the interfund equivalent of nonexchange transactions or transfers, previously known as "operating transfers" and "residual equity transfers." Refer to Chapter 3, Section 9, page 2 for additional information.
 - *Interfund transfers* are defined as "flows of assets (such as cash or goods) without equivalent flows of assets in return and without a requirement for repayment." They should be reported as other financing sources in the receiving fund and other financing uses in the providing fund.
 - *Interfund reimbursements* are repayments from a fund responsible for an expenditure to the fund that initially made the disbursement. Reimbursements are treated as adjustments and **not** reported in the financial statements.

Classification of Governmental Fund Revenues and Expenditures

Expenditures should be classified by fund, function (or program), organization unit, activity, character, and principal classes of objects. (GASB Cod. Sec. 1100.110b. See also Sec. 1800, “Classification and Terminology.”)

For state reporting purposes, revenue is categorized by local, state, federal, and other sources, which are further broken down by type of revenue (e.g., taxes, interest, and sale of supplies). Expenditures are also categorized and reported by program, activity, and object.

Proprietary Fund Revenues and Expenses

Revenues and expenses of Proprietary Funds should be classified in essentially the same manner as those of similar business organizations, functions, or activities. (GASB Cod. Sec. 1100.110c. See also Sec. 1800, “Classification and Terminology.”)

The state of Washington does not currently allow use of Proprietary Funds by school districts.

Common Terminology and Classification

A common terminology and classification should be used consistently throughout the budget, the accounts, and the financial reports of each fund. (GASB Cod. Sec. 1100.111. See also Sec. 1800, “Classification and Terminology.”)

Persons responsible for preparing the budgets and for preparing the financial statements and reports should work with those responsible for designing and operating the accounting system. Agreement on a common terminology and classification scheme is needed to make sure that the accounting system produces the information needed for budget, financial statements, and financial report preparation.

Interim and Annual Financial Reports

Appropriate interim financial statements and reports of financial position, operating results, and other pertinent information should be prepared to facilitate management control of financial operations, legislative oversight, and, where necessary or desired, for external reporting purposes. (GASB Cod. Sec. 1100.112a. See also Sec. 1900, “Financial Reporting,” and Sec. 2100–2900.)

Interim financial reports required in the state of Washington are the Monthly Budget Status Report and the Statement of Financial Condition. (For more information, see Chapter 2—Budgeting.)

A comprehensive annual financial report (CAFR) covering all funds and account groups of the reporting entity—including introductory section; appropriate combined, combining, and individual fund statements; notes to the financial statements; required supplementary information; schedules; narrative explanations; and statistical tables—should be prepared and published. The reporting entity is the oversight unit and all

other component units combined in accordance with Section 2100, “Defining the Reporting Entity.” (GASB Cod. Sec. 1100.112b. See also Sec. 1900, “Financial Reporting,” and Sec. 2100–2900.)

A CAFR is not required in the state of Washington. School districts preparing a CAFR may seek a Certificate of Excellence in Financial Reporting from the Government Finance Officers’ Association (GFOA) and/or the Association of School Business Officials (ASBO).

Basic financial statements (BFS) of the reporting entity may be issued separately from the comprehensive annual financial report (CAFR). Such statements should include the basic financial statements and notes to the financial statements that are essential to fair presentation of financial position and results of operations (and cash flows of Proprietary Fund types). Those statements may also be required to be accompanied by required supplementary information, essential to financial reporting of certain entities. (GASB Cod. Sec. 1100.112c. See also Sec. 1900, “Financial Reporting,” and Sec. 2100–2900.)

GAAP basic financial statements (BFS) include the following:

- a. **Districtwide Financial Statements**—These display information about the district as a whole, except for Fiduciary Funds. They are prepared using the economic resources measurement focus and accrual basis of accounting. Districtwide statements are (1) the statement of net assets and (2) the statement of activities. Reconciliation between the districtwide and fund financial statements is also required as part of BSF.
- b. **Fund Financial Statements**—These statements display information about major funds, individually. To enable comparability in statewide reporting, all funds (General, ASB Special Revenue, Capital Projects, Transportation Vehicle, Debt Service, and Permanent, if applicable) are reported as major funds. Fiduciary statements include financial information for Fiduciary Funds. Governmental fund reporting focuses on sources, uses and balances of current financial resources and uses the modified accrual basis of accounting. Fiduciary Funds focus on net assets and changes in net assets and use the economic resources measurement focus and accrual basis of accounting.
- c. **Notes to the Financial Statements**—The notes are an integral part of the basic financial statements. They present essential information for the fair presentation of the financial statements that is not displayed on the face of the financial statements.

In addition, GAAP prescribe required supplementary information (RSI). This includes Management’s Discussion and Analysis (MD & A), information required by GASB Statements 10 (as amended), 25, and 27, and budgetary comparison schedules. (See Chapter 8—Reporting.)

In the state of Washington, the F-196, annual financial statement section, represents the fund financial statements. These statements display information about major funds, individually. To enable comparability in statewide reporting, all funds (General, ASB Special Revenue, Capital Projects, Transportation Vehicle, Debt Service, and Permanent, if applicable) are reported as major funds. Fiduciary statements include financial information for Fiduciary Funds. Governmental fund reporting focuses on sources, uses, and balances of current financial resources and uses the modified accrual basis of accounting. Fiduciary Fund reporting focuses on net assets and changes in net assets and uses the economic resources measurement focus and accrual basis of accounting.

In addition, a Schedule of Long-Term Debt is required. Sample “Notes to the Financial Statements” are included in Appendix B of this manual.

A component unit financial report (CUFR) covering all funds and account groups of a component unit—including introductory section; appropriate combined, combining, and individual fund statements; notes to the financial statements; schedules; narrative explanations; and statistical tables—may be prepared and published as necessary. (GASB Cod. Sec. 1100.112d. See also Sec. 1900, “Financial Reporting,” and Sec. 2100–2900.)

In the state of Washington, school districts are primary governments and, accordingly, issue a CAFR or BFS. A district may be financially accountable for a component unit that should be reported as either a blended or discreet unit in the district’s financial statements. (See guidance on GASB Statement 14—*The Reporting Entity* in Appendix C.)