



## BEST PRACTICE

### **Relationship Between Budgetary and Financial Statement Information (1999) (BUDGET)**

**Background.** The term "basis of accounting" is used to describe the timing of recognition, that is, *when* the effects of transactions or events should be recognized. The basis of accounting used for purposes of financial reporting in accordance with generally accepted accounting principles (GAAP) is not necessarily the same basis used in preparing the budget document. For example, governmental funds are required to use the modified accrual basis of accounting in GAAP financial statements whereas the cash basis of accounting or the "cash plus encumbrances" basis of accounting may be used in those same funds for budgetary purposes. Disparities between GAAP and the budgetary basis of accounting often occur because regulations governing budgeting (e.g., laws or ordinances of the state, county, city or some other jurisdiction) differ from GAAP.

An understanding of the GAAP basis of accounting is critical to the proper budgeting of available financial resources. Explaining the major differences between the basis of accounting used in the budget document and the basis of accounting used in the GAAP financial statements helps stakeholders better understand and interpret the numbers presented in both documents. Likewise, providing a documented reconciliation of the two bases of accounting can help to prevent errors from occurring when the budget is prepared or interpreted.

For those governments that use a budgetary basis of accounting other than GAAP, some of the more common differences between GAAP and the budgetary basis of accounting are as follows:

- The timing of revenue and expenditures may be different under the GAAP basis of accounting than under the budgetary basis of accounting. For example, in GAAP accounting revenues are recognized in governmental funds as soon as they are both "measurable" and "available" whereas revenue recognition under the budgetary basis of accounting may be deferred until amounts are actually received in cash.
- Encumbered amounts are commonly treated as expenditures under the budgetary basis of accounting while encumbrances are never classified as expenditures under the GAAP basis of accounting.
- Budgetary revenues and expenditures may include items classified as "other financing sources" and "other financing uses" under the GAAP basis of accounting.
- Under the GAAP basis of accounting, changes in the fair value of investments generally are treated as adjustments to revenue, which commonly is not the case under the budgetary basis of accounting.
- Under the GAAP basis of accounting, expenditure is recognized for the net present value of minimum lease payments at the time a government enters into a capital lease involving a governmental fund. No such expenditure typically is recognized under the budgetary basis of accounting.
- There may be differences between the fiscal year used for financial reporting and the budget period (e.g., the use of lapse periods in connection with encumbrances, projectlength budgets, grant budgets tied to the *grantor's* fiscal year).
- The fund structure used in GAAP financial statements may differ from the fund structure used for budgetary purposes (e.g., debt service payments may be accounted for in the general fund for budgetary purpose, but reported in a debt service fund in the GAAP financial statements).
- The government's budget document may not include all of the component units and funds incorporated into the GAAP financial statements (e.g., a school district included in the GAAP financial statements may not be incorporated into the budget).

- Under the GAAP basis of accounting used in proprietary funds, the receipt of longterm debt proceeds, capital outlays and debt service principal payments are not reported in operations, but allocations for depreciation and amortization expense are recorded. Often the opposite is true under the budgetary basis of accounting.

**Recommendation.** The Government Finance Officers Association (GFOA) recommends that the budget document clearly define the basis of accounting used for budgetary purposes. If the budgetary basis of accounting and the GAAP basis of accounting are the same, this fact should be clearly stated. If the budgetary basis of accounting and the GAAP basis of accounting are different, major differences and similarities between the two bases of accounting should be noted. Disparities may include basis differences, timing differences, fund structure differences, and entity differences. The description of the differences between the GAAP basis of accounting and the budgetary basis of accounting should be written in a manner that is clearly understandable to those without expertise in either accounting or budgeting. The use of technical accounting terms should be avoided whenever possible. In cases where the use of technical accounting terms cannot be avoided, those terms should be clearly defined and fully explained.

### **References**

- *Recommended Budget Practices: A Framework for Improved State and Local Government Budgeting*, NACSLB, 1998.
- *Recommended Budget Practices* CD-ROM, NACSLB, 1998.
- *Budget Awards Program: Illustrations and Examples of Program Criteria*, Juliet Carol Powdar, GFOA, 1999.
- *Governmental Accounting, Auditing and Financial Reporting (GAAFR)* and *GAAFR Update Supplement*, Stephen J. Gauthier, GFOA 1994 and 1999.

Approved by the GFOA's Executive Board, 1999.