The New Blue Book

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WHAT’S CHANGED SINCE 2005?

The last edition of the GAAFR was released in 2005. Since then, a number of significant developments have taken place that significantly affect accounting, auditing, and financial reporting for state and local governments:

- The Governmental Accounting Standards Board (GASB) issued 21 statements, two technical bulletins, and three concepts statements. Meanwhile, the GASB’s staff continued to offer extensive guidance on a broad range of technical issues by means of annual updates to the GASB’s Comprehensive Implementation Guide.

- The Government Accountability Office (GAO) revised Government Auditing Standards (commonly known as the “Yellow Book”).

- The Committee of Sponsoring Organizations (COSO) of the Treadway Commission issued detailed guidance on the monitoring component of its comprehensive framework of internal control.

- The GFOA issued or updated 19 best practices or advisories that directly relate to governmental accounting, auditing, and financial reporting.

As a result of these developments, among other things:

- The rules for identifying component units and incorporating their data into the report of the financial reporting entity have been substantially modified.

- Governments must now distinguish assets from deferred outflows of resources and liabilities from deferred inflows of resources.

In addition, the GASB has provided a wealth of detailed guidance on a variety of specialized topics, including termination benefits, pollution remediation obligations, intangible assets (including computer software), derivatives, and service concession arrangements (that is, public/private and public/public partnerships, or PPPs).

WHAT’S NEW ABOUT THE BOOK ITSELF?

All the recent editions of the GAAFR have used a 8 ½” x 11” format to accommodate the reproduction of a complete illustrative comprehensive annual financial report (CAFR). The illustrative CAFR that accompanies this new edition of the Blue Book has been made available online, which allowed the new version to be printed in a more compact and convenient 7” x 10” format.

Previous editions of the Blue Book were also accompanied by a separate study guide that offered outlines and exercises. The new GAAFR offers a “chapter in brief” summary and exercises (with correct responses) for each chapter, obviating the need for a separate study guide.

In the past, individual chapters of the GAAFR were often broad in scope. For example, the 2005 edition of the Blue Book devoted a single chapter to all four sets of basic financial statements. Conversely, the new edition of the GAAFR aims to facilitate easy access to specific topics through the use of shorter, more narrowly focused chapters. Thus, the new Blue Book replaces the single chapter previously devoted to “Financial Reporting” with separate individual chapters on “Governmental Fund Financial Statements,” “Proprietary Fund Financial Statements,” “Fiduciary Fund Financial Statements,” and “Government-wide Financial Statements.” In the same way, the single chapter on “Governmental Funds” in the previ-
ous edition has been replaced by separate chapters on “Revenue Recognition in Governmental Funds,” “Expenditure Recognition in Governmental Funds,” “Other Financing Sources and Uses,” and “Asset and Liability Recognition and Measurement in Governmental Funds.”

Also in the past, aspects of a single technical topic were often addressed in different chapters. Thus, for example, a reader who wanted to gain a comprehensive understanding of the appropriate accounting and financial reporting for an advance refunding needed to consult both the chapter on “Governmental Funds” and the chapter on “Proprietary Funds.” In contrast, the new GAAFR has been expanded to include chapters that offer a comprehensive treatment of a wide range of specialized topics (for example, “Capital Assets,” “Debt,” “Derivatives,” “Risk Financing and Insurance”).

The combined effect of the changes just described explains how the number of chapters in the new GAAFR has more than doubled, from 19 to 47.

WHAT’S IN THE NEW GAAFR?

The text of the new GAAFR is divided into five parts: 1) Background and Framework; 2) Fund Accounting and the Basic Financial Statements; 3) Specialized Accounting Applications; 4) Reporting Beyond the Basic Financial Statements; and 5) Internal Control, Auditing, and Analysis.

Part I: Background and Framework. The first part of the new GAAFR is subdivided into three subsections that address basic background, the governmental financial reporting model, and basic recognition principles.

Section A: Basic Background. The first three chapters of the new Blue Book provide a basic foundation for approaching governmental accounting and financial reporting.

Chapter 1, “Accounting, Financial Reporting, and the Financial Statement Audit: an Overview,” explains how accounting, auditing, and financial reporting relate to each other, taking special care to distinguish accounting from financial reporting. It then goes on to examine the different types of financial reporting (internal financial reporting, special-purpose external financial reporting, general purpose external financial reporting), the different means of communicating financial information in general-purpose external financial reports (display, disclosure, supporting information), the basic financial statement elements (assets, liabilities, deferred inflows of resources, deferred outflows of resources, inflows of resources, outflows of resources, and net position), and the essential characteristics of accounting data.

Chapter 2, “The Government Environment and Its Impact on Accounting and Financial Reporting,” describes the special environment in which state and local governments operate (service motive versus profit motive, focus on stewardship versus focus on return on investment, budgets that have the force of law versus budgets that function solely as financial plans for management) and explains how that environment led to certain unique features of accounting and financial reporting for state and local governments (the use of more than one measurement focus and basis of accounting, the use of fund accounting, the inclusion of budgetary comparisons as part of financial reporting).

Chapter 3, “Sources of Governmental GAAP,” examines the nature and purpose of generally accepted accounting principles (GAAP), the legal authority for setting GAAP for state and local governments, the historical development of GAAP, and the structure and procedures used to set new standards. It also describes the “GAAP hierarchy” as it applies to state and local governments.

Section B: The Governmental Financial Reporting Model. The next three chapters of the new Blue Book introduce the governmental financial reporting model, with its unique combination of fund accounting and government-wide reporting.

Chapter 4, “Funds, Fund Types and Interfund Activity,” describes the nature and purpose of fund accounting, the “number of funds principle,” how funds are classified into fund types and fund categories, and the proper use of each fund type. It also explores the different types of interfund activity (loans, interfund services provided and used, transfers, reimbursements).
Chapter 5, “Government-wide Financial Reporting” explains how fund data are incorporated into the two activities columns reported in the government-wide financial statements, a process that requires converting fund data to a single measurement focus and basis of accounting (conversion), eliminating duplications (consolidation), and ensuring that functional costs report all associated direct costs and only direct costs.

Chapter 6, “The Primary Government and Its Component Units,” explains how financial reports for state and local governments combine the primary government, as legally defined, with certain other legally separate component units. It also explains how data from individual component units are incorporated into the financial statements of the combined financial reporting entity. The discussion incorporates the important recent changes that resulted from the issuance of GASB Statement No. 61, The Financial Reporting Entity: Omnibus, an amendment of GASB Statements No. 14 and No. 34.

Section C: Basic recognition principles. The following two chapters consider what is measured (measurement focus) and when it is measured (basis of accounting). They also explain how transactions are classified and how their classification affects when they are recognized.

Chapter 7, “Measurement Focus and Basis of Accounting,” compares and contrasts the economic resources measurement focus and the accrual basis of accounting with the current financial resources measurement focus and the modified accrual basis of accounting.

Chapter 8, “Categories of Transactions and Events and Their Recognition,” distinguishes exchange transactions and exchange-like transactions from various types of non-exchange transactions (derived tax revenues, imposed nonexchange revenues, government-mandated nonexchange transactions, and voluntary nonexchange transactions). It also distinguishes extraordinary items from special items and clarifies when direct adjustments to net position are appropriate.

Part 2: Fund Accounting and the Basic Financial Statements. The second part of the new GAAFR, which is devoted to fund accounting and the basic financial statements, is subdivided into subsections that address governmental funds, proprietary funds, fiduciary funds, government-wide financial statements, and disclosure.

Section A: Governmental Funds. There follow five chapters devoted to the various aspects of accounting and financial reporting for governmental funds.

Chapter 9, “Revenue Recognition in Governmental Funds,” examines how the current financial resources measurement focus and the modified accrual basis of accounting affect the recognition of the various types of revenues commonly accounted for in governmental funds.

Chapter 10, “Expenditure Recognition in Governmental Funds,” examines how the current financial resources measurement focus and the modified accrual basis of accounting affect the recognition of different types of expenditures accounted for in governmental funds.

Chapter 11, “Other Financing Sources and Uses,” explains the nature and purpose of the other financing sources and other financing uses categories. It also provides a comprehensive list of situations where the use of these categories is appropriate.
Chapter 12, “Asset and Liability Recognition and Measurement in Governmental Funds,” examines which specific assets and liabilities should be reported in a governmental fund. It also addresses the appropriate valuation of supplies inventories, foreclosure properties, and redevelopment properties, as well as the appropriate treatment for revenue anticipation notes and tax anticipation notes.

Chapter 13, “Governmental Fund Financial Statements,” examines the format and content of each of the basic financial statements presented for governmental funds. It also explains the process used to determine whether an individual governmental fund should be reported separately as a major fund. In addition, it provides detailed guidance on the proper application of GASB Statement No. 54, Fund Balance Reporting and Governmental Fund Type Definitions, to the classification of the various components of fund balance.

**Section B: Proprietary Funds.** The next two chapters of the new Blue Book are devoted to accounting and financial reporting for proprietary funds.

Chapter 14, “Enterprise Funds,” emphasizes specific points of difference between the accounting and financial reporting used for enterprise funds and the accounting and financial reporting used for private-sector business enterprises (interest capitalization, capital asset impairments, refundings, compensated absences, postemployment benefits, cash flows reporting, segment reporting, changes in net position, categories of net position). It also addresses the proper accounting and financial reporting for regulated industries and for certain transactions that are unique to the public sector (connection fees and impact/developer fees).

Chapter 15, “Internal Service Funds,” focuses on how accounting and financial reporting for enterprise funds and internal service funds differ.

Chapter 16, “Proprietary Fund Financial Statements,” examines the format and content of the three basic financial statements presented for proprietary funds, with special emphasis on the statement of cash flows, and how the various categories of cash flows are defined for state and local governments.

**Section C: Fiduciary Funds.** The next two chapters consider accounting and financial reporting for fiduciary funds.

Chapter 17, “Fiduciary Fund Accounting,” explains when the use of fiduciary funds is appropriate and how to distinguish trust funds from agency funds. It also clarifies the point at which a beneficiary’s interest in the assets of a trust fund constitutes a liability. The chapter also explores issues specific to each individual fiduciary fund type.

Chapter 18, “Fiduciary Fund Financial Statements,” examines the format and content of the two basic financial statements required for fiduciary funds. It also clarifies how data from fiduciary-type component funds should be incorporated into the financial statements.

**Section D: Government-wide Financial Statements.** The two chapters in this section explore government-wide financial reporting and its relationship to the fund financial statements.

Chapter 19, “Converting and Consolidating Fund Data,” provides a practical explanation of how to convert governmental fund data (current financial resources measurement focus/modified accrual basis of accounting) for inclusion in the government-wide financial statements (economic resources measurement focus/accrual basis of accounting). It also provides practical guidance on how to consolidate data, including data from internal service funds.

Chapter 20, “Government-wide Financial Statements,” provides detailed guidance on the format and content of both of the government-wide basic financial statements. The chapter includes a detailed discussion of program revenue, as well as practical guidance on the calculation of the various components of net position (net investment in capital assets, restricted, unrestricted). It also clarifies the relationship between total restricted net position for enterprise funds, as reported in the proprietary fund statement of net position, and the amount reported as restricted net position — business-type activities in the government-wide statement of net position.

**Section E: Disclosure.** This section explores the disclosures that must accompany the basic financial statements for fair presentation in conformity with GAAP.

Chapter 21, “Summary of Significant Accounting Policies,” offers a conceptual description of the contents of the summary of significant policies, followed by a detailed discussion of each of its specific components.

Chapter 22, “Detailed Note Disclosures,” describes both the type of information that ought to be included in the notes to the financial statements (clearly and demonstrably related to
the financial statements and essential) and types of information that ought not to be included there (subjective assessments, negative disclosures). It also provides detailed, comprehensive coverage of each of the note disclosures required by GAAP for state and local governments.

Part 3: Specialized Accounting Applications. The third part of the new GAAFR, which is devoted to specialized accounting applications, features eight chapters devoted to individual topics or combinations of topics.

Chapter 23, “Pension Benefits, Other Postemployment Benefits (OPEB), and Termination Benefits,” explains current accounting and financial reporting for pension benefits and OPEB, as well as pending changes. The chapter also examines the appropriate accounting and financial reporting for termination benefits. Among the issues addressed are the proper treatment of pension-related debt and contributions financed from the proceeds of pension obligation bonds.

Chapter 24, “Budgetary Integration,” explains the nature and purpose of budgetary integration, as well as the various budgetary accounts used for that purpose and the corresponding journal entries.

Chapter 25, “Capital Assets,” addresses a wide variety of practical issues that commonly arise in connection with accounting and financial reporting for capital assets. Those issues include defining major asset classes, identifying capitalizable costs, distinguishing improvements from repairs, valuation, depreciation/amortization, and accounting for impairments, replacements, and retirements.

Chapter 26, “Debt,” addresses a wide variety of practical issues that commonly arise in connection with accounting and financial reporting for debt. Specific issues addressed include the proper treatment of deep-discount debt (zero-coupon bonds, capital appreciation bonds), current and advance refundings, demand bonds, special assessment debt, conduit debt, borrowings within the primary government, the assignment of general obligation debt to proprietary funds, and rebatable arbitrage.

Chapter 27, “Derivatives,” explains what constitutes a derivative and how derivative instruments are used (including hedge accounting). It then describes how derivatives themselves, and changes in their fair value, should be reported in financial statements.

Chapter 28, “Landfill Closures and Pollution Remediation,” explains the special treatment applied to costs associated with landfill closure and postclosure care. It also describes the appropriate accounting and financial reporting for pollution remediation obligations.

Chapter 29, “Risk Financing and Insurance,” addresses the basic accounting treatment for claims and judgments, as well as how centralized risk financing activities should be reported in fund financial statements (reflecting new guidance on the topic provided in GASB Statement No. 66, Technical Corrections — 2012. The chapter also deals with accounting and financial reporting for participants in various types of public-entity risk pools, as well as the proper treatment of insurance recoveries.

Chapter 30, “Other Specialized Applications,” discusses a number of specialized topics specifically addressed by authoritative accounting standards: compensated absences; grants (recipient perspective); investments; lease accounting; special assessments; sales and pledges of receivables; joint ventures and similar arrangements; sales and pledges of future revenues; escheat property; service concession arrangements; and bankruptcies.

Part 4: Reporting Beyond the Basic Financial Statements. The fourth part of the new GAAFR, which is devoted to reporting beyond the basic financial statements, is subdivided into four subsections that address required supplementary information, the comprehensive annual financial report, specialized entities, and other reporting.

Section A: Required Supplementary Information (RSI). The two chapters in this section explore the different types of RSI required of state and local governments.

Chapter 31, “MD&A," discusses the content of management’s discussion and analysis (MD&A), as well as its relationship to the letter of transmittal. It also examines the independent auditor’s responsibility for MD&A.
Chapter 32, “Other RSI,” examines the types of required supplementary information (RSI) other than MD&A (budgetary comparisons; infrastructure condition and maintenance data; trend data on postemployment data; and trend data on revenue and claims development).

**Section B: The Comprehensive Annual Financial Report (CAFR).** Three chapters are devoted to the format and contents of a CAFR.

Chapter 33, “Structure and Contents of the CAFR,” describes the purpose, structure, and content of a comprehensive annual financial report (CAFR). It also describes the GFOA’s Certificate of Achievement for Excellence in Financial Reporting Program.

Chapter 34, “Supplementary Budgetary Reporting within the CAFR,” explains the additional budgetary comparisons that are required for governments that prepare a CAFR, with special emphasis on how they differ from the budgetary comparisons presented as part of the basic financial statements or RSI.

Chapter 35, “The Statistical Section,” describes the information that needs to be included in each of the five basic components of the statistical section of a CAFR.

**Section C: Specialized Entities.** The four chapters in this section consider the unique reporting applicable to special-purpose governments and states.

Chapter 36, “Postemployment Benefit Plans,” describes the special financial reporting requirements that apply to the separate financial reports of postemployment benefit plans, including a detailed review of the recommended contents of both the actuarial section and the investment section of a postemployment benefit plan’s CAFR.

Chapter 37, “Public-entity Risk Pools,” considers the types of public-entity risk pools and the appropriate financial reporting for each.

Chapter 38, “School Districts,” deals with issues of special interest to school districts (charter schools, the use of school buildings for some other purpose, donated commodities, single-program grants applicable to multiple functions, tuition revenue, shared revenues, contributed services, annualized payroll, and the classification of student activity funds). It also describes how the letter of transmittal and statistical section can be tailored for a school district.

Chapter 39, “States, Investment Pools, and Special Purpose Governments,” considers issues of special interest to state governments, investment pools, and special purpose governments.

**Section D: Other Reporting.** The two chapters in this section cover two types of financial reporting beyond the scope of GAAP, as currently defined.

Chapter 40, “Popular Reporting,” explores how to prepare financial presentations designed to meet the needs of less sophisticated users of financial information who might be unable or unwilling to sort through the detailed information provided in a CAFR.

Chapter 41, “Performance Reporting,” considers the relationship between general purpose external financial reporting and nonfinancial measures of performance. The discussion includes a review of the GASB’s service efforts and accomplishments initiative, as well as the work of the National Performance Management Advisory Commission.

**Part 5: Internal Control, Auditing, and Analysis.** The fifth and last part of the new GAAFR, which is devoted to internal control, auditing, and analysis, is subdivided into subsections that address internal control and auditing and analysis.
Section A: Internal Control. This section features two chapters that consider the application of relevant private-sector guidelines on internal control to state and local governments.

Chapter 42, “Comprehensive Framework of Internal Control,” explains the nature and purpose of internal control, the relative responsibilities of management and the governing body for internal control, the inherent limitations of internal control, and the essential elements of a comprehensive framework of internal control as defined by the Council of Sponsoring Organizations of the Treadway Commission on Fraudulent Financial Reporting. It also explores the move toward placing internal control within the broader conceptual context of enterprise risk management.

Chapter 43, “Monitoring the Periodic Evaluation of Internal Control,” explains why it is necessary to establish and maintain a baseline of effective internal control for monitoring. It also explains when that baseline needs to be revisited and how identified deficiencies need to be resolved.

Section B: Auditing and Analysis. This final section of the new GAAFR considers the different types of auditing encountered in the public sector and how to analyze state and local government financial statements.

Chapter 44, “The Financial Statement Audit,” considers certain unique features of a financial statement audit in the public sector, including the differing levels of responsibility assumed by an auditor for the contents of a report and the use of specialized auditing standards (Government Auditing Standards, or the “Yellow Book”). It also considers issues related to audit procurement (length of audit contract and mandatory auditor rotation).

Chapter 45, “Single Audit,” explores the special requirements of a “Single Audit” for governments that receive significant federal financial assistance, including the determination of what constitutes a major program and the special responsibilities attached to the auditing of major programs.

Chapter 46, “Internal Auditing and Performance Auditing,” considers a number of issues related to internal auditing (independence, reporting to top management versus reporting to the audit committee, relationship to the financial statement audit, alternatives when a separate internal audit function is not feasible) and performance auditing (audit scope, selection of criteria, applicable professional standards to be followed).

Chapter 47, “Financial Statement Analysis,” explains why the techniques commonly used to analyze financial statements in the private sector generally are ill suited to the analysis of state and local government financial statements. It then suggests an approach to financial statement analysis for state and local governments that focuses on near-term financial position, net position, and economic condition.

APPENDIXES

The text of the new GAAFR is supplemented by several appendixes. An initial set (A-E) focuses on the preparation of an illustrative CAFR (available at the GFOA’s website). Appendix A offers a complete set of illustrative journal entries for one fund of each fund type used in the illustrative CAFR. Appendix B provides trial balances (beginning, pre-closing, and post-closing) for each of the individual funds for which journal entries are presented in Appendix A. Appendix C presents the journal entries used to convert and consolidate fund data for incorporation into the government-wide financial statements. Appendix D (available electronically) offers a complete illustrative CAFR. Appendix E presents the chart of accounts used to prepare the illustrative CAFR.

As already mentioned, each chapter of the new GAAFR is accompanied by multiple-choice and true/false questions for which the correct response is provided at the bottom of the page. Appendix F offers an explanation for the correct responses to those questions. Appendix G is a glossary of technical terms used in the text, while Appendix H identifies acronyms used throughout the text. Finally, Appendix I contains an index.

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Training is Available

The GFOA is offering a two-hour Internet-based training seminar designed to familiarize participants with the guidance provided in the new GAAFR. That training is scheduled to take place between 2:00 - 4:00 p.m. (Eastern) on September 19, 2012, and December 12, 2012.