INTRODUCTION

This section of SAAM is organized a bit differently from most of the other sections. That is because this section of SAAM does not consist of enumerated policy statements; rather, this section of SAAM is a primer dealing with the concepts, terminology and principles used by the State of Arizona in accounting for financial transactions and preparing its principal financial statements. This technical information may help financial professionals working in State government to more fully understand the underpinnings of the financial transactions recorded and reports prepared by the State of Arizona Government and why these might differ from their counterparts encountered in the private sector.

The State of Arizona maintains its accounting system to ensure compliance with all legal requirements. Legal requirements may, at times, conflict with what are known as Generally Accepted Accounting Principles (GAAP). A variety of possible conflicts of this kind may be encountered. For example, each year, the State prepares two principal sets of financial statements, the Annual Financial Report (AFR) and the Comprehensive Annual Financial Report (CAFR). The former is prepared using Arizona's Legal Budgetary Basis (LBB), while the latter is prepared in accordance with GAAP. These two sets of financial statements are prepared for two different sets of users, each with its own requirements.

CONCEPTS

Basis of Accounting.

A basis of accounting is a set of accounting conventions and assumptions that determine when transactions and other accounting events are recognized. There are two principal bases of accounting: cash and accrual.

The cash basis of accounting ties the recognition of financial events to the inflow and outflow of cash.

The accrual basis of accounting, on the other hand, recognizes financial events when a transaction occurs, irrespective of when the related payment is received or expended.

State and local government fund financial reporting, as used in preparing the CAFR, primarily employs a modified accrual basis of accounting. The modified accrual basis of accounting recognized revenues when they are measurable and will be received in time to pay the current year's liabilities; liabilities are recognized when they must be paid.

Entity-wide financial reporting of state and local governments uses the accrual basis of accounting.

Measurement Focus.

A measurement focus is an accounting convention that deals with what is being reported upon and why. There are two principal measurement foci: economic resources and current financial resources.

From an accounting perspective, private sector entities generally attempt to measure the overall economic effect of transactions and to evaluate and report upon all of the economic resources they have at their disposal, in both the short and long term, to generate income and increase business value. The economic measurement focus uses the full accrual basis of accounting to support its financial reporting.

For most of their operations, governments have, for their accounting and financial reporting, traditionally calculated the current financial resources necessary to continue, in the relatively short term, providing the services for which their citizens hold them responsible. The current financial resources measurement focus uses the modified accrual basis of accounting to support its financial reporting.

Fund Accounting.

Fund accounting is the type of accounting used by state and local governments (as well as some not-for-profit entities). Fund accounting is an accounting system in which an entity's resources are divided between two or more accounting entities known as funds.

A fund is a fiscal and accounting entity, with a self-balancing set of accounts, used to account for resources, and claims against them, that are segregated in accordance with legal or contractual restrictions or to carry out specific activities.

The diverse nature of governmental operations and the necessity of assuring legal compliance preclude recording and summarizing all governmental financial transactions and balances in a single accounting entity. Unlike a private business, which is accounted for as a single entity, a governmental unit is accounted for through several separate funds, each accounting for designated assets, liabilities, and equity or other balances. Thus, from an accounting and financial management viewpoint, a governmental unit is a combination of several distinctly different fiscal and accounting entities, each having a separate set of accounts and functioning independently of other funds.

Various types of legal provisions require establishment of funds. Funds may be created pursuant to constitutional provisions or Arizona Revised Statutes. In addition, funds may be created by the Department of Administration to achieve sound and expeditious financial administration and reporting and/or to comply with grant or contract accounting and financial reporting requirements.

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 of a complete set of accounts for each fund refers to identification of accounts in the accounting records, and does not necessarily extend to physical segregation of assets or liabilities.

The funds of a governmental unit may have financial transactions and debtor-creditor relationships with other funds of the governmental unit. Interfund receivables and payables may result from services rendered by a department financed from one fund to a department financed from another fund, or from interfund loans. Interfund loans normally must be authorized by statute. Because each fund is a fiscal and accounting entity, the amounts due to one fund from other funds, as well as the amounts owed to other funds, should be reflected in the fund accounts and in fund financial statements. Where money is owed from one fund to another fund and money is also owed from the latter to the former, the amounts receivable and payable should not be offset in the accounts. However, for purposes of reporting, current amounts due from and due to the same funds may be offset and the net amounts shown in the respective fund balance sheets.

Funds.

Three categories of funds are used by state and local governments for accounting and financial reporting purposes: Governmental Funds, Proprietary Funds, and Fiduciary Funds. Each of these categories is further broken down into fund types. Each fund type represents a particular kind of function performed or service provided by governments.

It is desirable that the minimum number of separate funds—consistent with legal specifications, operational requirements, and the principles supporting the types of funds discussed below—be established.

Governmental Funds.

These types of funds are those through which most governmental functions typically are financed. The acquisition, use, and balances of the government's financial resources and the related current liabilities—except those accounted for in proprietary funds—are accounted for through governmental funds.

Governmental funds are, in essence, accounting segregations of financial resources. Assets are assigned to the various governmental funds according to the purposes for which they may or must be used; current liabilities are assigned to the fund from which they are to be paid; and the difference between governmental fund assets and liabilities, the fund equity, is referred to as the "Fund Balance."

Governmental fund financial reporting uses the current financial resources measurement focus and the modified accrual basis of accounting.

The statement of revenues, expenditures, and changes in fund balance is the primary governmental fund operating statement. It may be supported or supplemented by more detailed schedules of revenues, expenditures, transfers, and other changes in fund balance.

There are five governmental fund types:

The General Fund. The general fund accounts for all resources not accounted for in another fund. Each government, including the State of Arizona, must have a general fund and can have no more than one general fund. The majority of a government's general purpose transactions are conducted through and recorded in the general fund.

Special Revenue Funds. These account for the proceeds of special revenue sources that are legally or administratively restricted or committed to expenditure for specified purposes other than debt service or capital projects.

Capital Projects Funds. These account for financial resources to be used for the acquisition or construction of major capital facilities (other than those financed by proprietary or fiduciary funds).

Debt Service Funds. Debt service funds account for the accumulation of financial resources for, and the payment of, general long-term debt principal and interest.

Permanent Funds. These funds are subject to legal restrictions that, while allowing their earnings to be used to finance government programs and operations, require their principal to be retained intact indefinitely.

Proprietary Funds.

Proprietary funds, sometimes referred to as "nonexpendable," "commercial type" or "income determination," funds, are used to account for a government's ongoing organizations and activities that are similar to those found in the private sector.

Because they account for businesslike activities, these funds employ businesslike accounting methods: they use the economic resources measurement focus and the full accrual basis of accounting. The elements of their financial statements—such as operating income—are also similar to those found in the private sector.

There are two types of proprietary funds:

Enterprise Funds. Enterprise funds account for operations that are financed and operated in a manner similar to private business enterprises, i.e., where the intent of the governing body is that the costs of providing goods or services to the general public are to be recovered primarily through user charges.

Internal Service Funds. These types of funds account for governmental businesslike activities in which one department or agency provides goods or services to another department or agency on a cost recovery basis.

Fiduciary Funds.

These funds are often referred to as "Trust and Agency Funds." These funds are used to 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. Fiduciary funds can be spent for the purposes designated by the trust agreement or by law.

Fiduciary funds use the economic resources measurement focus and the full accrual basis of accounting. It must be noted, however, that special rules may apply to the accounting for pension and investment trusts.

There are four fiduciary fund types:

Agency Funds. Agency funds account for assets in which the agency acts on behalf of external parties and is in effect only functioning as a conduit for the money passing through the fund. There are no responsibilities on the part of the agency other than to receive, temporarily safeguard, and disburse the monies held in trust.

Pension Trust Funds. Pension trust funds are monies that employees and employers set aside to fund future employee retirement benefits.

Investment Trust Funds. Investment trust funds are created when one government makes investments on behalf of another government.

Private Purpose Trust Funds. These funds are those that are set aside for specific uses. Endowment funds are the most common type of private purpose trust funds. The use of a private purpose trust fund’s assets must be restricted to benefit organizations or individuals other than the government that holds the funds in trust.