



California
Committee on
Municipal
Accounting

APPLICATION OF THE REVENUE RECOGNITION CRITERIA SET FORTH IN GASB NO. 33 TO REVENUE SOURCES SIGNIFICANT TO CALIFORNIA CITIES

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**APPLICATION OF REVENUE RECOGNITION CRITERIA
SET FORTH IN GASB NO. 33
TO REVENUE SOURCES SIGNIFICANT TO CALIFORNIA CITIES**

Background

The Governmental Accounting Standards Board (GASB) issued Statement No. 33 in December 1998, which addresses reporting the results of nonexchange transactions by state and local governments. In a nonexchange transaction, a government gives (or receives) value without directly receiving (or giving) *equal* value in return. Nonexchange transactions are typically described as taxes, fines, and certain grants. Exchange transactions, which are not covered by this statement, are more typically fee-for-service in nature. Certain transactions, while not representing an exact exchange of value, are considered to be "exchange-like" transactions, and are accounted for as exchange transactions. Examples of these transactions are business licenses, building permits, special assessments, developer fees, and connection fees. In these transactions cash is exchanged for a privilege granted. These revenues should be recognized when that privilege is granted.

The principal issue addressed in Statement No. 33 is the timing of recognition of nonexchange transactions. The Statement supersedes GASB Statement No. 22 and AICPA SOP 75-3, and parts of GASB Statements No. 6 and 11 and parts of NCGA Statement 2 and Interpretation 3.

The Statement applies to transactions involving financial or capital resources, but does not apply to contributed services. It will likely have a significant fiscal impact on California cities due to its provisions, which provide for recognition of revenues prior to receipt of the related resources and prior to satisfying purpose restrictions.

The Statement essentially bases the criteria for revenue recognition on the characteristics of the underlying transaction resulting in the resources provided. Four classes are identified as follows:

1. **Derived tax revenues** – result from assessments imposed on *exchange* transactions. Examples are transient occupancy taxes, local transportation sales tax and income taxes.
2. **Imposed nonexchange revenues** – result from assessments imposed on nongovernmental entities, including individuals, (other than assessments imposed on exchange transactions). Examples are property taxes, fines, and seized property.
3. **Government-mandated nonexchange transactions** – results from one level of government (State) providing resources to another level of government (city, county, special district) and requires the recipient to use the resources for a specific program. Examples are Federal or State programs that cities are mandated to perform, such as gasoline tax programs.

4. **Voluntary nonexchange transactions** – result from agreements entered into voluntarily by the parties thereto. Examples are State sales tax, certain grants and voluntary donations.

Time Requirements and Purpose Restrictions

The Statement addresses two kinds of stipulations associated with nonexchange transactions; time requirements (the period when the resources are required to be used or when use may begin or during which the assets must be held intact) and purpose restrictions (those in which the resources are required to be used for a specific purpose).

Basis of Accounting

The timing of recognition resulting from nonexchange transactions should be the same for assets, liabilities, expenses and expenditures whether the accrual or modified accrual basis of accounting is required. However, for revenue recognition to occur on the modified accrual basis, revenues must also be *available* as defined by previous GASB and NCGA pronouncements.

Timing of Recognition

The recognition of assets and revenues for the recipient of nonexchange transactions is summarized below.

1. **Derived tax revenues** (such as taxes based on gross receipts, gaming and paramutual betting revenues, and local transportation sales taxes):

<i>Assets</i>	When the underlying exchange transaction occurs or resources are received, whichever is first.
<i>Revenues</i>	When the underlying exchange transaction occurs.
<i>Deferred Revenues</i>	When resources are received before the underlying exchange has occurred.

2. **Imposed nonexchange revenues** (such as property taxes, fines, seized property):

<i>Assets</i>	When the government has an enforceable legal claim to the resources or resources are received, whichever is first.
<i>Revenues</i>	In the period when use of the resources is required or first permitted.
<i>Deferred Revenues</i>	When resources are received or recognized as receivable before the time requirements are met.

3. **Government-mandated nonexchange transactions** (such as Federal or State programs that cities are mandated to perform):

<i>Assets</i>	When all applicable eligibility requirements are met or the resources are received, whichever is first.
<i>Revenues</i>	When all applicable eligibility requirements are met. (On the modified accrual basis, revenues should be recognized when all applicable eligibility requirements are met and the resources are available).
<i>Deferred Revenues</i>	When the recipient is required to use the resources in the following year, resources provided before that period should be recognized as deferred revenues.

4. **Voluntary nonexchange transactions** (such as State sales tax, certain grants and voluntary donations):

Same as for #3 Government-mandated nonexchange transactions.

Effective Date

Statement 33 is effective for financial statements for periods beginning after June 15, 2000, with earlier application encouraged.

Discussion of Specific Revenue Sources

Revenues from nonexchange transactions frequently applicable to California municipalities are discussed below (with respect to the accounting treatment applied at the fund level using the modified accrual basis of accounting).

Derived Tax Revenues

Transient Occupancy Taxes – Transient occupancy taxes are assessed by the governmental entity to lodging establishments as a percentage of room rates. The tax is collected by the establishment and remitted to the governmental entity on a monthly or quarterly basis. Remittances are typically due by July 31 for the month or quarter ended June 30. These revenues are taxes derived from an exchange transaction, and accordingly the provisions of Paragraph 16 of the Statement apply. Paragraph 16 provides that resources *derived from exchange transactions* should be recognized at the time the exchange transaction on which the tax is imposed occurs. Therefore transient occupancy tax revenues should be recognized in the reporting period in which the payment for room occupancy occurred.

Real Property Transfer Tax (derived tax revenue) – These are taxes assessed on the value of real estate when it is sold or *exchanged*. The tax is typically assessed on the seller, collected by the County from the escrow company, and remitted to the Governmental entity after the property is recorded. Paragraph 16 provides that resources *derived from exchange transactions* should be recognized at the time the exchange transaction on which the tax is imposed occurs. Amounts may vary significantly from month to month. Due to the difficulty in estimating these revenues prior to receipt, cities may need to use actual subsequent remittances to establish appropriate accruals, if such revenues are deemed material to the Governmental entity's financial statements. If not considered material, revenues may be recognized at the time of collection.

Nonregulatory Business Taxes – Some cities use the *business license tax* to finance governmental operations by imposing a tax on the gross receipts of the businesses in the community. In many cases, the amount collected is significantly greater than the cost to monitor, control, and regulate businesses in the community, and also significantly greater than the “value” of the privilege granted to that business to operate in the community. For these cities, this tax functions more as a revenue generating device for the city than a pure regulatory function and therefore, such taxes (and similar other gross receipts taxes) should be considered to be *derived tax revenues*. Accordingly they would be estimated and accrued in the period for which the “taxed” revenues were earned by the paying business, subject to the *measurable* and *available* rules applicable to the modified accrual basis of accounting.

Utility Users Taxes – Utility users tax revenue is derived from an exchange transaction, that being the purchase of electric, natural gas, water, cable television and telephone service. The rate is set by the governmental entity, collected by the utilities and subsequently remitted to the local government. Revenue should be recognized in the same period in which the underlying sales transaction occurred. Estimations may be appropriate and may require knowledge of historic trends and current relevant economic and demographic conditions.

Gaming (Casino) Revenues – Gaming (casino revenues are assessed by the governmental entity to gaming establishments. The assessment is typically imposed as an amount per card hand played or per hour, or fraction thereof, played. The assessment is paid by the establishment within approximately ten days after the month to which it pertains. These revenues are derived from an exchange transaction, that being the payment of the gaming house, or assumption of risk, of loss, in exchange for the right to participate in the house games. Revenues should be recognized in the reporting period in which the gaming activity occurs.

Paramutual Betting Taxes – Paramutual betting taxes are assessed by the governmental entity to racetracks. The assessment is imposed as an amount per dollar wagered. The assessment is paid by the establishment within approximately two weeks of the month of collection. These revenues are derived from an exchange transaction, that being the assumption of risk of loss in exchange for the right to participate in paramutual betting. Revenues should be recognized in the reporting period in which the gaming activity occurs.

Imposed Nonexchange Transactions

Property Taxes – In California, property taxes are levied July 1 or later based on the assessed valuation as of the most recent January 1. However, the amount of the taxes to be levied is not determined until the levy rate is approved and adjustments are decided by the County Assessor, both of which occur subsequent to July 1. Further, ***the actual claim to the property tax does not arise until the respective governing body adopts the levy.*** Therefore, for governments with June 30 fiscal year-ends (the vast majority of California governments), the government's enforceable legal claim to the collection of property taxes arises in the same fiscal year in which the property taxes are levied and received.

Paragraph 17 of the standard states that ***taxes receivable*** should be recorded on the date that an *enforceable legal claim* to the property taxes occurs.

Paragraph 18 of the standard also states that the ***revenue associated with property taxes should not be recognized until the period for which the taxes are being levied.*** However, in California, where most local governments have June 30 fiscal year ends, this would typically be the same fiscal year in which the enforceable legal claim occurs. Therefore, *taxes receivable* and *the related revenue* for the property taxes levied for fiscal year 2000-01 should be recorded in 2000-01 and, at year end, accrued property taxes would represent the uncollected remainder of the tax levy for that fiscal year (and any prior fiscal years), net of estimated uncollectible amounts. When the modified accrual basis of accounting is used, the amount recognized as revenue should be limited to the amounts collected soon enough after year-end to be considered available to finance the prior year expenditures.

Certain local governments in California participate in the "Teeter Program" pursuant to the Revenue and Taxation Code Section 4701 which provides that these entities may receive the property tax levy on a specified date, regardless of whether the property taxes have been collected by the County Treasurer/Tax Collector. Because these local governments have an enforceable legal claim to the property tax revenues (as determined by the formula set forth in Assembly Bill 8) at the time the property taxes are levied, the same timing as that described above would apply.

For those local governments with a September 30 year end, the action necessary to make the property tax levy enforceable will occur between July 1 and September 30. At that time the local government should recognize taxes receivable and deferred revenue. Revenue may be recognized as of September 30 for amounts expected to be collected within an appropriate "availability" period not to exceed 60 days. Additional amounts being levied are for the following fiscal year and revenue should not be recognized prior to this period.

Motor Vehicle In Lieu Tax – This tax is imposed as part of the automobile registration process in lieu of personal property tax. There is no tangible benefit received by the payer, and thus this is a nonexchange transaction. Paragraphs 17 and 18 require that these revenues are recognized in the period when an enforceable legal claim to the asset arises or when the resources are received, whichever occurs

first. The Governmental entity's claim on these resources exists from the time of collection by the State. Collections are typically remitted to cities the following month. Therefore, the amount normally received in July should be accrued in June. Amounts to be accrued may be estimated.

Air Quality (AB 2677) Revenues – These revenues represent the portion of automobile registration fees remitted to Counties and subsequently disbursed to cities, based on population, for use in improving air quality. These revenues include purpose restrictions and time requirements. Paragraphs 14 states that ***purpose restrictions do not affect the timing of revenue recognition***. Paragraphs 17 and 18 provide that, when timing requirements exist, revenues should be recognized in the period when the resources are required to be used or when use is first permitted.

The timing requirement associated with AB 2677 revenues relates to the expenditure of such revenues within 3 years. Because the entire amount of such revenues may be expended in year 1, and assuming that no other factors suggest that such expenditures will not occur within 3 years, these revenues may be recognized in the period when an enforceable legal claim to the asset arises, or when the resources are received, whichever occurs first. Thus, recognition would be consistent with that utilized for Motor Vehicle In Lieu Taxes. If material, the amount normally received in July should be accrued in June.

Paragraph 21 provides that recipients should recognize receivables and revenues when all applicable eligibility requirements, including time requirements, are met.

Narcotics Asset Seizure Funds – These revenues are initiated by Federal agencies and remitted to cities based on the amount of assets seized in connection with narcotics enforcement activities. The seizure of the asset is clearly a nonexchange transaction, and the revenues must be used to supplement, not supplant, certain law enforcement activities. Accordingly these revenues constitute imposed nonexchange transactions with a *purpose restriction*, not an *eligibility requirement*. Paragraph 14 states that purpose restrictions do not affect the timing of revenue recognition. Upon the implementation of GASB Statement No. 34, the net assets (or equity or fund balance) are reported as restricted until the resources are used for the specified purpose.

Narcotics asset seizure funds must be expended within 2 years. Because the entire amount of such revenues may be expended in year 1, and assuming that no other factors suggest that such expenditures will not occur within 2 years, Paragraph 18 would apply and these revenues may be recognized in the period when an enforceable legal claim to the asset arises, or when the resources are received, whichever occurs first. Typically these revenues would be recognized upon receipt.

Developer Contributions – Where developer contributions to a local government are in amounts substantially greater than the economic value of the privilege granted for project approval, such amounts are considered to be *imposed nonexchange transactions* as provided by example 12 in appendix D to GASB Statement No. 33.

Development processing fees whose value approximates the cost of processing, regulating, and approving development projects in the community are *exchange transactions* (the amount paid is approximately equal to the economic value of the privilege granted) and not covered by GASB Statement No. 33.

Government-Mandated Nonexchange Transactions

Gas Tax – This tax is paid by persons purchasing fuel to the sellers of that fuel. The tax is assessed to the distributor (wholesaler) at the time of distribution of the gasoline or diesel fuel. The taxes are remitted the following month to the State Board of Equalization and the State allocates gas taxes to local governments such that they are received approximately one month after collection by the wholesaler. The State mandates that cities and counties accept a share of the tax and use it to carry out road and street maintenance and improvement projects. As a government-mandated nonexchange transaction, revenue should be recorded when all applicable eligibility requirements are met and, if on the modified accrual basis, the resources are available. Therefore gas tax revenue should be recognized in the period in which the retail sale of fuel took place, which is generally one month prior to receipt by the local government.

Voluntary Nonexchange Transactions

Sales Taxes – The California sales tax (base tax) is not a *locally imposed tax*. It is a *shared state tax*. It is imposed as a result of state legislation. Local jurisdictions cannot increase or decrease the tax or void the tax for their jurisdiction. GASB No. 36, which amends GASB No. 33, states that shared derived tax revenues should follow the rules for voluntary or government-mandated nonexchange transactions. This means that local governments should recognize such revenues when all applicable eligibility requirements have been met. GASB No. 36 states that the eligibility requirements are met (the applicable period is considered to have begun and the recipient possesses the required characteristics to be a recipient) at the time that the exchange transaction (merchant sale) on which the tax is imposed occurs (see Example 1 in the amendment to GASB No 33)".

Amounts collected by the State for sales occurring in the quarter including April, May and June are typically remitted to the local government in June, July and August, with a portion of the remittance occasionally occurring in September. Amounts recognized as revenue may be estimated and should be only the amounts collected soon enough after year-end to be considered available to finance expenditures of the same period.

Transportation-Related Add-ons to the Sales Tax (locally imposed derived tax revenues with a purpose restriction) – revenue recognition would be the same as that for general sales tax with the following additional considerations. Typically, these taxes are imposed on a County-wide basis. As such, they are a shared tax revenue from the standpoint of a reporting City. These monies are generally restricted for transportation related projects. This is a *purpose restriction*, not an *eligibility requirement*. Paragraph 14 states that purpose restrictions do not affect the timing of revenue recognition, but rather the net assets (or equity or fund balance) are

reported as restricted until the resources are used for the specified purpose. Derived tax revenues are to be accrued when the underlying exchange transaction occurs. Amounts collected by the State for sales occurring in the quarter including April, May and June are typically remitted to the local government in June, July and August, with a portion of the remittance occasionally occurring in September. Amounts recognized as revenue should be only the amounts collected soon enough to be considered available to finance expenditures of the same period.

These monies also typically must be spent within three years of receipt. However, Example 10a of Appendix D of the Statement clarifies that the requirement to spend money within a specified period of time is **not** considered to be an eligibility requirement because all of the monies received *could* be expended in either the year of receipt or at any time within the three-year period provided by law. GASB Statement No. 33 stipulates that, in this type of situation, revenues should be recorded when the sale occurs—deferred revenues should **not** be recorded for the amounts received prior to expenditure.

Any monies later determined to be returned back to the funding agency because they were not expended within the time frame specified in the enabling statute would be recorded as an expenditure (function *streets and highways*) and accrued as a liability at the time that it becomes apparent that the Governmental entity will not expend all of the funds within the indicated three year period.

Reimbursement Grant Revenues – Reimbursement grant agreements typically stipulate that the government must incur grant allowable expenditures (which represent eligibility requirements) in order to become entitled to receive the grant resources. Paragraph 21 states that these revenues should be recognized when all applicable eligibility requirements are met. Accordingly these revenues should be accrued in the period in which those reimbursable expenditures are incurred. Amounts received in advance of the incurring of grant reimbursable costs should be recorded as a liability (deferred revenues) until those costs are incurred.

GASB No. 33 clarifies that under the modified accrual basis of accounting, a local government can only recognize as revenue those grant reimbursements that will be collected soon enough after year end to be considered available to finance the expenditures of the prior period. GASB has established a conceptual model for revenue recognition under the modified accrual basis of accounting that should be consistently applied to all governmental non-exchange revenues. GASB no longer will permit reimbursement grant revenues to be accrued to cover reimbursable costs incurred without regard to the measurable and available rules. This means that some grant funds will have deficit fund balances if they are not claiming and collecting their reimbursements in a timely manner. Grant receivables recorded at year-end that are not collected soon enough after year-end to be considered to be “available” to finance the expenditures of the prior period should be recorded by crediting deferred revenue.

Capital Contributions Made to Proprietary Funds – Statement 33 includes **a significant change to the recognition of capital contributions** to proprietary funds. Such resources, to the extent that contributions are received after

implementation of Statement 33, are recognized as revenues (not as contributed capital) typically in the period in which those amounts are received. Prior year financial statements should not be restated to eliminate contributed capital recognized in previous years until GASB Statement 34 is implemented.

In the unlikely event that the resources were intended to be expended in future periods, they should be recorded as deferred revenue upon receipt. Also, should the contribution require the governmental entity to perform a particular action (such as construction of a street, fire station, etc.), the governmental entity should recognize the resources and related revenues when the action has been performed.

The stipulation that these amounts be expended for general capital purposes is a purpose restriction, not an eligibility requirement, and revenue recognition should not be deferred until the capital outlays are made.

* * * * *

A summary of revenue sources and the likely appropriate revenue recognition policy (at the fund level using the modified accrual basis of accounting) is presented in the attached Schedule of Revenue Recognition. Further information regarding the application of GASB Statement No. 33 to other revenue sources may be found in Appendix D of Statement No. 33 which provides discussion of 25 example revenues.

Schedule of Revenue Recognition

<u>REVENUE CLASSIFICATION</u>	For June 30 year-ends, accrue as revenue amounts normally received in:	
	<u>Per GASB 22</u>	<u>Per GASB 33</u>
<u>Derived Tax Revenues</u> (accrue revenue when the underlying exchange transaction occurs)		
Transient Occupancy Taxes	July	July
Real Property Transfer Tax	Upon receipt	Upon receipt
Utility Users Tax	July	July
Nonregulatory Business Taxes	July	July
Gaming (Casino) Revenue	July	July
Paramutual Betting	July	July
<u>Imposed Non-Exchange Transactions</u> (accrue revenue when use of the resources is required or permitted)		
Property Taxes	July - August	July - August
Motor Vehicle In Lieu Tax	July	July
Air Quality (AB 2677) Revenues	July	July
Narcotics Asset Seizure Funds *	Upon receipt	Upon receipt
Developer Contributions	Upon receipt	Upon receipt
<u>Government-Mandated Non-Exchange Transactions</u> (accrue revenue when eligibility requirements are met; availability criteria applies with modified accrual accounting)		
Gas Tax	July	July
<u>Voluntary Non-Exchange</u> (accrue revenue when eligibility requirements are met; availability criteria applies with modified accrual accounting)		
Sales Tax	July - August	July – August
Transportation-related Sales Tax (shared revenue imposed by County)	July – August	July - August
Reimbursement Grant Revenues	As expenditures incurred	As expenditures incurred (and available)**
Capital Contributions to Proprietary Funds*	Not a revenue	Upon receipt

* Assumes eligibility requirement is met.

** Collected within the local government's normal period for liquidating liabilities accrued during the prior fiscal year.

Note: The timing reflected above represents the most typical situation and may not reflect all circumstances. The text of this White Paper, GASB 33 and the Amendment to GASB 33 should be read for guidance in unusual situations.