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By James P. Trebby and Robert B. Yahr

When the National Council on Governmental Accounting (NCGA) revised the basic accounting principles for governmental units in 1979, its final product—NCGA Statement No. 1 [4]—was generally acknowledged as eliminating several inconsistencies in governmental accounting and, in many instances, simplifying governmental accounting procedures. However, one issue that was neither fully resolved at that time nor through subsequent NCGA actions was the accounting for special assessments. Consequently, the conclusions in NCGA Statement No. 1 regarding the accounting for these assessments continued to attract much criticism.

Probably the primary reasons for this criticism were that (1) special assessment bonds were recorded as a liability rather than as an "other financing source" and (2) the modified accrual basis of accounting was used for these activities, where revenues had to be both "measurable" and "available" in order to be recognized. Because of these requirements, the NCGA concluded that the only "other financing sources" for special assessment funds were operating transfers from other governmental funds (such as the general fund) and that only the current portions of special assessments were revenue. Since construction-related expenditures were recognized immediately as incurred, it was normal for a special assessment fund to report a deficiency throughout most of its life. Thus, this fund's "artificial" deficit led to potentially misleading inferences regarding the fund's (and possibly the governmental unit's) financial health.

Additional criticism also resulted from the argument that special assessment activities (especially those involving capital improvements) were no different from activities presently being accounted for in other funds—notably the capital projects and debt service funds. The ambiguity of the NCGA statement's conclusions regarding service assessments was also noted, since questions had arisen regarding whether a separate special assessment fund was even required for these activities.

Because of these concerns, the Governmental Accounting Standards Board (GASB) placed this topic on its active agenda shortly after the Board's inception in 1984. Its initial public document was an October, 1985, Discussion Memorandum [1] that explored the alternative accounting treatments. After considering the input received from various respondents, the GASB reported its tentative conclusions in a July, 1986, Exposure Draft [2]. Again, additional comments were received from the public, and, after making several revisions, the GASB issued

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its final pronouncement, "Accounting and Financial Reporting for Special Assessments" (GASB Statement No. 6) [3] in January, 1987.

As a result of the Board's deliberations, new accounting and reporting procedures for special assessments must now be implemented. These requirements, the most notable of which includes the termination of the separate fund type for special assessments, are effective for financial statements issued for periods beginning after June 15, 1987, and are applicable for all state and local governmental entities that levy special assessments. Thus, all governmental units on a calendar year must comply with these new standards in their 1988 financial statements.

THE NATURE OF SPECIAL ASSESSMENTS

Special assessments are typically divided into two categories, those providing capital improvements and those providing services. In addition, when special assessment bonds are issued by the municipality to provide resources for some capital improvements, the municipality's legal responsibility for that debt can vary significantly. This section summarizes the particular aspects of special assessments that influenced the GASB's eventual conclusions.

Capital improvement assessments have two separate phases, a construction activity and a financing activity. The construction activity, which involves such projects as street or sewer improvements, is generally accomplished within a short time period. In contrast, the financing activity often involves (1) the sale of special assessment bonds so that their proceeds can be used for construction expenditures, (2) the levying of special assessments against the property owners benefited by the capital project, and (3) the subsequent collection of special assessments, with these proceeds used to retire the special assessment bonds. This activity is typically conducted over a much longer time period than the construction activity.

Service assessments include such services of a governmental unit as snow plowing, street lighting, and tree planting. These types of services are often normal activities of that unit and are provided without charge to the unit's residents. That unit may also provide these services, but on a fee basis, to users living outside the usual service area or to those living within that area but utilizing the service on a more frequent interval than normal. These fees charged represent the service assessments levied on these various users.

While the assessments against benefiting property owners generally represent the primary source for repayment of special assessment debt, the governmental unit may also have differing degrees of responsibility toward that debt. In some instances, the governmental unit might have direct responsibility for a portion of the debt, either because the improvement is a public benefit or because the unit is a property owner who benefits from the improvement.

Aside from the above, the unit may also have other types of liability for special assessment debt in the event of default by the property owners. For example, the unit may pledge its full faith and credit as security for the special assessment bonds, in which case a legal liability actually exists. In other instances the governmental unit may make a general commitment to back some or all of the bond issue, thereby assuming a secondary liability on the debt. At other times the government may have no liability at all and would not have to repay the debt should the property owner default. The GASB analyzed these different positions in which a governmental unit may find itself in determining what standards should be adopted in accounting for special assessments.

NEW ACCOUNTING STANDARDS

This section of the paper details the new accounting and financial reporting requirements of GASB Statement No. 6. The reasoning behind the Board's conclusions is also discussed as well as the changes from the Board's earlier Exposure Draft.

Services

Special assessments for operating services provided to the public, such as snow plowing, should be reported in the fund that best reflects the nature of the transaction. Usually these services will be accounted for in the general fund, in a special revenue fund, or in an enterprise fund. Special assessment revenues and expenditures should be budgeted and accounted for using the same basis of accounting as that normally used by that particular fund.

Thus, the GASB decided that service assessments revenue should be recorded like user fees. While admitting that service-type assessments are often billed and collected like property taxes, the GASB contends that the charge is more in the nature of a user fee. This is because assessed amounts are normally based on the expenditures required to provide the services. Like user fees, there is a more direct exchange relationship for service-type assessments than for services financed by general property taxes.

Capital Improvements - Related Debt

If government *is* obligated in any manner for payment of debt service should property owners default (as discussed in the previous section), transactions of the debt service phase should be reported in the debt service fund, and the debt itself is shown in the long-term obligations account group. When levied, special assessments receivable should be recorded in the debt service fund and be offset by deferred revenue. As assessments become measurable and available, deferred revenue should be reduced. Construction phase transactions should be reported in the capital projects fund. Fixed assets other than those of an enterprise fund should be reported in the general fixed asset account group in accordance with the entity's capitalization policy. A comparison between the previous method of accounting for special assessments and the new requirement is shown later in this article.

In the Exposure Draft, the Board did not provide for receivable recognition in the debt service fund for unbilled special assessment levies. The reasoning was that the long-term receivable in the debt service fund and an amount to be provided in the General Long Term Obligations Account Group was "double counting." Many respondents disagreed, arguing that special assessments receivable are a valid asset. In addition, the respondents pointed to the Board's proposed inconsistent treatment of reporting special assessment receivable as a fund asset when existing resources are used to finance construction but not reporting the receivable when debt proceeds were used. The Board reconsidered its position and concluded that special assessments receivable should be recognized. The benefits of consistent asset recognition outweighed the perceived double counting of the receivable and the amount to be provided.

Capital Improvements - Government NOT Obligated

In contrast, debt service for which *no* government has an obligation is to be accounted for in an agency fund, not in a debt service fund. This treatment reflects the government's role as an agent for the assessed property owners and creditors. In the agency fund, amounts received from property owners are shown as both assets (cash) and liabilities (amount held for debt service). Since the governmental unit has no obligation for payment of the debt, the special assessment bonds are excluded from that unit's financial statements.

The construction phase of the transaction should be reported in the capital projects fund in the same manner as when the governmental unit is obligated. The GASB advised that the source of funds in the capital projects fund be identified specifically (such as "contribution from property owners") and not just be labeled "bond proceeds." The fixed assets acquired should be reported in the general fixed asset account group in accordance with normal capitalization policies.

Special Assessment Financing with Existing Government Resources

If, instead of using debt, an improvement is financed with existing resources, a direct capital expenditure or a transfer to a capital projects fund is to be reported. When levied, special assessments receivable equal to the amount of the levy and deferred revenue in the amount not measurable and available should be recognized in the fund providing the resources.

This treatment contrasts with that proposed in the Exposure Draft, which advocated recognizing as revenue the full amount of the levy in the fund that provided the resources. The original belief by the FASB was that a lien on the special assessment properties justified the recognition of the receivable and that the corresponding recognition of revenue for the full amount of the receivable was justified to offset the outlay to the capital projects fund for the construction activity. This change to recording deferred revenue was primarily made to conform to the normal revenue recognition criteria of availability and measurability used for all governmental funds.

Special Assessment and Enterprise Funds

The provisions under *Capital Improvements - Related Debt* should be followed even when the improvements financed by special assessments provide capital assets to a government's enterprise fund. However, the cost of the improvements should be capitalized on the enterprise fund's balance sheet and be offset by contributed capital (net of resources provided by the enterprise fund for construction). The GASB took this position even though a majority of respondents to the Discussion Memorandum and some of the respondents to the Exposure Draft argued that *all* transactions and balances (e.g., project cash, receivables, and related debt) for capital improvements providing fixed assets to an enterprise fund should be reported within the enterprise fund receiving the benefits of those assets. The Board contends that this position represents an inflexible requirement that would often result in fragmented reporting and excessive accounting adjustments and allocations. The Board believes that its treatment offers a more flexible standard that is adaptable to the different situations that exist in each state.

Special Assessment Districts as Units

This area, not covered in the Exposure Draft, was added in response to questions regarding the method of reporting the accounts, including the debt, of a special assessment district in a larger reporting entity. The Board decided that the criteria governing the entity defintion should be used. Therefore, the accounts of special assessment districts that constitute component units, including special assessment debt for which government *is* obligated, are to be included in the reporting entity in accordance with Codification Section 2600, "Reporting Entity and Component Unit Presentation and Disclosure." This manner of reporting should be followed even though the oversight unit may have no obligation for the debt.

The Board noted that some members find it inconsistent to exclude some special assessment debt where the entity is not obligated but to include the debt if property owners are organized as a special assessment district constituting a component unit. On the other hand, the Board recognized that there are other situations where the debt of the component unit is included in the entity's financial statements even though the oversight unit has no obligation. The Board would like these issues resolved as part of its project on the governmental financial reporting entity. At the present time, however, a majority of Board members believes that, as long as the special assessment district is obligated for the debt and the district meets the criteria for inclusion in the reporting entity, the reporting entity presentation of Codification Section 2600 fairly presents the special assessment debt of the reporting entity.

Required Disclosures

The notes to the financial statements should disclose general government obligation for special assessment debt as required in Codification Section 2300, "Notes to the Financial Statements," as it applies to long-term debt. In addition, the notes should describe the nature of the government's obligation and any guarantees, reserves, or sinking funds that have been set up to cover property owner defaults. If delinquent special assessments receivable are not identified directly on the financial statements, the delinquent amount should be disclosed in the notes to these statements.

The footnotes should also disclose the amount of any special assessment for which the general government has no obligation. The notes clearly indicate that the government is merely acting as an agent for the property owners and is not itself liable for debt repayment.

If a comprehensive annual financial report (CAFR) is prepared, the statistical section should include a schedule of special assessment billings and collections for the last ten fiscal years if the general government is obligated for special assessment debt.

Effective Date of the Statement

The accounting and financial reporting standards of Statement No. 6 are effective for periods beginning after June 15, 1987, although the Board urged an earlier application of these standards. If possible, a retroactive application of any accounting changes to conform to the provisions of this Statement is specified, to be accomplished by restating the financial statements for all prior periods presented. Footnotes to the financial statements in the year that Statement No. 6 is first applied should disclose the nature and effect of restatement. If prior periods are not restated, the reasons for not doing so should be explained.

ILLUSTRATION OF NEW REPORTING REQUIREMENTS

The differences in financial reporting between the old and the new requirements for a capital improvement assessment for which the governmental unit has either directly or secondarily assumed liability are shown in Table 1 (for the Balance Sheet) and Table 2 (for the Statement of Revenues, Expenditures, and Changes in Fund Balance). The most obvious difference between these two requirements is the replacement of the special assessment fund with a capital projects fund, a debt service fund, and the general long-term obligations account group.

TABLE 1

	Current Practice		Revised Standards			
	Special Assessment Fund	GFAAG*	Capital Projects Fund	Debt Service Fund	GLTOAG	GFAAG*
BALANCE SHEET						
Assets						
Cash	304,000		300,000	4,000		
Special Assessment Receivables--Deferred	400,000			400,000		
Construction in Progress		350,000				350,000
Amount to be Provided to Retire Special Assessment Bonds					400,000	
Total Assets	704,000	350,000	300,000	400,000	400,000	350,000
Liabilities and Fund Equity						
Contracts Payable	50,000		50,000			
Special Assessment Bonds Payable	400,000					
Deferred Revenues	400,000			400,000		
Special Assessment Debt with Government Commitment					400,000	
Fund Balance (Deficiency)	(146,000)		250,000	4,000		
Investment in General Fixed Assets		350,000				350,000
Total Liabilities, Fund Equity	704,000	350,000	250,000	404,000	400,000	350,000

*Use of the General Fixed Asset Account Group is optional.

TABLE 2

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE	Current Practice	Revised Standards	
	Special Assessment Fund	Capital Projects Funds	Debt Service Fund
Revenues			
Special Assessments	100,000	100,000	
Interest on Special Assessments	20,000	______	
Total Revenues	120,000	100,000	20,000
Expenditures			
Capital Outlay	350,000	350,000	
Interest (debt Service)	16,000	______	16,000
Total Expenditures	366,000	350,000	16,000
Excess of Revenues Over (Under) Expenditures	(246,000)	(250,000)	4,000
Other Financing Sources			
Operating Transfer from General Fund	100,000	100,000	
Proceeds from Special Assessment Bonds	______	400,000	______
Total Other Financing Sources	100,000	500,000	0
Excess of Revenues and Other Financing Sources Less Expenditures	(146,000)	250,000	4,000
Fund Balance--Beginning	0	0	0
Fund Balance--Ending	(146,000)	250,000	4,000

Assumptions regarding above illustrations:

1. Resources for construction included (a) $100,000 operating transfer from the General Fund, (b) $400,000 special assessment bonds, and (c) $100,000 from the initial special assessment of property owners.
2. Contract price for construction is $595,000; at year-end $350,000 had been billed and $300,000 had been paid.
3. Interest income and expense are collected and paid at the same time; therefore, the modified accrual basis of accounting is appropriate.

The capital projects fund is used for all activities relating to construction. The proceeds from the sale of the special assessment bonds and operating transfers for other governmental funds are both shown on the Statement of Revenues, Expenditures, and Changes in Fund Balance as "Other Financing Sources." The initial assessment of property owners benefited by the improvement is recorded as revenue (assuming that the proceeds from this original installment are used for construction-related expenditures). Accounting for the expenditures remains unchanged.

The debt service fund is used for all financing aspects of the capital project. The primary change involves the recording of assessments to be collected after the first year as both a receivable and a deferred revenue on that fund's balance sheet. As these assessments and related interest are collected, these items are recognized as revenues. Payments for interest expense and retirement of principal for special assessment bonds are now reported in this fund in the same manner as all other interest expenditures and principal retirements.

The general long-term obligations account group previously included only debt for which the governmental unit had a direct obligation (usually general obligation bonds). This account group now includes special assessment bonds for which the unit has either direct or secondary obligation for their repayment.

It must again be emphasized that the above reporting for special assessment activity is consistent with all state laws, even those requiring separate accounting for special assessment activity. As the GASB concluded, a separate type of fund used exclusively for special assessments was unnecessary; requirements for separate accounts are met through the use of individual capital projects and debt service funds for each special assessment project.

CONCLUSION

GASB Statement No. 6, "Accounting and Financial Reporting for Special Assessments," eliminates the special assessment fund type for financial reporting purposes for periods beginning after June 15, 1987. The Statement discusses the accounting and financial reporting for services and capital improvements that are financed in whole or in part by special assessments paid by the property owners receiving the services or benefiting from the capital improvements. With respect to capital improvements, the Statement distinguishes between projects for which general government is obligated for payment of the debt should property owners default and those for which the general government has no obligation for the related debt service.

REFERENCES

1. Governmental Accounting Standards Board. "Accounting and Financial Reporting for Special Assessments (Discussion Memorandum)." Stamford, Connecticut: Governmental Accounting Standards Board, October, 1985.
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4. National Council on Governmental Accounting. "Governmental Accounting and Financial Reporting Principles (Statement No. 1)." Chicago, Illinois: National Council on Governmental Accounting, 1979.