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**Statement of
Position**

80-2

**Accounting and
Financial Reporting
by Governmental Units**

June 30, 1980

**Amendment to
AICPA Industry Audit Guide
*Audits of State and Local
Governmental Units***

**Issued by
Accounting Standards Division
American Institute of
Certified Public Accountants**

AICPA

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NOTE

The American Institute of Certified Public Accountants has issued an industry audit guide, *Audits of State and Local Governmental Units* (1974), that presents recommendations on auditing procedures and auditors' reports and on accounting principles. This statement of position has been prepared to revise or clarify certain of the recommendations in that guide. This statement of position represents the considered judgment of the AICPA Committee on State and Local Government Accounting.

To the extent that this statement of position is concerned with auditing procedures and auditors' reports, its degree of authority is the same as that of the 1974 guide. With regard to such matters, members should be aware that they may be called upon to justify departures from the recommendations of the committee.

To the extent that this statement of position relates to standards of financial accounting or reporting (accounting principles), the recommendations of the committee are subject to ultimate disposition by the body responsible for setting standards for financial accounting and reporting by state and local governmental units.

Accounting and Financial Reporting by Governmental Units

An Amendment to Industry Audit Guide *Audits of State and Local Governmental Units*

Background

1. The 1974 AICPA industry audit guide, *Audits of State and Local Governmental Units*, acknowledged *Governmental Accounting, Auditing, and Financial Reporting* (GAAFR), a 1968 publication of the National Committee on Governmental Accounting (NCGA), as an authoritative source in the area of accounting for state and local governmental units. The guide (p. 9) states, "GAAFR's principles do not represent a complete and separate body of accounting principles, but rather are a part of the whole body of generally accepted accounting principles which deal specifically with governmental units. Except as modified in this guide, they constitute generally accepted accounting principles."

2. In March 1979 the NCGA (now known as the National Council on Governmental Accounting) published a document entitled *Governmental Accounting and Financial Reporting Principles* (Statement 1). That document specifies that the basic general purpose financial statements of the governmental unit as a whole are combined financial statements by fund types and account groups rather than financial statements of individual funds and account groups. It also updates, clarifies, amplifies, and reorders other portions of GAAFR. Since the guide recognizes GAAFR, it is necessary to amend the guide to recognize Statement 1 as an authoritative modification of GAAFR.¹

¹NCGA Statement 2, *Grant, Entitlement, and Shared Revenue Accounting and Reporting by State and Local Governments*, was also issued in March 1979 and is consistent with the AICPA industry audit guide.

Recommendation

3. The AICPA Committee on State and Local Government Accounting recommends that *Audits of State and Local Governmental Units* be amended throughout to refer to Statement 1 rather than GAAFR. Accordingly, financial statements presented in accordance with Statement 1 are in conformity with generally accepted accounting principles. The following paragraphs amplify that conclusion and explain its implementation with respect to the auditor's standard report.

4. The following are the basic general purpose financial statements (GPFS) for a state or local governmental unit:

- a. Combined balance sheet: all fund types and account groups.
- b. Combined statement of revenues, expenditures, and changes in fund balances: all governmental fund types.
- c. Combined statement of revenues, expenditures, and changes in fund balances—budget and actual: general and special revenue fund types (and similar governmental fund types for which annual budgets have been legally adopted).
- d. Combined statement of revenues, expenses, and changes in retained earnings (or equity): all proprietary fund types.
- e. Combined statement of changes in financial position: all proprietary fund types.
- f. Notes to the financial statements.

(Trust fund operations may be reported in statements *b*, *d*, and *e* as appropriate, or separately.)

These financial statements, referred to collectively as the combined financial statements, are discussed and illustrated in Statement 1.

5. Accounting and reporting of encumbrances should follow the approach recommended in Statement 1: Encumbrances outstanding at year-end should not be reported as expenditures or liabilities. The budgetary comparison statement (paragraph 4 *c*), however, should present comparisons of the legally adopted budget with actual data on the budgetary basis, which may include encumbrances or other differences from generally accepted accounting principles.

6. The type of report that the auditor can issue depends on the financial statements that a governmental unit presents and on the scope of the examination. The combined financial statements listed in paragraph 4 are required for conformity with generally accepted accounting principles, and the auditor should report on those statements, as discussed in paragraph 7. In addition to the combined financial statements, a governmental unit may also issue combining, individual fund, and account group financial statements and supporting schedules, most likely for inclusion in a comprehensive annual financial report, as described in Statement 1 (pp. 19–20). The auditor's reports on such presentations are described in paragraphs 8 and 9. Paragraphs 10 through 13 describe the auditor's reports to be used if governmental units present other types of financial statements.

7. If the auditor is engaged to examine the combined financial statements and the governmental unit presents only combined financial statements, the auditor should express an opinion on the financial position of the governmental unit, the results of its operations, and the changes in financial position of its proprietary fund types (see Appendix A). In these circumstances, because Statement 1 requires fund accounting (p. 2) and disclosures related to individual funds and account groups (pp. 5, 6, and 24), the scope of the auditor's examination of the combined financial statements ordinarily would include application of auditing procedures related to individual fund and account group financial data.

8. If the auditor is engaged to examine the combined financial statements and the governmental unit also presents combining, individual fund, and account group financial statements and supporting schedules, the auditor should follow the guidance in SAS No. 29, *Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents*. Accordingly, the auditor's report should state whether the combining, individual fund, and account group financial statements and supporting schedules are stated fairly in all material respects in relation to the combined financial statements taken as a whole (see Appendix B), and the auditor should be satisfied that the combining, individual fund, and account group financial statements and supporting schedules are suitably titled. As explained in paragraph 7, the scope of the auditor's examination of the combined financial

statements ordinarily would include application of auditing procedures to individual fund and account group data, and the auditor would be in a position to express such an opinion.

9. If the auditor is engaged to examine both the combined financial statements and the combining, individual fund, and account group financial statements, his opinion should include both presentations. Ordinarily, in such circumstances the auditor will need to expand the auditing procedures that would otherwise be applied to the combining, individual fund, and account group financial statements. If supporting schedules accompany these financial statements, the auditor's report should state whether the information in the schedules is stated fairly in all material respects in relation to the financial statements taken as a whole (see Appendix C) or should disclaim an opinion on that information.

10. If financial statements for fund types, funds, or account groups that should be included in the combined financial statements (such as the general fixed assets account group or an enterprise fund) are omitted, the auditor should consider the need to express a qualified opinion (see Appendix D) or an adverse opinion because of departure from generally accepted accounting principles (see SAS No. 2, paragraphs 15 through 17). The auditor's report should include an explanatory paragraph that either describes the omitted fund types, funds, or account groups or, preferably, refers to a note that describes those matters.

11. If all material individual funds and account groups are presented but the governmental unit does not present combined financial statements, the auditor should express an adverse opinion on the financial position of the governmental unit, the results of its operations, and the changes in financial position of its proprietary fund types. However, the auditor may also express an unqualified opinion on the individual fund and account group financial statements (see Appendix E).

12. The auditor may be engaged to examine financial statements of only a specified enterprise fund and may express an opinion on whether those financial statements are prepared in conformity with generally accepted accounting principles (see Appendix F). A similar report would also be appropriate for a fund of

another type (except for the general fund) or an account group. If the financial statements of only the general fund are presented, the auditor should follow the guidance in paragraph 13.

13. If an auditor is engaged to examine the financial statements of the general fund or the financial statements of more than one fund or account group that are not intended to present fairly the financial position of the governmental unit taken as a whole, results of its operations, or changes in financial position of its proprietary fund types in conformity with generally accepted accounting principles, the auditor's report should be in the form indicated in Appendix F and should include a middle paragraph such as the following:

As described more fully in Note _____, the financial statements presented are only for the funds and account groups referred to above and are not intended to present fairly the financial position of the City of Example, Any State, at December 31, 19X2, or the results of its operations and the changes in the financial position of its proprietary fund types for the year then ended, in conformity with generally accepted accounting principles.

14. Combined financial statements of fund types and account groups may have a "total" column that aggregates the columnar statements by fund type and account group. If a total column is shown, it should be captioned "Memorandum Only" because the total column on a combined financial statement is not comparable to a consolidation. A note to the financial statements should disclose the nature of the column and should explain that it does not present consolidated financial information.

15. The provisions of this statement of position should be adopted for years ending on or after July 1, 1980. Early adoption is encouraged. If these recommendations are adopted early, conformity with principles in Statement 1 should be disclosed.

16. Statement 1 (p. 26) states, "Adjustments resulting from a change to comply with these principles should be treated as adjustments of prior periods, and financial statements presented for the periods affected should be restated." Thus, accounting changes for governmental funds that are required to comply with Statement 1 principles—such as accrual of property taxes, a change in report-

ing encumbrances, or presentation of financial statements of a different reporting entity (such as a fund not previously included in the financial statements)—should be reported by restatement of the financial statements for all prior periods presented. The auditor should refer to SAS no. 1, section 546, for guidance on reporting on a change in accounting principle. Statement 1 does not change proprietary fund accounting principles.

APPENDIX A

Auditor's Report: Unqualified Opinion on Combined Financial Statements

We have examined the combined financial statements of the City of Example, Any State, as of and for the year ended December 31, 19X2, as listed in the table of contents. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the combined financial statements referred to above present fairly the financial position of the City of Example, Any State, at December 31, 19X2, and the results of its operations and the changes in financial position of its proprietary fund types for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

APPENDIX B

Auditor's Report: Unqualified Opinion on Combined Financial Statements Presented With Combining, Individual Fund, and Account Group Financial Statements and Supporting Schedules

We have examined the combined financial statements of the City of Example, Any State, as of and for the year ended December 31, 19X2, as listed in the table of contents. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the combined financial statements referred to above present fairly the financial position of the City of Example, Any State, at December 31, 19X2, and the results of its operations and the changes in financial position of its proprietary fund types for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Our examination was made for the purpose of forming an opinion on the combined financial statements taken as a whole. The combining, individual fund, and account group financial statements and schedules listed in the table of contents are presented for purposes of additional analysis and are not a required part of the combined financial statements of the City of Example, Any State. The information has been subjected to the auditing procedures applied in the examination of the combined financial statements and, in our opinion, is fairly stated in all material respects in relation to the combined financial statements taken as a whole.

APPENDIX C

Auditor's Report: Unqualified Opinion on Combined Financial Statements and Combining, Individual Fund, and Account Group Financial Statements Presented With Supporting Schedules

We have examined the combined financial statements of the City of Example, Any State, and the combining, individual fund, and account group financial statements of the city as of and for the year ended December 31, 19X2, as listed in the table of contents. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the combined financial statements referred to above present fairly the financial position of the City of Example, Any State, at December 31, 19X2, and the results of its operations and the changes in financial position of its proprietary fund types for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. Also, in our opinion, the combining, individual fund, and account group financial statements referred to above present fairly the financial position of the individual funds and account groups of the City of Example, Any State, at December 31, 19X2, and the results of operations of such funds and the changes in financial position of individual proprietary funds for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Our examination was made for the purpose of forming an opinion on the combined financial statements taken as a whole and on the combining, individual fund, and account group financial statements. The accompanying financial information listed as supporting schedules in the table of contents is presented for purposes of additional analysis and is not a required part of the combined financial statements of the City of Example, Any State. The information has been subjected to the auditing procedures applied in the examination of the combined, combining, individual fund, and account group financial statements and, in our opinion, is fairly stated in all material respects in relation to the combined financial statements taken as a whole.

APPENDIX D

Auditor's Report: Qualified Opinion on Combined Financial Statements (One or More Fund Types, Funds, or Account Group Financial Statements Omitted)

We have examined the combined financial statements of the City of Example, Any State, as of and for the year ended December 31, 19X2, as listed in the table of contents. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As described more fully in Note ____, the combined financial statements referred to above do not include financial statements of the [identify fund types, funds, or account groups omitted], which should be included to conform with generally accepted accounting principles.

In our opinion, except that the omission of the financial statements described above results in an incomplete presentation, as explained in the preceding paragraph, the combined financial statements referred to above present fairly the financial position of the City of Example, Any State, at December 31, 19X2, and the results of its operations and the changes in financial position of its proprietary fund types for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

APPENDIX E

Auditor's Report: Adverse Opinion (Omission of Combined Financial Statements) With an Unqualified Opinion on the Individual Fund and Account Group Financial Statements

We have examined the financial statements of the individual funds and account groups of the City of Example, Any State, as of and for the year ended December 31, 19X2, as listed in the table of contents. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The city has not prepared combined financial statements that show the financial position of the City of Example, Any State, at December 31, 19X2, and the results of its operations and the changes in financial position of its proprietary fund types for the year then ended, as required by generally accepted accounting principles. Thus, in our opinion, the financial statements listed in the table of contents do not present fairly the financial position of the City of Example, Any State, at December 31, 19X2, or the results of its operations and the changes in financial position of its proprietary fund types for the year then ended, in conformity with generally accepted accounting principles.

In our opinion, however, the financial statements listed in the table of contents present fairly the financial position of the individual funds and account groups of the City of Example, Any State, at December 31, 19X2, and the results of operations of such funds and the changes in financial position of individual proprietary funds for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

APPENDIX F

Auditor's Report: Unqualified Opinion on an Enterprise Fund's Financial Statements

We have examined the financial statements of the [identify enterprise fund] of the City of Example, Any State, as of and for the year ended December 31, 19X2, as listed in the table of contents. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of the [identify enterprise fund] of the City of Example, Any State, at December 31, 19X2, and the results of its operations and the changes in its financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

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The division gratefully acknowledges the contribution made to the development of this statement of position by past members of the AICPA Committee on State and Local Government Accounting (1978–1979):

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