

SPECIAL PURPOSE REPORTING (MODIFIED CASH BASIS) VERSUS GAAP REPORTING

All financial statements are prepared in accordance with a ***financial reporting framework***. A financial reporting framework is defined as a set of criteria used to determine measurement, recognition, presentation, and disclosure of all material items appearing in the financial statements, for example, U.S. GAAP or a special purpose framework.

Financial reporting frameworks determine both the form and content of financial statements and are generally classified in professional standards as either general purpose frameworks or special purpose frameworks.

Simply stated, financial statements prepared in accordance with GAAP are considered financial statements prepared in accordance with a general-purpose framework and are referred to as general purpose financial statements.

Financial statements prepared in accordance with a special purpose framework are referred to as special purpose financial statements.

The term financial statements means a complete set of financial statements, including the related notes. A complete set of financial statements is intended to present both financial position and changes in financial position. The form and content of special purpose financial statements and what constitutes a complete set of financial statements is determined by the applicable financial reporting framework. For special purpose financial statements of state or local governments, the most commonly used financial reporting framework is the cash basis (including modifications as chosen and applied by management or those charged with governance that are acceptable in view of the nature of the entity and the objective of the financial statements).

Reasons for Application of Special Purpose Frameworks in the Financial Statements of State and Local Governments

Why is the use of special purpose frameworks so prevalent in small state and local governmental entities?

Special purpose framework accounting and financial statement alternatives, if properly applied, may offer some benefits to certain government financial statement preparers and users, including the following:

- Special purpose framework accounting records may be easier to understand and maintain. In many small governments, the accounting and finance personnel responsible for maintaining the accounting records lack the necessary skills, knowledge, and experience to maintain the records on a GAAP basis. Cash basis accounting records may be easier for them to understand and maintain.
- Special purpose financial statements may be easier to prepare. As with the maintenance of accounting records, special purpose financial statements are often easier to prepare than GAAP basis financial statements. The relatively complex reconciliation in state and local government GAAP-basis statements between the government-wide and fund financial statements may not apply as frequently to special purpose financial statements.

- Special purpose framework accounting and financial reporting may be less costly than GAAP. Most small governments have significant limitations on resources and experience dramatic competition for the allocation of such resources. Therefore, resources allocated to accounting, financial reporting, and auditing may not be sufficient to maintain GAAP basis accounting records and to prepare and audit GAAP basis financial statements.
- Special purpose financial statements may be more understandable and usable by some government officials. Many governments prepare their annual budgets using special purpose frameworks (such as a cash basis). As a result, for these governments, the internal accounting records and interim reports focus more on the basis of accounting used for budgetary accounting, reporting, and monitoring than on measuring the complete economic financial condition and results of operations. In addition, most elected officials and government managers and administrators might not be sufficiently trained to understand and effectively use GAAP basis financial statements.

Limitations of Special Purpose Financial Statements

Although the use of a special purpose framework may be an acceptable financial reporting framework in specific circumstances, may meet the needs of intended financial statement users, and may offer some benefits to certain governmental entities compared with the use of GAAP, special purpose framework accounting and financial reporting also has its limitations, including the following:

- Special purpose financial statements are not intended to be a comprehensive measure of the government's complete economic financial condition and changes therein. Cash basis financial statements report only certain financial statement elements that are applicable to the special purpose framework applied. As a result, they are limited to only reporting revenues and expenditures or expenses and related assets and liabilities when the transactions meet the timing requirements or limitations of that framework. Consequently, special purpose financial statements are not intended to be a comprehensive measure of a government's complete economic condition and changes therein.
- Special purpose financial statements may not meet the needs of all potential users. Because special purpose financial statements do not report all assets, deferred outflows, liabilities, deferred inflows of resources, inflows (such as revenues), and outflows (such as expenditures or expenses) of the government, certain potential financial statement users, such as investors, creditors, and credit rating agencies, may not readily receive the information they need to evaluate the creditworthiness of the government (that is, the ability of the government to pay short-term and long-term obligations as they become due).
- As the government competes with other governments that provide complete GAAP-basis financial information, the availability of only special purpose financial statements could affect the government's ability to borrow or could have a negative impact on debt ratings or interest rates on debt if lenders and rating agencies are unable to obtain their needed information through other means.
- Special purpose financial statements can make financial decision-making problematic. Government officials could inadvertently rely on financial information prepared in

accordance with a special purpose framework to make certain management or policy decisions that would be better made with GAAP financial information.

- Decision makers who rely on information prepared in accordance with a special purpose framework could make inappropriate funding or financing decisions because this information does not always include timely financial information on the complete economic financial condition, including certain long-term obligations of the government and complete results of operations.
- Special purpose framework financial condition and results can be more easily manipulated. Because the cash basis of accounting recognizes financial activity only when that activity results from cash receipt and disbursement transactions or events, cash basis financial results can be easily manipulated by speeding up or slowing down the receipt and disbursement of cash.

Most Common Modification to Cash Basis used in most South Dakota Counties:

The modified cash basis of accounting involves the measurement of cash and cash equivalents and changes in cash and cash equivalents resulting from cash receipt and disbursement transactions.

Under the modified cash basis of accounting, the statement of financial position reports only cash and cash equivalents (those investments with terms to maturity of 90 days (three months) or less at the date of acquisition).

Under the modified cash basis of accounting, transactions are recorded in the accounts when cash and/or cash equivalents are received or disbursed and assets and liabilities are recognized to the extent that cash has been received or disbursed.

The acceptable modification to the cash basis of accounting implemented by the County in these financial statements is:

Recording long-term investments in marketable securities (those with maturities more than 90-days (three months) from the date of acquisition) acquired with cash assets at cost.