



DEMYSTIFYING DEFERRALS

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INTRODUCTION

No aspect of governmental accounting may bewilder those working in the public sector more than deferred outflows of resources and deferred inflows of resources. The mere mention of “deferrals” seems to create a fog that envelops the minds of otherwise intelligent people, including experienced and knowledgeable auditors, government finance officers, and municipal bond analysts.

[Carr, Riggs & Ingram](#) (CRI) is clearing the air about deferrals because they are a unique and important aspect of state and local government accounting that financial statement preparers, auditors, and users need to comprehend. With that goal in mind, CRI has developed [a variety of free, plain-language resources](#) to help everyone, from the layperson to the experienced technician, better understand what deferrals are, where they came from, why they are important, and how they can be interpreted.

CRI designed this free ebook, *Demystifying Deferrals*, specifically for undergraduate and graduate courses covering governmental accounting and financial reporting in both accounting and public administration or public policy programs. However, it serves equally well as an easy way to access the full range of deferral resources CRI has made available to the public.

Demystifying Deferrals contains three informative plain-language articles about deferrals at different depths of discussion and from different perspectives:

- “Deferred Outflows and Deferred Inflows of Resources in a Nutshell” is perfect for the nonaccountant or anyone looking for a brief and easy-to-understand explanation of deferrals.
- “Demystifying Deferrals: What They Are, What They Mean, and Why They Are Important” is an in-depth—but still plain-language—exploration of the important role deferrals play in governmental accounting and the reasons they exist.
- “Deferrals from the Perspective of the User of Governmental Financial Statements” discusses deferrals in the context of how they fit into analyses of a government’s financial health and how they can inform decisions such as whether to buy a government’s bonds, how to vote on a school budget, where to locate a business, or where to buy a home.

Those articles connect with the other resources CRI has made available to help you understand deferrals, including a detailed video presentation, short videos on key deferrals issues, a slide deck covering the technical requirements for deferrals, slide decks for the webinar and videos, and a study guide. This ebook concludes with discussion questions and exercises for classroom use.

Whether you’re a government finance officer, citizen group member, elected official, college student, or taxpayer, you can find clarity surrounding deferrals with CRI’s expansive collection of resources and dedicated team of governmental accounting professionals.

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Deferred Outflows and Deferred Inflows of Resources in a Nutshell

Government finance operates under a unique set of principles and practices distinct from those in the private sector. One concept that often presents challenges, even to seasoned government accountants, is deferrals.

“Deferred Outflows and Deferred Inflows of Resources in a Nutshell” demystifies deferrals in easy-to-understand, plain language and is ideal for the interested layperson with little or no prior experience with government financial statements, as well as for the government finance professional looking for help explaining deferrals to their elected officials and constituents.

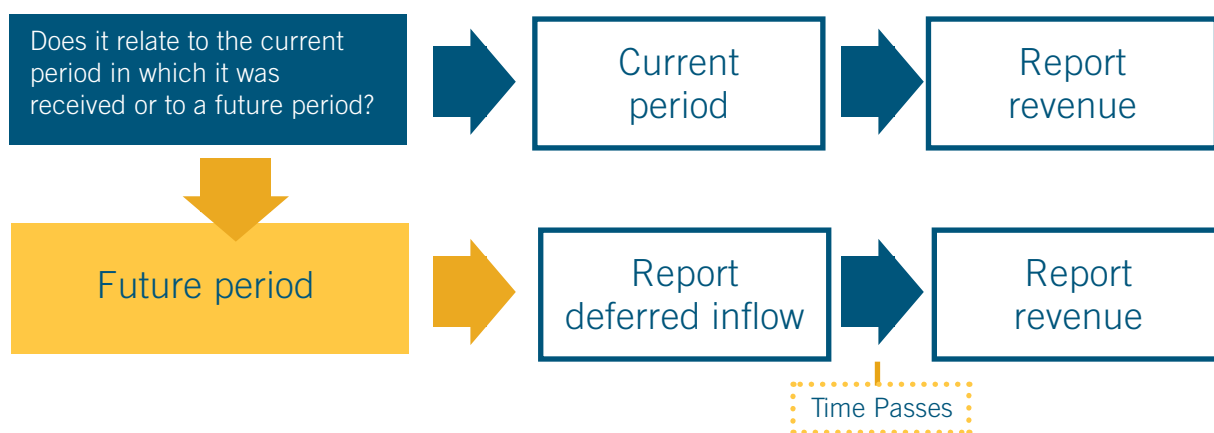
The financial statements of state and local governments contain two items not found in the financial statements of companies or not-for-profits: *deferred outflows of resources* and *deferred inflows of resources* (referred to together as deferrals). Deferrals are important to some of the unique aspects of government finance, but even some experienced government accountants have difficulty explaining them. A [recorded presentation](#) by CRI provides a plain-language explanation of what deferrals are, where they came from, and what they say about a government's finances. This article summarizes the most important points.

Confusion about Deferrals Begins with Their Name

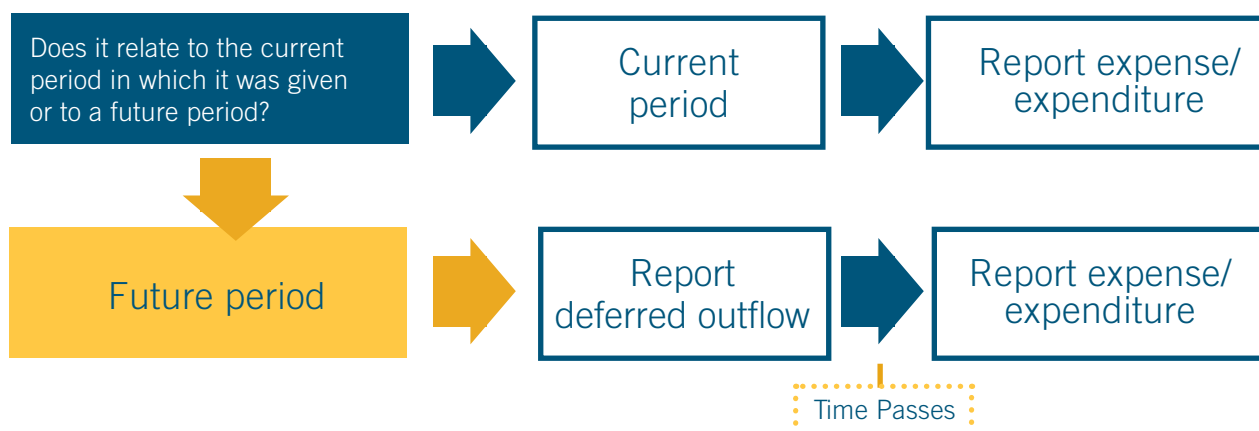
Part of the reason why some people are confused about what deferrals are stems from the name given to them by the [Governmental Accounting Standards Board \(GASB\)](#), the organization that establishes accounting and financial reporting rules for U.S. governments below the federal level. The names *deferred outflows* and *deferred inflows* suggest that the flow of resources into a government (such as cash receipts or accounts receivable) and out of a government (such as cash payments and accounts payable) will not happen until sometime in the future. But that is not the case.

When a government receives resources, it generally reports revenue in its income statement. When it provides resources, it generally reports expenses (or expenditures in its governmental funds). Occasionally, the resources a government receives or provides during the year are related to a future period. As a result, the government *defers* reporting revenues or expenses until that future period arrives. In other words, despite their name, deferred outflows and deferred inflows are not postponements of outflows and inflows of resources but, rather, *postponements of reporting them as expenses and revenues*, respectively.

Government *receives* cash or a promise to pay



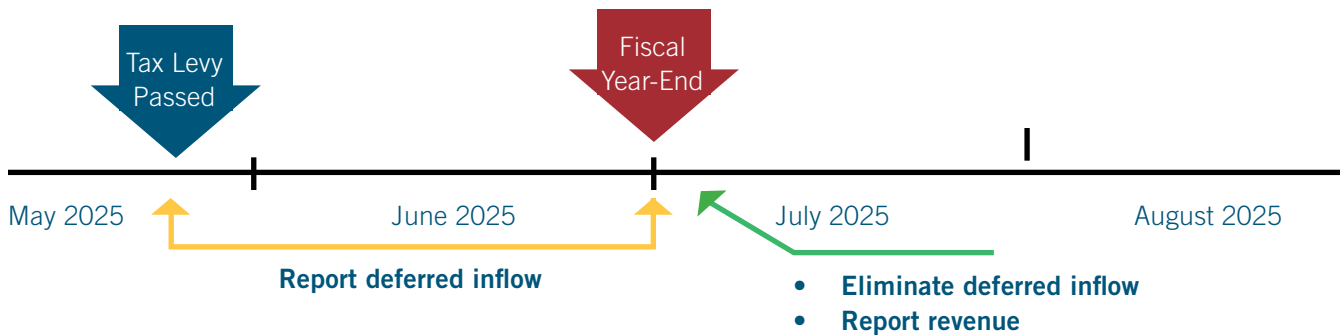
Government *gives* cash or a promise to pay



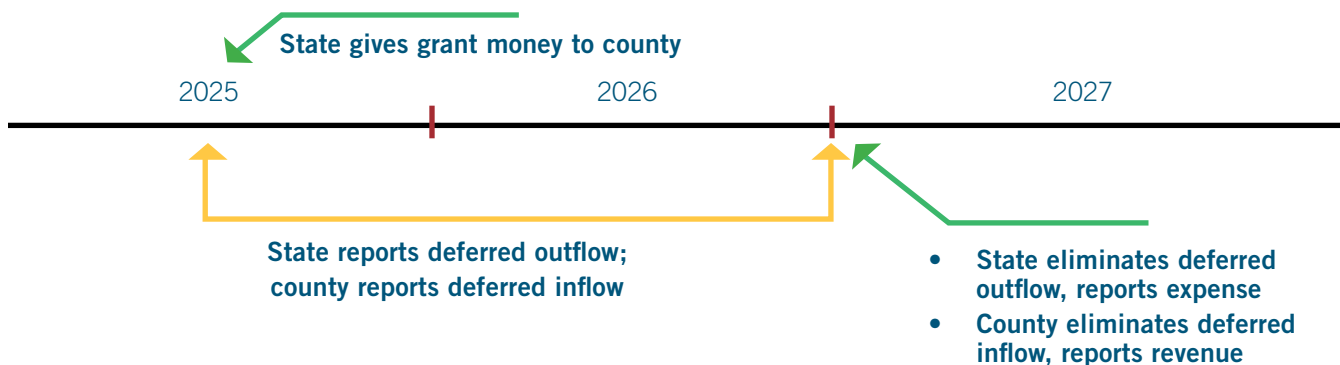
Common Examples of Deferrals

Consider a city with a fiscal year that ends on June 30. Each May, it adopts a budget and levies property taxes for the next fiscal year, starting July 1. Often, a government is legally entitled to property tax payments as soon as it levies the tax; GASB rules say that when a government is legally entitled to property tax payments, it should report the new property taxes it is owed as a receivable and revenue. However, in this case, the new property taxes are levied *for the next fiscal year*. Reporting them as revenue in the current year would overstate this year's revenue and understate next year's revenue.

Because those new property taxes are related to next year, the government should temporarily report them as a deferred inflow in its balance sheets. Then, when the next fiscal year begins on July 1, the government removes the deferred inflow and reports the property tax revenue in its income statements.



Another common example of a deferral relates to government grants with time restrictions. Most grants from the federal and state governments are not received until the grant recipient has met the grant program's eligibility requirements—usually by spending money on a specific service or program, such as policing or free school lunches—and subsequently applied for reimbursement. Imagine, though, that a county receives a state government grant in 2025 that it is not allowed to spend until 2027. If that grant has no eligibility requirements (or the county already has met the eligibility requirements), all the county has to do is wait until the time restriction expires before spending the money. The county temporarily reports the grant money received as a deferred inflow; when 2027 arrives, the county eliminates the deferral and reports the grant as revenue.



Consider the same example, but from the perspective of the state providing the time-restricted grant. Until 2027, the state reports the grant payment as a *deferred outflow*. When 2027 begins, the state eliminates the deferral and reports the grant as expense. That essentially is the mirror image of the way the county accounts for the transaction.

Why Deferrals Are Important

As those examples illustrate, deferrals can be used to ensure that governments report revenues and expenses in the proper years. That helps to meet an important objective of governmental financial statements—to provide the public with information for assessing *interperiod equity*. Stated differently, a reader of government financial statements should be able to tell whether a government is *living within its means* each year. There is a general expectation that governments should not spend more each year than they take in.

There are sometimes good reasons to pay for something over time. It may be financially prudent for a government to take out a loan to purchase new vehicles; since the vehicles will be used to provide services for several years, paying for them over several years may make sense. However, a government cannot routinely spend more than its income on recurring annual costs of operating and providing services without exhausting its savings, pushing today's costs onto future taxpayers, or accelerating future income to the present. All of those actions would deepen the government's financial problems.

In this regard, government finances are much like personal finances. If a person earns \$40,000 annually after taxes but spends \$50,000, how do they pay for the \$10,000 above and beyond their earnings? If they have savings, they might withdraw from their account. Or they might borrow the money by using a credit card. Neither option is limitless; eventually, the savings account will be emptied and the credit card will be maxed out if one continues to spend above their income. Furthermore, using up savings and borrowing increase one's cost of living because of the lost interest income on the savings and the interest charges on the outstanding credit card balance.

Reporting deferrals helps ensure that the appropriate revenues and expenses are reported each year, enabling the most accurate assessment of whether a government has balanced its checkbook, so to speak.

Where to Learn More about Deferrals

Intrigued by deferrals and want to learn more? CRI has developed several resources to help you explore further:

- A recorded presentation, [Demystifying Deferrals](#), is available online.
- [A longer article](#) covers similar ground as the webinar and contains links to shorter videos on the most important points.
- For government accountants, auditors, and others interested in the [technical side of deferrals](#), there is another slide deck that reviews all of the existing deferral requirements, identifies the relevant GASB requirements, and walks through their debits and credits.
- [A third plain-language article](#) looks at deferrals from the perspective of the financial statement reader, focusing on how deferrals can be interpreted to draw conclusions about a government's financial health.

You also can reach out to your [CRI advisor](#) at any time to get answers to your questions about deferrals.



Demystifying Deferrals:

What They Are, What They Mean, and Why They Are Important

State and local governments have their own body of accounting and financial reporting standards—established by the Governmental Accounting Standards Board (GASB)—separate from those for companies and nongovernmental not-for-profits (NFPs).

Many provisions of those two sets of standards are identical. However, the disparity is sometimes considerable when the generally accepted accounting principles established by the GASB differ from private-sector standards. There may be no better example of this than the GASB requirement to report deferred outflows of resources and deferred inflows of resources (together, deferrals), which are unique to governments.

To people familiar only with corporate or NFP financial statements, the appearance of deferrals in government financial statements is a strange new concept that they often need help understanding and that even experienced governmental accountants have trouble explaining. Deferrals do not have to be confusing. Though unfamiliar to some, deferrals are an essential aspect of governmental accounting and communicate important information about a government's financial health.

“Demystifying Deferrals: What They Are, What They Mean, and Why They Are Important” delves into the world of deferrals using clear, nontechnical language. It's packed with easy-to-understand text, helpful visual aids, and links to multimedia resources. This guide is equally valuable for accountants in government and CPA firms, accounting students, financially curious citizens, and anyone interested in understanding deferrals more deeply.

Introduction

State and local governments have their own body of accounting and financial reporting standards—established by the [Governmental Accounting Standards Board \(GASB\)](#)—separate from the standards established by the [Financial Accounting Standards Board \(FASB\)](#) for companies and nongovernmental not-for-profits (NFPs). Nevertheless, many provisions of those two sets of standards are identical. For instance, when an employee works and earns a salary, it results in the reporting of salaries payable and salaries expense no matter what type of entity the employer is.

When the generally accepted accounting principles (GAAP) established by the GASB and the FASB differ, the disparity is sometimes considerable. There may be no better example of this than the GASB requirement to report deferred outflows of resources and deferred inflows of resources (together, deferrals), which are unique to state and local governments.¹ To people familiar only with corporate or NFP financial statements, the appearance of deferrals in government financial statements is a strange new concept, one that they often have difficulty understanding and that even experienced governmental accountants have trouble explaining.

Deferrals do not have to be confusing. Though unfamiliar to some, deferrals are an essential aspect of governmental accounting and communicate important information about a government's financial health. This article, adapted from a [recorded presentation](#), is intended to help clear the fog that surrounds deferrals by explaining:

- What deferrals are and how they differ from other items in financial statements like assets and expenses
- How deferrals arrived in governmental financial statements in the first place
- Why deferrals are important
- What types of deferrals the GASB requires and how they are reported
- What deferral information says about a government's financial health

What Are Deferrals?

Like any other type of entity, governments prepare two types of financial statements:

- **Statements of Resource Flows:**
Sometimes called income statements or statements of revenue and expense, these statements report current-period inflows of resources (primarily revenues) and outflows of resources (primarily expenses).²
- **Statements of Financial Position:**
Sometimes called statements of net position, statements of net assets, or balance sheets, these statements report assets, liabilities, and the difference between them (which is called net assets, net equity, net position, or fund balance, depending on where you look).

This is where governmental accounting differs from the accounting requirements for other types of entities: Deferrals will get reported on the government's statement of financial position. Specifically, you'll see the following two categories of deferrals:

- A **deferred outflow of resources** is an outflow of resources that has occurred but is related to a future period, rather than the current period; therefore, a government postpones reporting it as an expense until that future period (i.e., the government *defers* it).
- A **deferred inflow of resources** is an inflow of resources that has occurred but is related to a future period, rather than the current period; therefore, a government postpones reporting it as revenue until that future period.

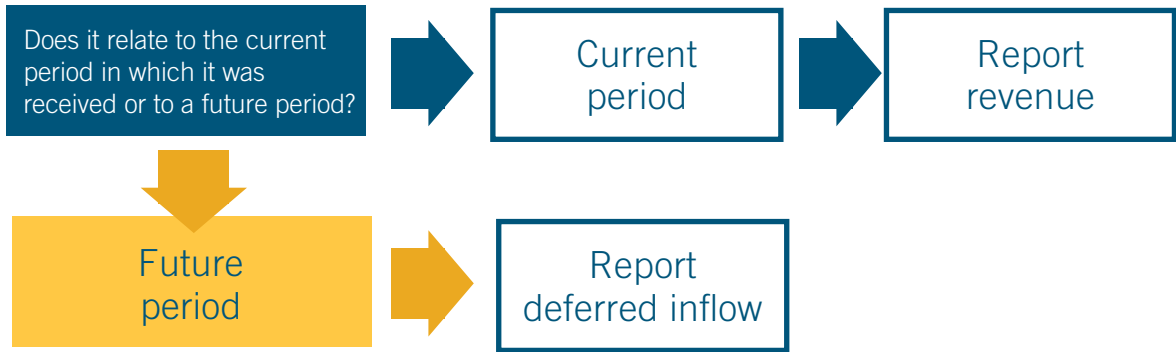
¹ Deferrals are not an aspect, however, of the standards established for the federal government by the Federal Accounting Standards Advisory Board (FASAB).

² For ease of reading, this document refers to all current-period outflows as expenses and all current-period inflows as revenue. In practice, current-period outflows in the governmental funds are reported as expenditures. In the fiduciary funds, the current-period inflows are reported as additions and the current-period outflows as deductions.

One source of the confusion surrounding deferrals is their names, which suggest that the outflows and inflows of resources will occur later. But, as the preceding definitions say, *the flows have already happened—it is the reporting of them as expense and revenue that will occur later.*

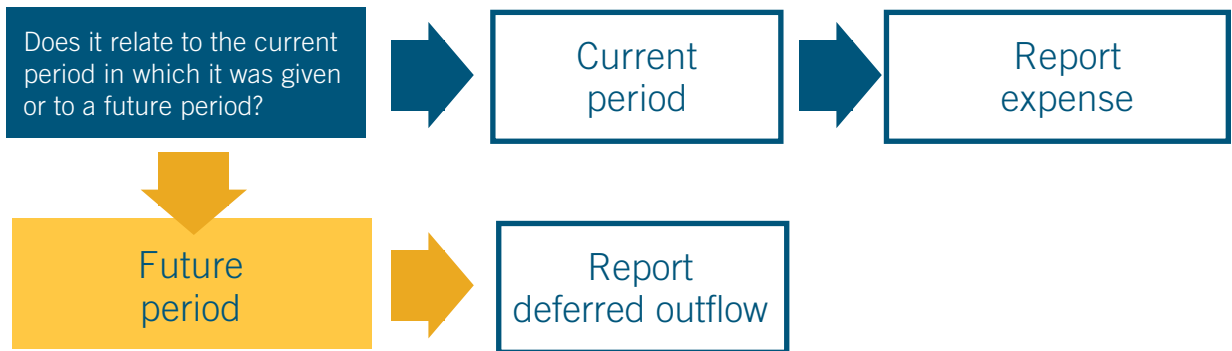
The vast majority of a government’s inflows and outflows of resources in any given year are related to that year and, therefore, the government reports them in the statements of resource flows³ as revenues and expenses. However, suppose a government receives an inflow of resources from a local business (such as cash or an account receivable) during the year, but those resources are related to a future year. In that case, the government reports a deferred inflow of resources in its statements of financial position⁴ until that future year arrives, at which time it reports the inflow as revenue.

Government *receives* cash or a promise to pay



Similarly, if a government provides an outflow of resources to a business (such as cash or a payable) during the year, but those resources are related to a future year, then the government reports a deferred outflow of resources in its statements of financial position until that future year arrives, at which time it reports the outflow as expense.

Government *gives* cash or a promise to pay



3 For governments, those are the government-wide statement of activities; governmental funds statement of revenues, expenditures, and changes in fund balances; proprietary funds statement of revenues, expenses, and changes in fund net position; and fiduciary funds statement of changes in fiduciary net position.

4 For governments, those are the government-wide statement of net position; governmental funds balance sheet; proprietary funds statement of fund net position; and fiduciary funds statement of fiduciary net position.

Where Did Deferrals Come From?

In the early 2000s, the GASB was working on definitions for the items reported in statements of financial position. As expected, it found assets and liabilities:

An **asset** is a resource that (1) a government controls at present and (2) has service capacity the government can use to provide service (e.g., a school building) or to support the provision of service (e.g., an office building that houses executive staff), or invest or sell the asset to produce income that pays for services.

A **liability** is an amount a government owes at present to another entity or individual, and it is certain or close to certain that the government must meet that obligation.

The GASB also found items in those financial statements that don't meet the definition of an asset or a liability. They don't have service capacity that can be used to provide service or to support the provision of service, and they can't be invested or sold. They also don't represent an amount that a government must pay to another party or satisfy by other means. Most of those items being reported as assets and liabilities were the things we now call deferrals.⁵ To paraphrase a character from a schlock horror film, "They have always lived among us."

As explained in the preceding section, deferrals look a lot like the items that are reported in the statements of resource flows:

An **outflow of resources** is a using up of a government's net assets (assets minus liabilities) that relates to the current period. These generally are reported as expenses or losses in the financial statements.

An **inflow of resources** is an acquisition of net assets that relates to the current period. These generally are reported as revenues or gains in the financial statements.

The key difference between an outflow reported as an expense and one reported as a deferral is that the former relates to the current period, and the latter applies to a future period (at which time it will become an expense). Likewise, the key difference between an inflow reported as a revenue and one reported as a deferral is that the former relates to the current period, and the latter to a future period (at which time it will become a revenue).

The GASB published its definitions in Concepts Statement No. 4, [Elements of Financial Statements](#), in 2007. The next year, it issued Statement No. 53, [Accounting and Financial Reporting for Derivative Instruments](#), the first pronouncement that required the reporting of deferrals. In 2010, the GASB issued Statement No. 60, [Accounting and Financial Reporting for Service Concession Arrangements](#) (SCAs), which also required deferrals. Governments preparing to implement those Statements faced a dilemma: The GASB's standards did not address how deferrals should be displayed on the face of the financial statements or disclosed in notes to financial statements. Furthermore, the items that the GASB identified as deferrals when developing Concepts Statement 4 were still being reported as assets and liabilities.

How Should Deferrals Be Reported?

The GASB dealt with how to display and disclose deferrals in Statement No. 63, [Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position](#):

- Governments are required to present deferred outflows separately after the assets. There must be separate totals for assets and deferred outflows.
- Governments are required to present deferred inflows separately after the liabilities. There must be separate totals for liabilities and deferred inflows.

Prior to Statement 63, governments reported the difference between assets and liabilities as net assets. However, when deferrals are added to the equation, the remaining amount reported is called *net position* (comparable to equity in corporate financial statements, but a government is not owned in the way that a company is). A government's statement of net position is arranged like the following equation:

Assets +
deferred outflows

—

Liabilities +
deferred inflows

=

Net position

⁵ Some of those items reported as assets and liabilities met the definition of a current-period inflow or outflow, such as the costs related to issuing debt, and are now reported as revenue or expense.

Figure 1

GOVERNMENT-WIDE STATEMENT OF NET POSITION

	Primary Government			
	Governmental Activities	Business-Type Activities	Total	Component Units
ASSETS				
Cash and cash equivalents	\$ 2,934,874	\$ 1,877,643	\$ 4,812,517	\$ 2,110,099
Investments	1,989,343	1,101,259	3,090,602	1,123,876
Receivables, net of allowances for uncollectibles				
Taxes receivable	3,909,221	-	3,909,221	-
Fees and charges receivable	283,420	2,098,745	2,382,165	3,189,230
Due from federal government	1,903,487	33,009	1,936,496	2,874,543
Due from state government	1,224,911	214,598	1,439,509	990,877
Other	454,333	11,002	465,335	101,822
Internal balances	(90,322)	90,322	-	-
Other assets	307,356	33,111	340,467	32,099
Restricted assets				
Restricted cash	1,128,001	787,832	1,915,833	773,214
Restricted investments	1,330,777	1,100,223	2,431,000	1,923,456
Capital assets				
Land and construction in progress	3,905,123	2,763,293	6,668,416	3,298,734
Buildings, equipment, and infrastructure, net of depreciation	13,893,202	8,900,356	22,793,558	7,324,564
Intangible right-to-use assets, net of amortization	334,556	450,008	784,564	112,344
Total capital assets	18,132,881	12,113,657	30,246,538	10,735,642
Total assets	\$ 33,508,282	\$ 19,461,401	\$ 52,969,683	\$ 23,854,858
DEFERRED OUTFLOWS OF RESOURCES				
	\$ 328,654	\$ 364,302	\$ 692,956	\$ 312,072
LIABILITIES				
Payables:				
Salaries payable	\$ 1,452,098	\$ 173,928	\$ 1,626,026	\$ 803,452
Accounts payable	1,139,283	982,343	2,121,626	1,330,293
Accrued interest payable	203,912	383,920	587,832	230,192
Due to other governments	93,451	-	93,451	78,324
Deposits and retainage payable	-	829,672	829,672	254,121
Liabilities payable from restricted assets	2,112,003	923,099	3,035,102	2,308,745
Noncurrent liabilities				
Due within one year	1,004,923	335,846	1,340,769	449,702
Due after one year				
Claims and judgments	209,444	90,332	299,776	138,030
Compensated absences	987,345	111,000	1,098,345	490,322
Leases payable	317,828	427,508	745,336	106,727
Net pension liability	4,987,453	809,342	5,796,795	1,109,342
Net other postemployment benefits liability	2,333,023	500,245	2,833,268	789,324
Bonds and notes	6,238,749	3,099,261	9,338,010	4,111,783
Total liabilities	\$ 21,079,512	\$ 8,666,495	\$ 29,746,007	\$ 12,200,357
DEFERRED INFLOWS OF RESOURCES				
	\$ 416,174	\$ 79,074	\$ 495,248	\$ 203,127
NET POSITION				
Net investment in capital assets	\$ 11,894,132	\$ 9,014,396	\$ 20,908,528	\$ 6,623,859
Restricted for:				
Debt service	107,320	33,090	140,410	77,319
Capital projects	134,099	45,122	179,221	32,335
Perpetual cemetery care	34,102	-	34,102	-
Other purposes	22,943	18,733	41,676	32,222
Unrestricted	148,654	1,968,792	2,117,446	4,997,712
Total net position	\$ 12,341,250	\$ 11,080,133	\$ 23,421,383	\$ 11,763,447

In the governmental funds balance sheet, which employs modified accrual accounting, the equation is:

$$\text{Assets} + \text{deferred outflows} = \text{Liabilities} + \text{deferred inflows} + \text{Fund balance}$$

Governments are required to report their deferrals by type. Governments should disaggregate deferrals and list them by type either (1) on the face of the financial statements, or (2) in notes to financial statements. Figure 1 illustrates a government-wide statement of net position that shows totals for deferrals, with the required detail disclosed in a note illustrated in Figure 2.

Figure 2

NOTE 10. DEFERRED OUTFLOWS OF RESOURCES AND DEFERRED INFLOWS OF RESOURCES

	Primary Government		
	Governmental Activities	Business-Type Activities	Total
Deferred Outflows of Resources			
Leases	\$ 158,914	\$ 213,754	\$ 372,668
Hedging derivative instruments	-	87,345	87,345
Loss on refundings	-	32,009	32,009
Related to pensions	99,749	16,187	115,936
Related to other postemployment benefits	69,991	15,007	84,998
Total deferred outflows of resources	\$ 328,654	\$ 364,302	\$ 692,956
Deferred Inflows of Resources			
Property taxes levied in advance	\$ 232,944	\$ -	\$ 232,944
Grants with time restrictions	23,007	-	23,007
Hedging derivative instruments	-	31,744	31,744
Gain on refundings	24,110	22,566	46,676
Related to pensions	84,787	13,759	98,546
Related to other postemployment benefits	51,327	11,005	62,332
Total deferred outflows of resources	\$ 416,174	\$ 79,074	\$ 495,248

Why Are Deferrals Important?

Although there are similarities between the reasons why governments prepare audited financial statements for public consumption and why corporations and NFPs do, some of them are unique to governments. First, it is important to governments to accurately measure the cost of providing services. Consider the following:

- Many grants are awarded based on the costs incurred to provide specific services, such as free or reduced—price meals in schools or health care provided to persons living in poverty. This makes accurate cost reporting crucial.
- Obtaining disaster relief funding from the federal government is based on documenting the cost of recovery. During the pandemic, for example, entities were expected to produce reports that documented how they used hundreds of billions of dollars of federal relief funds.
- Because governments are largely funded by taxes (which are not provided willingly) and grants (which the providing government also pays for with taxes), there is a need to be accountable to taxpayers and grantors for the efficiency with which tax and grant dollars are used to provide services. Efficiency typically is evaluated as the cost per unit of service, such as cost-per-student or cost-per-lane-mile of highways paved.
- Measuring service costs accurately using the same approach across governments and over time enables comparisons that inform the degree of efficiency (“Is the government more or less efficient than other governments? Is efficiency improving or deteriorating?”) and program choices (“Which method of providing service produces the best quantity and quality for the money available?”).

For these reasons it is important to ensure that expenses are accurately stated. Deferrals ensure costs are recognized as expenses in the proper periods, which helps to keep expenses from being overstated or understated in any given year.

Second, governments are expected to be accountable for making ends meet, year in and year out. In other words, governments need to demonstrate that they have raised sufficient revenue each year to cover expenses instead of draining savings or pushing costs off to future taxpayers. The GASB refers to that concept as interperiod equity. A unique objective of governmental accounting and financial reporting is to provide financial statement readers with information that allows them to assess interperiod equity. Deferrals assist with that assessment by ensuring that revenues and expenses are reported in the proper periods and not overstated or understated.

In summary, deferrals contribute to the information value of government financial statements by either postponing the reporting of revenues and expenses until the appropriate period or ensuring that certain inflows and outflows of resources are never reported as revenues and expenses.

What Types of Deferrals Do Governments Report?

Among the deferrals that postpone the reporting of revenues and expenses until the proper year arrives, governments report the following if they engage in the related transaction:

1. Debt refundings
2. Property taxes levied in advance
3. Advances on grants with time restrictions
4. Leases
5. Public-private and public-public partnerships (P3s), including service concession arrangements (SCAs)
6. Revenue recognition in governmental funds
7. Increases and decreases in a pension or other postemployment benefit (OPEB) liability due to:
 - Changes in assumptions
 - Differences between expected and actual economic and demographic factors
 - Differences between expected and actual proportionate share of contributions
 - Changes in contribution proportion
8. Pension and OPEB contributions after the measurement date
9. Sales of future revenues
10. Transfers of revenue from one part of a government to another part
11. Sale-leasebacks
12. Payments from borrowers for points
13. Fees paid related to loans held for sale
14. Rate-regulated entities
15. Irrevocable split-interest agreements
16. Asset retirement obligations

The deferrals that may result in inflows and outflows never being reported as revenue and expense, include:

17. Changes in a pension or OPEB liability due to differences between expected and actual investment income
18. Hedging derivative instruments

This section discusses the most commonly reported deferrals: 1-4, 6-8, and 17. The slide deck, [Demystifying Deferrals: Technical Requirements & Resources](#), covers all 21 (#7 includes four related types).

Debt Refundings

To reduce their costs for repaying outstanding bonds, governments may engage in a “refunding”—they issue new bonds at a lower interest rate and use the proceeds to pay off the old bonds. If the amount a government needs to issue in new refunding bonds is *less* than the amount of old bonds being paid off, it results in an economic *gain*. Governments initially report the economic gain as a *deferred inflow* and then gradually report a *reduction* in interest expense and the deferred inflow over the shorter of the remaining years on the old or new bonds, typically in equal annual installments. This transaction stretches over multiple years, and the gain is related to the entire period, not just the year of the refunding. Therefore, reporting all of the gain at the time of the refunding would overstate the effect on interest expense in the initial year and understate it in all of the remaining years that the debt is outstanding.

Imagine that a government issues \$14 million of new refunding bonds to refund \$15 million of outstanding bonds, and both the new and old bonds have 20 years remaining. The government would:

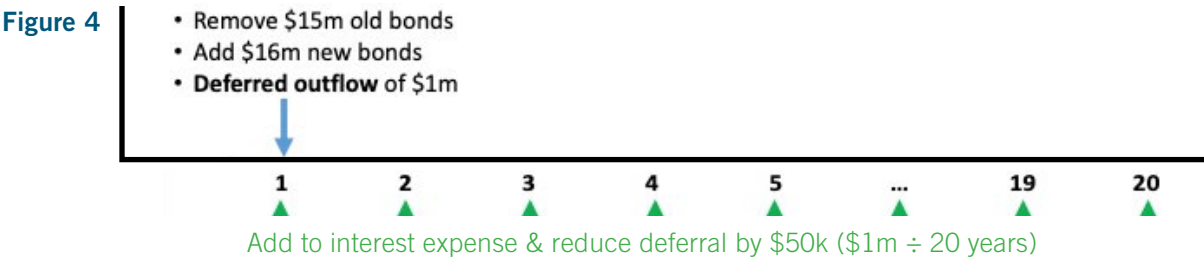
- Initially report a deferred inflow of \$1 million
- Reduce both debt service expense and the deferred inflow by \$50,000 ($\$1 \text{ million} \div 20 \text{ years}$) annually⁶ (see Figure 3)



If the entire \$1 million were reflected in the resource flows statements immediately, interest expense would be substantially understated (by \$950,000) in the first year and overstated in each of the next 19 years (by \$50,000 a year).

On the other hand, if the amount a government needs to issue in new bonds is *greater* than the amount of old bonds being paid off, it results in an economic loss. Governments initially report the economic loss as a deferred outflow and then gradually report an increase in debt service expense and a reduction in the deferred outflow over the shorter of the remaining years on the old or new bonds, typically in equal annual installments. Imagine that a government issues \$16 million of new bonds to refund \$15 million of outstanding bonds, and both the new and old bonds have 20 years remaining. The government would:

- Initially report a deferred outflow of \$1 million
- Increase debt service expense and reduce the deferred outflow by \$50,000 ($\$1 \text{ million} \div 20 \text{ years}$) annually (see Figure 4)



If the entire \$1 million were reflected in the resource flows statements immediately, interest expense would be substantially overstated (by \$950,000) in the first year and understated in each of the next 19 years (by \$50,000 a year).

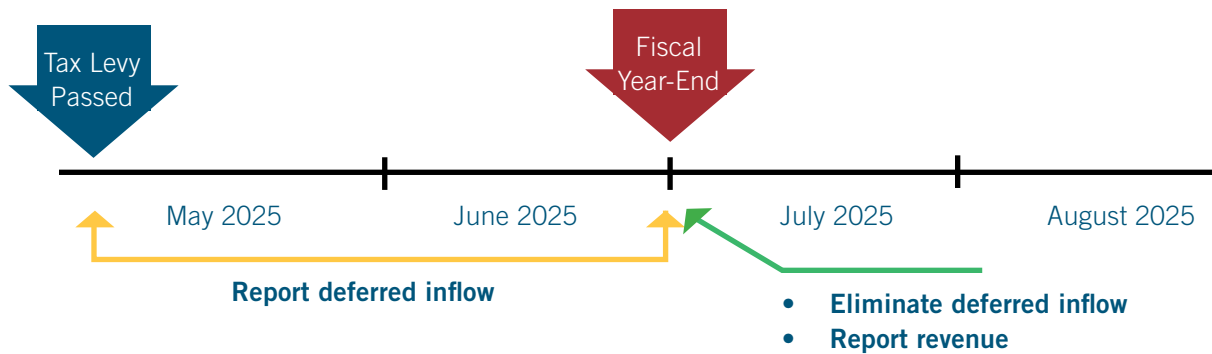
⁶ The GASB typically requires that the spreading of revenue and expense reporting over time be done “in a systematic and rational manner.” Most of the time, governments interpret that requirement as equal annual installments. For the sake of simplicity, the relevant examples in this document follow that practice.

Property Taxes Levied in Advance

Governments report property taxes receivable and property tax revenue when they are legally entitled to payment. Some governments levy property taxes toward the end of each fiscal year for the following fiscal year, say, in May for a fiscal year that begins July 1. If a government does so and has a legally enforceable claim to payment before the start of the fiscal year, it would report property taxes receivable—but it would not be appropriate to report next year's revenue in the current year. Therefore, governments report a deferred inflow until the start of the fiscal year for which the property taxes were levied. (See Figure 5.)

- ✓ **When the government has a legally enforceable claim:** report property taxes receivable and a deferred inflow
- ✓ **When the fiscal year begins:** eliminate the deferred inflow and report property tax revenue

Figure 5



Advances on Grants with Time Restrictions

The way many intergovernmental grants work is that the recipient must first spend on a particular service to be eligible to receive grant funds—so-called expenditure-driven grants. At the time the government incurs allowable expenditures, it can report a grant receivable and grant revenue. If a government receives grant funds prior to spending on the service or meeting some other eligibility requirement, it reports a liability back to the grantor until the eligibility requirements are met. That is proper because, if the government never meets the eligibility requirement, the grant must be returned to the grantor.

Consider, however, a government that receives a grant with no eligibility requirements, or for which the government already has met the requirements—but the grantor says that the government cannot use the grant money until next year. The government does not need to do anything but wait, so there is no liability to the grantor. Instead, the government would report a deferred inflow until the date when it is allowed to spend the money, at which point it is appropriate to treat the grant as revenue.

- ✓ **When the grant with time restrictions is received:** increase cash and report a deferred inflow
- ✓ **On the date the grant can first be used:** eliminate the deferred inflow and report grant revenue

If the grantor in this transaction is a government, it reports the mirror image of the grantee:

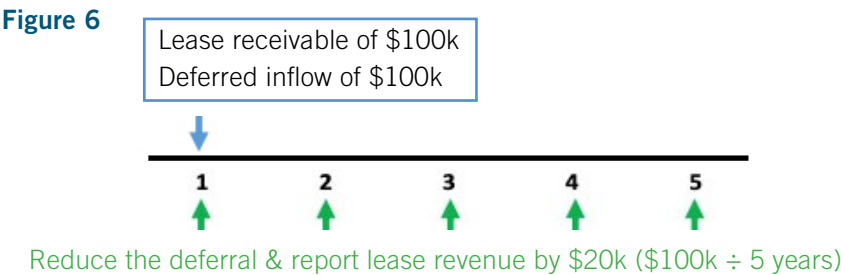
- ✓ **When the grant with time restrictions is paid:** reduce cash and report a deferred outflow
- ✓ **On the date the grant can first be used:** eliminate the deferred outflow and report grant expense

Leases

If a government leases an asset such as office space to a business for a period greater than a year, it reports a lease receivable equal to the present value of the future payments it will receive—in other words, the value of those payments if received today. Because the lease contract lasts for more than a year, it would not be appropriate to report the entire amount of the receivable as revenue immediately; rather, revenue should be reported over the course of the lease contract. Therefore, a government reports a deferred inflow, then reports revenue and reduces the deferral over time.

For example, if the lease lasts five years with five annual payments, the present value of which the government measures at \$100,000, the government would:

- ✓ Report a lease receivable and a deferred inflow at the start of the lease of \$100,000 each
- ✓ Reduce the deferred inflow by \$20,000 and report lease revenue of \$20,000 in each year of the lease (see Figure 6)



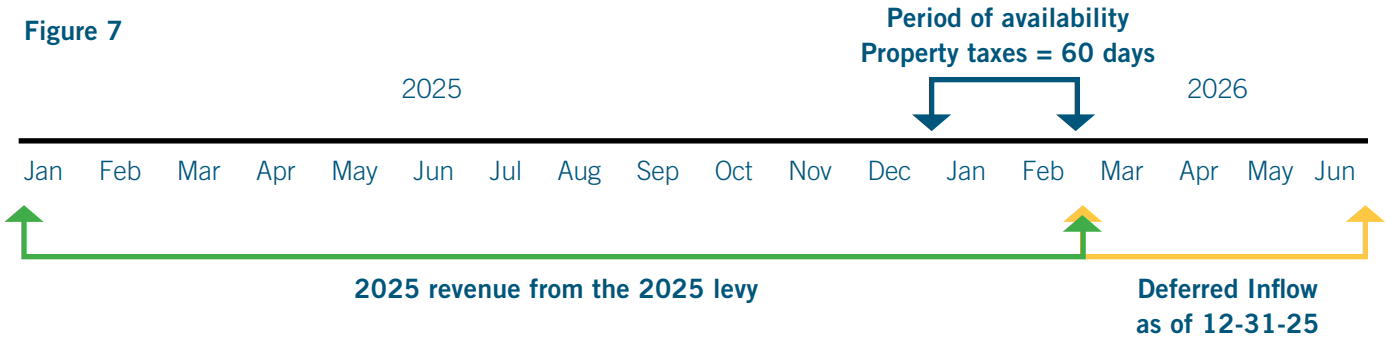
Revenue Recognition in Governmental Funds

Generally, governments report revenue when the applicable criteria in the accounting standards have been met—recall, for instance, that property tax revenue is reported when a government is legally entitled to payment from taxpayers—presuming that the amount is measurable and collectible. Stated differently, to avoid recording money that a government will never receive, revenue can be reported only if a government knows or can reasonably estimate how much it will actually receive. That is why a government may levy a property tax of \$1 million but report revenue of \$980,000 based on historical experience that it is unable to collect 2 percent on average.

That is how revenue reporting works under accrual accounting, which is used in all financial statements except those for the governmental funds, which employ modified accrual accounting. All of the revenue reporting rules of accrual accounting apply in the governmental funds, with an additional requirement that the revenue be *available*. Available means that payment will be received during this year or soon enough after the end of the year to pay for this year's expenditures. The GASB requires a period of availability of 60 days beyond fiscal year-end for property taxes but does not specify what the period should be for other types of revenue; governments are allowed to select their own.

Using the example of the \$1 million property tax levy, of which \$980,000 is collectable, let's say that \$950,000 is received during fiscal year 2025 or within 60 days after year-end. The government would:

- ✓ Report property tax revenue of \$950,000 in the governmental funds
- ✓ Report a deferred inflow of \$30,000, usually called *unavailable revenue*
- ✓ Eliminate the deferral and report the revenue when the payments are received later in fiscal year 2026 (see Figure 7)



Pension and OPEB Liabilities

The GASB's standards for liabilities to current and retired employees for defined benefit pensions and OPEB (most commonly, health insurance) are based in part on a view that this form of compensation is a multiyear transaction that unfolds over the years that an employee works for a government, rather than a series of separate annual transactions between governments and employees. That point of view affects how certain aspects of pension and OPEB expense are reported.

A variety of factors cause a government's pension and OPEB liabilities to increase and decrease each year. The *amount* of pension and OPEB expense reported by a government and *when* it is reported depend on the cause of the increase or decrease. The three factors that tend to cause the largest changes in pension and OPEB liabilities are *reported as expense immediately* because they relate specifically to each year:

- *Normal or service cost*, which is the value of pension and OPEB benefits earned during the year, adds to pension and OPEB expense.
- *Interest* on the balance of the liability at the start of the year also adds to pension and OPEB expense.
- *Changes in benefit terms*, such as how many years employees have to work or the percentage of their salary that is paid as pension, may increase the liability (and therefore add to pension and OPEB expense) or decrease it (and therefore reduce pension and OPEB expense).

Not all changes in pension and OPEB liabilities are recorded as expenses immediately. Some are initially reported as deferrals, then they get reversed and recorded as expenses evenly throughout the recognition period.

The recognition period is the average remaining years of employment of all members of the pension or OPEB plan, both active and retired (except for changes related to investment earnings and contributions after the measurement date). This approach mirrors how those liabilities change as employees continue to work and earn benefits. The four key factors that get expensed over multiple years are:

Changes in assumptions

The measurement of a pension or OPEB liability is the result of complex calculations based on a variety of assumptions, such as how much employees will be earning when they retire and how long they will live and collect benefits after retirement. If a government changes an assumption, the measurement of the liability will change as well.

For instance, if evidence shows that plan members are living longer on average, a government may increase the life expectancy assumption, which would have the effect of increasing the amount owed to those members. In other words, the liability would increase.

An illustration should help to visualize how the pension and OPEB deferrals are determined and reported. A government reduces its assumption about annual salary growth from 3.0 to 2.5 percent to better reflect actual salary increases over the past decade. That change in assumption reduces the projected future benefit payments to retirees, which reduces the pension liability by \$5 million. The average remaining years of service for current employees and retirees in the plan is four years. The government would:

✓ Initially report a deferred inflow for changes in assumptions of \$5 million

✓ Starting in that same year, and for the next three years, reduce the deferred inflow and pension expense by \$1.25 million (\$5 million ÷ 4 years) annually

Experience gains and losses

In any given year, actual experience is likely to be different from what was assumed. Those assumptions are expectations over a very long period (often 60 or 70 years)—in other words, they are a long-run annual average—but in any given year the actual experience will be higher or lower than the assumption. The differences between expected and actual experience are called “experience gains and losses” and can increase or decrease the pension and OPEB liabilities.

For example, if the liability calculation assumed annual inflation of 3 percent, but inflation in the most recent year was 4 percent, that additional percentage point will increase the liability more than expected—that is an experience loss. On the other hand, if actual inflation was 2 percent, the liability will not increase as much as expected due to that factor—that is an experience gain.

Differences between expected and actual proportionate share of contributions

Many governments participate in what are called cost-sharing multiple-employer plans, particularly for pensions. As the name suggests, two or more governments—even thousands of governments in state government-run plans—combine their contributions, invest them together, and share the cost of providing benefits to their employees. For other types of pension and OPEB plans, the liability is measured for each individual government; for cost-sharing plans, though, because their benefits are paid from a common pool of assets, the liability is measured for all participating governments combined. For each of those governments to report their own part of the liability, they need to calculate their percentage (or *proportion*) of the total. For example, if the collective liability for the plan is \$10 million and a government made contributions equal to 5 percent of all employer⁷ contributions to the plan, that government's proportionate share of the liability would be \$500,000 (\$10 million × 0.05).

As with other aspects of measuring the liability, the proportionate share is based on assumptions about how much a government will contribute to the plan relative to the total contributions of all participating governments. In any particular year, therefore, the actual proportionate share may be higher or lower than the expected proportion, which causes that government's liability to be higher or lower. Like the factors discussed in the preceding section, that change in the liability is reported as a deferral and introduced into pension or OPEB expense gradually.

For instance, if the total number of members in the plan increases during the year but one government's number remains the same, that government's contributions will be a smaller share of all contributions than expected. Consequently, that government's actual proportionate share of the liability would be less than expected, with the difference initially reported as a deferred inflow.

Changes in contribution proportion

Actual experience over time may lead to a government changing its assumption about its proportion of contributions to the plan. Like other changes in assumption, a change in contribution proportion directly affects the measurement of a government's liability; a larger proportion increases the liability, all other factors being equal, and a smaller proportion reduces the liability. That change in the liability is reported initially as a deferral and brought into pension and OPEB expense over multiple years.

Pension and OPEB Contributions After the Measurement Date

Due to the need for coordination between governments and pension plans, as well as the time required to perform the necessary calculations, accounting standards permit pension and OPEB liabilities to be measured up to one year before fiscal year-end. For instance, a government measuring its liability for the fiscal year ending June 30, 2026, could measure the liability as of June 30, 2025. Consequently, the contributions the government makes to the pension plan during the year occur after the date on which the liability was measured and, therefore, are not reflected in the amount reported for the liability in the financial statements. For those contributions made after the measurement date, governments would:

✓ Initially report a deferred outflow for contributions after the measurement date

✓ Reduce the following year's pension liability and eliminate the deferred outflow

⁷ The total contributions to the plan may also include contributions from nonemployer contributing entities—primarily governments—that make contributions to the plan on behalf of the employees of other governments. For example, some state governments make contributions to the pension plans of teachers employed by local school districts.

Differences between expected and actual investment income

Another of the assumptions that feeds into the measurement of pension and OPEB liabilities is how much income the contributions to the plan will earn when invested. That assumption is called the *long-term expected rate of return*. As with the other long-term assumptions, the actual investment earnings in any year are likely to be higher or lower because the assumption is an average. When the actual investment earnings are higher than expected, the amount of the liability in excess of the plan's assets is less than expected; when the actual investment earnings are lower than expected, the amount of the liability in excess of the plan's assets is more than expected.

If a government has selected an appropriate investment return assumption, the greater returns in some years will offset the lower returns in other years and, thereby, achieve the expected returns over the long run. For that reason, although there can be both deferred inflows and deferred outflows related to changes in assumptions, experience gains and losses, differences between expected and actual proportionate shares, and changes in contribution proportion, there can only be either a deferred inflow or a deferred outflow related to investment returns.

Because assumed investment returns factor into the measurement of the pension and OPEB liabilities, those returns already are incorporated into pension and OPEB expense. By acknowledging that some or all of the annual ups and downs in investment earnings will offset, only the *net* amount by which actual earnings exceed or fall short of assumptions over time is reported as a deferral that adds to or reduces pension and OPEB expense. The accounting standards require all governments to bring that deferral into pension and OPEB expense over five years. The difference between a given year's *actual* and *estimated* investment returns should first be deferred, then expensed over five years.

An example should help to illustrate how governments report this deferral. The amounts in column A of Figure 8 are the differences between actual and expected investment earnings in 2025-2030.

- In 2025, actual earnings were \$20 million *below* expected returns, resulting in a deferred outflow of the same amount (column B) that adds \$4 million to pension expense (column C, \$20 million ÷ 5 years).
- In 2026, actual earnings were \$25 million *above* expected returns (column A). The remaining deferred outflow from 2025 was \$16 million after the \$4 million was added to pension expense. Subtracting the 2026 excess earnings of \$25 million results in a deferred inflow of \$9 million. That deferred inflow divided by 5 reduces pension expense in 2026 by \$1.8 million.
- In 2027, actual earnings were \$45 million *below* expected returns (column A). The remaining deferred inflow from 2026 was \$7.2 million after the \$1.8 million reduced pension expense. Adding the 2027 earnings shortfall of \$45 million results in a deferred outflow of \$37.8 million. That deferred inflow divided by 5 adds \$7.56 million to pension expense in 2027.

Figure 8

(dollars in thousands)

	(A) Expected Minus Actual Earnings	(B)* Deferred Outflow (Inflow)	(C) Expenses (B ÷ 5)				
			2025	2026	2027	2028	2029 2030
2025	\$20,000	\$20,000	\$ 4,000				
2026	(25,000)	(9,000)		\$ (1,800)			
2027	45,000	37,800			\$ 7,560		
2028	(35,000)	(4,760)				\$ (952)	
2029	15,000	11,192					\$ 2,238
2030	(5,000)	3,954					\$ 791

* B = prior year's B – prior year's C + current year's A

The same pattern continues in 2028-2030. Comparing the amounts in column A with those in column B reveals how the earnings-related deferrals allow for annual earnings above and below assumptions to offset each other, rather than inflate or deflate pension and OPEB expense each year. The years that best exemplify that effect are 2026—expenses are reduced by \$1.8 million rather than \$5 million (\$25 million ÷ 5)—and 2028—expenses are reduced by \$952,000 rather than \$7 million (\$35 million ÷ 5).

What Does Deferral Information Communicate About a Government's Finances?

Reporting deferrals in government financial statements is a win-win; they provide potentially valuable information in a way that does not diminish the value of other information. The reader of the financial statements does not need to conduct a deferral hunt because governments are required to separate them in the financial statements. If one chose to ignore deferrals, one would still be able to use all of the other information for one's desired purpose.

Ignoring deferrals and the messages they communicate about a government's finances may, however, deprive one of valuable insights. There are at least five reasons why it is beneficial to pay attention to deferrals:

- Deferrals keep the reader from misidentifying assets and liabilities.
- Deferrals improve the accuracy of financial ratios.
- Deferrals may offer clues as to a government's ability to collect its receivables.
- Deferrals provide a heads up as to trends in future pension and OPEB expenses.
- Deferrals assist with the evaluation of interperiod equity.

Misidentifying Assets and Liabilities

The items that are required to be reported in financial statements as deferrals are not assets or liabilities. They are not resources that can be used to provide service or sold or invested to generate income to finance services. Nor are they amounts that a government will need to pay off or otherwise satisfy. When deferrals previously were reported as assets and liabilities, they usually were not easy to identify. Consequently, the asset and liability amounts in the financial statements potentially were overstating the resources governments could call upon and the bills that would have to be paid in the future. Sometimes, the overstatement could be significant enough to alter the conclusions one would draw about a government.

Here is a stark example: "Deferred revenue" used to be reported among liabilities and often was a combination of (1) liabilities and (2) revenues waiting to be recognized. Unfortunately, there was no way for readers to distinguish them. Many readers would therefore remove or ignore deferred revenue when analyzing the financial statements, trading overstated liabilities for understated liabilities in the process.

Figure 9 shows a portion of a governmental funds balance sheet before and after the requirements for deferrals were introduced. In this example, almost all of the items reported as the deferred revenue liability were not actually liabilities; \$7.9 million of the \$9.3 million reported as liabilities (85 percent) would now be reported as "deferred inflows—unavailable revenue." Overall, the liabilities reported in the general fund were overstated by 121 percent and the liabilities for total governmental funds were overstated by 106 percent. It is not difficult to imagine that a reader might draw very different conclusions about this government after the hidden deferrals were revealed.



Figure 9

	General	Federal & State Grants	Economic Development	Capital Projects	Total Governmental Funds
Before Deferrals					
LIABILITIES AND FUND BALANCES					
Liabilities:					
Accounts payable	\$ 3,408,680	\$ 129,975	\$ 190,548	\$ 2,179,463	\$ 5,908,666
Due to other funds	—	25,369	—	—	25,369
Payable to other governments	94,074	—	—	—	94,074
Deferred revenue	4,250,430	4,837,446	250,000	11,000	9,348,876
Total liabilities	7,753,184	4,992,790	440,548	2,190,463	15,376,985
After Deferrals					
LIABILITIES, DEFERRED INFLOWS OF RESOURCES, AND FUND BALANCES					
Liabilities:					
Accounts payable	\$ 3,408,680	\$ 129,975	\$ 190,548	\$ 2,179,463	\$ 5,908,666
Due to other funds	—	25,369	—	—	25,369
Payable to other governments	94,074	—	—	—	94,074
Advances on grants	—	1,435,599	—	—	1,435,599
Total liabilities	3,502,754	1,590,943	190,548	2,179,463	7,463,708
Deferred inflows of resources:					
Unavailable revenue—taxes	4,250,430	—	—	—	4,250,430
Unavailable revenue—grants	—	3,401,847	250,000	11,000	3,662,847
Total deferred inflows of resources	4,250,430	3,401,847	250,000	11,000	7,913,277
Overstatement of liabilities before deferrals	121%	214%	131%	1%	106%

Accuracy of Financial Ratios

Given that potential for overstating assets and liabilities, it follows that the removal of deferrals from the assets and liabilities improved the accuracy of the financial ratios that readers calculate using asset and liability information. For example, a commonly used ratio is total liabilities divided by total assets. It is a *leverage* ratio that indicates the extent to which a government's assets are financed by incurring liabilities, such as by purchasing on account or borrowing. All other factors being equal, a government that is less leveraged (has a lower leverage ratio) is less burdened with the cost of repayment and is better able to afford more borrowing, if necessary.

Total assets for the general fund in Figure 9 were \$9,460,102. If one were to calculate the total liabilities divided by total assets ratio for the general fund, the results would be markedly different before and after the introduction of deferrals because of the significant overstatement of the deferred revenue liability. Prior to deferrals, the ratio would have been 82 percent ($\$7,753,184 \div \$9,460,102$), whereas after deferrals the ratio would be 37 percent ($\$3,502,754 \div \$9,460,102$). The latter result indicates a substantially less leveraged government.

Ability to Collect Receivables

Recall that unavailable revenue is a deferred inflow that represents resources a government is owed but did not receive during the fiscal year or within the period of availability beyond fiscal year-end. Tracking *deferred inflows for unavailable revenue* relative to *revenue reported* over time can be insightful; it could inform a government's ability or inability to collect the money it is owed over time.

Figure 10 calculates a ratio by dividing the unavailable grant revenue deferral by total grant revenues for an eight-year period. At least two things immediately catch the eye. First, between 2018 and 2022, it appears to have taken this government a long time to collect on its grants. Between 40 and 50 percent of the grants that it was owed were not collected until beyond the period of availability. That may send up a red flag that bears further exploration. Is the government not processing its grant requests in a timely manner? Is the grantor not making its grant payments to the government in a timely manner? A combination of both?

Figure 10

	2018	2019	2020	2021	2022	2023	2024	2025
Deferred inflow: unavailable revenues - grants	\$ 44,405	\$ 35,513	\$ 33,433	\$ 36,642	\$ 38,480	\$ -	\$ 6,361	\$ 1,447
Grant revenues	\$ 88,251	\$ 83,348	\$ 76,448	\$ 79,726	\$ 81,431	\$ 86,005	\$ 102,592	\$ 104,933
Unavailable revenue ÷ revenue	50.32%	42.61%	43.73%	45.96%	47.25%	0.00%	6.20%	1.38%

Second, something significant occurred in 2023 that also may bear following up on: The government had no unavailable grant revenue in 2023, and the amounts in the following two years were considerably smaller relative to earlier years. What happened? Were the issues causing the delays in grant payments resolved? Alternatively, do those issues remain but are not as readily apparent because the government extended its period of availability to encompass grant payments received well after the end of the fiscal year? Either way, the answers to those question may be relevant to a reader's interests in the government.

Trends in Future Pension and OPEB Expenses

Governments are required to disclose in notes to financial statements the balances for their pension- and OPEB-related deferrals, disaggregated by each of the factors discussed above. Additionally, governments disclose the aggregate amount by which pension and OPEB expense will increase or decrease due to those deferrals for each of the next five years and in five-year increments after that. Those notes can be used to assess future trends in pension and OPEB expense and how they are affected by changes from year to year in deferral balances.

Figure 11 illustrates a government's disclosure of pension deferrals for two consecutive years. One of the notable changes is a shift related to the difference between expected and actual investment earnings from a deferred outflow of \$16.1 million to a deferred inflow of \$37.5 million—a total change of \$53.1 million. A quick look at the government's required supplementary information schedule of changes in the pension liability over the past 10 years likely will show substantial earnings above expectations in the most recent year.

Figure 11

(dollars in thousands)

	2026		2025	
	Deferred Outflows of Resources	Deferred Inflows of Resources	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	\$ 25,638	\$ 8,075	\$ 26,744	\$ 5,291
Changes of assumptions	11,859	-	17,358	-
Net difference between projected and actual earnings on pension plan investments	-	37,508	16,095	-
City contributions subsequent to the measurement date	64,676	-	21,874	-
Total	\$ 102,173	\$ 45,583	\$ 82,071	\$ 5,291

What impact will that change in the earnings-related deferral have on the government's pension expense in the near term? The note disclosures illustrated in Figure 12 show what would be expected based on the prior discussion of these types of deferrals: The change in the earnings-related deferral was so substantial that the expected impact on pension expense for *all deferrals combined* changed from increases in expense each year to either decreases or significantly smaller increases. For example, the 2025 disclosure shows an expected addition to pension expense for 2027 of \$13.3 million, but in the 2026 disclosure that addition is a mere \$306,000. The expected addition to expense of \$11.3 million in 2028 has become a *reduction* of pension expense of \$1.7 million.

Figure 12
(dollars in thousands)

2026			2025		
Fiscal year ending June 30:			Fiscal year ending June 30:		
2027	\$	306	2026	\$	12,187
2028		(1,738)	2027		13,322
2029		(3,721)	2028		11,278
2030		(9,441)	2029		9,295
2031		925	2030		3,575
Thereafter		5,583	Thereafter		5,249

Interperiod Equity

As previously noted, deferrals are an essential part of enabling financial statement readers to evaluate whether a government is living within its means from year to year—also known as interperiod equity. That evaluation is dependent on revenues and expenses being reported in the correct years. One major impact that deferrals have with regard to interperiod equity relates to property taxes levied in advance of the fiscal year they are levied for. As explained earlier, deferrals are reported to avoid reporting next year’s property tax revenues in the current year. If property tax revenues were reported whenever a government has a legal claim to payment, regardless of what year those taxes are levied for, it would undermine the reader’s ability to assess interperiod equity.

The effect of these types of deferrals is also apparent for agreements like leases and service concession arrangements (SCAs), which often last many years and may involve a government receiving an upfront payment. The accounting requirements ensure that a transaction that provides resources to a government for multiple years will be reported as revenue throughout the course of the agreement and not entirely at the start of the agreement when cash prepayments and receivables are reported. Recall that a government acting as a lessor reports a lease receivable when the lease term begins but does not immediately report the full amount as revenue; instead, it reports a deferred inflow and spreads the revenue reporting across the years of the agreement. If the government had received a prepayment from the lessee related to the years during the lease term, that too would be deferred and reported as revenue over the full lease term.

Governments engaging in such multi-year transactions that result in the reporting of deferrals will show those deferrals separately from other types of deferrals either on the face of the financial statements or in a note to financial statements. The amount of the deferred inflow that is disclosed for leases can be compared with information about how many years remain on the transaction (in the separate note about the transaction). That comparison can inform the reader about how much the transaction will contribute to a government’s ability to achieve interperiod equity going forward.

For example, if a government’s deferral note shows a balance on an SCA deferred inflow of \$50 million and the SCA note indicates that 25 years are left on the agreement, one can ascertain that the transaction will contribute revenue of \$2 million annually for the remainder of the transaction term.



Deferrals from the Perspective of the User of Government Financial Statements

The audited financial statements of state and local governments serve as a vital communication tool for a diverse array of individuals and entities engaged in assessing government financial health, making informed decisions regarding government finance, and ensuring governmental accountability. These users of financial statements each have their own unique interests in and knowledge of various aspects of government finances. Despite the diversity in their backgrounds and areas of focus, there is a shared necessity among all these stakeholders for reliable and relevant information from audited government financial statements.

One of the common challenges faced by financial statement users—including experienced municipal bond analysts at rating agencies and investment companies, accounting and public administration professors, and researchers at citizen groups and think tanks—is understanding two distinctive features of government financial statements: deferred outflows of resources and deferred inflows of resources, collectively known as “deferrals.”

“Deferrals from the Perspective of the User of Government Financial Statements” covers similar ground to the other two articles in this ebook but from the particular vantage point of people who need to understand the information in government financial statements to make decisions, perform analyses, and hold governments accountable. This article is also valuable to preparers and auditors of government financial statements who want to understand why the accounting standards require governments to report deferral information to the public.

Deferrals from the Perspective of the User of Government Financial Statements

The audited financial statements of state and local governments are intended to communicate with a wide variety of people who analyze government financial health, make decisions about government finance, and hold governments accountable. Those “users” of financial statements have vastly different levels of experience and knowledge and are interested in a broad range of topics related to government finances. Despite those differences, they share a common need for reliable and relevant governmental financial information from audited financials.

Another thing different types of users have in common—and in common with experienced auditors and government finance officers—is difficulty understanding two unique features of government financial statements: **deferred outflows of resources** and **deferred inflows of resources** (referred to as “deferrals”). To help the users, preparers, and auditors of financial statements to understand deferrals better, CRI has developed free plain-language resources that include:

- Recorded presentation and slide deck, “[Demystifying Deferrals](#)”
- Short plain-language article, “[Deferred Outflows and Deferred Inflows of Resources in a Nutshell](#)”
- Longer plain-language article, “[Demystifying Deferrals: What They Are, What They Mean, and Why They Are Important](#)”
- Technical [slide deck](#) for those who want to dig into the accounting standards, including debits and credits

This article complements those resources by focusing specifically on what deferrals communicate to users and how deferrals information can play a role in their analyses, decisions, and accountability—with as much plain language and as little technical jargon as possible.

Users in a Nutshell

As “general purpose” financial statements, the audited financials that governments issue based on generally accepted accounting principles (GAAP) as published by the [Governmental Accounting Standards Board \(GASB\)](#) should be usable by and understandable to both seasoned technical experts and average citizens. No matter their prior knowledge or experience, a person who (1) has an interest in and need for government financial information, and (2) is willing to invest a reasonable amount of time in getting up to speed on government accounting basics and reading the financial report, should be able to use financial statement information meaningfully.

Users are [categorized by the GASB](#) as investors and creditors, oversight and legislative, and the citizenry.

Investors and Creditors

Investors and creditors play crucial roles in supporting governments by participating in the sale and purchase of municipal bonds and notes, as well as extending loans and providing goods and services on credit. Analysts at those entities generally evaluate a government's "creditworthiness"—its ability to repay its debts on time. Rating agency analysts evaluate creditworthiness and assign governments "credit ratings" based on that analysis.

Analysts at other companies evaluate creditworthiness to inform decisions about, among other purposes:

- Whether to buy a government's bonds as investments
- Whether to hold those bonds or subsequently sell them (and at what price)
- Whether to "underwrite" or insure a government's bonds and how much to charge for those services, and
- Whether to allow a government to purchase goods or services on account and in what amounts

As frequent and intensive readers of financial statements, those users are very familiar with the information they contain and understand the underlying accounting rules better than most users.

General Characteristics of Financial Statement Users			
Type of User	Frequency of Use	Experience & Knowledge of:	
		Governments	Accounting Standards
Investors & Creditors	High	High	Medium
Academics & researchers	Medium	High	High
Oversight	Medium	High	Medium
Legislative	Low	High	Low
Citizen/Taxpayer Groups	Low	Medium	Low
Average Citizen	Low	Low	Low

Legislative and Oversight

Elected legislators, their staff, and governmental oversight entities (such as state education departments and state-appointed fiscal monitors) make up another category of users of financial statements. Elected legislators and their staff are particularly interested in allocating a government's tax revenues and other scarce resources among competing public services through the budget process. They subsequently need to monitor actual experience against the budget and ensure that revenues and expenditures are balanced for the year. They also perform oversight functions, along with dedicated oversight agencies and commissions, through which they seek to hold governments accountable for the effective and efficient use of public dollars. Legislative users are generally knowledgeable about governments and government finances and are familiar with, but not knowledgeable about, government accounting. Oversight users have a comparable degree of knowledge about governments and are generally knowledgeable about accounting standards as well.

Average Citizens

The citizenry, comprising the largest group of potential users, often lacks knowledge about government accounting and is less likely to utilize government financial reports directly. However, staff at citizen groups and taxpayer associations, who are studying and reporting publicly on issues that are important to citizens, may have a basic knowledge of government accounting as necessary to understand those issues and report on them to the public. Similar to legislative and oversight users, a common interest of citizen users is holding governments accountable for the effective and efficient use of limited public resources.

Academics and Researchers

A fourth user category might include professors in colleges and universities who teach or conduct research on topics related to government finance, as well as people conducting research on such topics at think tanks and public policy groups. They may be knowledgeable about governmental accounting and generally are knowledgeable about governments and the governmental financial environment.

Shared Interests

Differences in experience, knowledge, and primary focuses notwithstanding, the various kinds of users share some concerns about governments and need information about the same aspects of government finance. For example, information about a government's level of indebtedness is potentially significant to all user types. However, the nature of their concern may diverge because of the different purposes for which they utilize the information. A legislative or oversight user may focus on how close the amount of outstanding debt is to the government's state-imposed debt limit, perhaps to ensure the limit is not exceeded or to assess available legal borrowing authority to finance necessary infrastructure investments. A citizen group may concentrate on the government's debt burden, the cost of repaying it, and the resulting property tax bills. A municipal bond analyst may evaluate the amount of outstanding debt in the context of the government's financial capacity to repay existing debt and whether it can afford to issue additional debt.

Similarly, the various types of users often compare annual revenues with annual expenses or expenditures. Municipal bond analysts may view a government that raises enough revenue each year to cover its expenses as more creditworthy, all other factors being equal, than a government that spends more than it takes in and covers the difference by draining its reserves or pushing costs off to the future. Legislative and oversight users may be monitoring whether the government balanced its budget for the year. Citizen groups may be attentive to budget balance in addition to holding the government accountable for "making ends meet" or "living within its means" each year, a concept the GASB calls *interperiod equity*.



How Deferrals Inform Users' Shared Interests

The information about deferrals in government financial statements is important to these shared interests.

Government Indebtedness

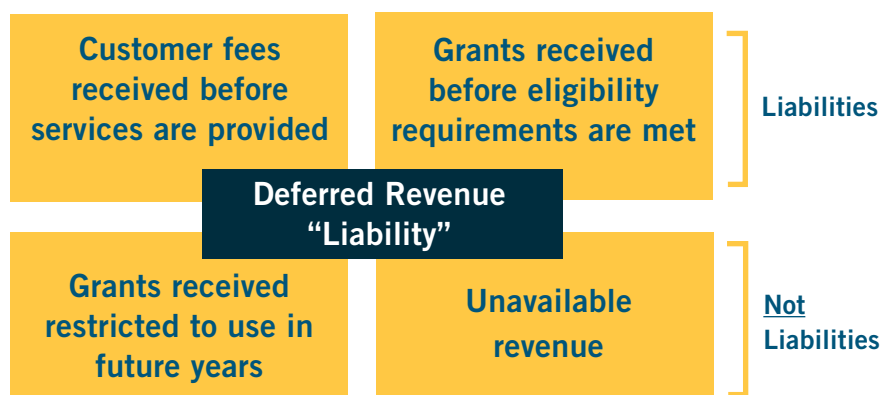
Appropriately evaluating a government's degree of indebtedness depends in part on having accurate information about its liabilities (and assets, too). Some debt indicators are limited to bonds, notes, and loans, while some are more broadly inclusive of other amounts owed. These may include liabilities related to pensions, retiree health insurance (also known as other post-employment benefits or OPEB), long-term leases, accrued vacation and sick leave to be paid in the future, claims and settlements, and costs associated with landfill closure.

One of the essential consequences of introducing deferrals to government financial statements was the reclassification of things that previously were reported as assets or liabilities but were not actually resources owned or amounts owed. Before the GASB required those items to be reported as deferred outflows of resources and deferred inflows of resources, they generally were indistinguishable from other assets and liabilities. The result was potentially overstated assets and liabilities, which could lead to inaccurately calculated indebtedness indicators, and therefore mistaken conclusions about a government's ability to repay existing liabilities or to incur additional liabilities. In many cases, users were unaware they were incorporating faulty information into their analyses, decision-making, and accountability efforts.

Consider how the following typical indicators of indebtedness were affected before deferrals were removed from the assets and liabilities:

Indicator	Potential Negative Effect on Government
Liabilities ÷ population	Appears more indebted than it really is
Liabilities ÷ assets	Could appear more or less indebted than it really is
Liabilities ÷ net assets (or fund balance)	Could appear more or less indebted than it really is
Liabilities ÷ expenses (or expenditures)	Appears more indebted than it really is
Liabilities ÷ assessed property values	Appears more indebted than it really is

Before deferrals were introduced to governmental accounting, no "liability" was more notorious than "deferred revenues." In a typical governmental fund, the amounts reported as deferred revenues liabilities may have included amounts owed to others (customer fees and grants received in advance) and amounts waiting to be reported as revenues (grants with time restrictions and unavailable revenue).



Customer fees received before services are provided are reported as liabilities because, if the government doesn't provide the service, the money must be returned to the customer. The same can be said if a government never meets the eligibility requirements for grants it received in advance. On the other hand, grants with time restrictions but no further eligibility requirements aren't liabilities because the government just needs to wait until the year when it is allowed to spend them. Lastly, unavailable revenue (a product of the modified accrual basis of accounting in governmental funds) represents amounts due to the government that were not collected during the year or soon enough after fiscal year-end to be used to pay this fiscal year's expenditures.

It used to be common that deferred revenue was one of the larger liabilities in the governmental funds. To the extent that it contained items that were not really amounts owed, it caused total liabilities to be overstated and made a government look worse off financially, all other factors being equal. Compounding that problem, it was also common that unavailable revenue was the largest component of deferred revenue, sometimes larger than the other parts of deferred revenue combined.

The financial statements are more accurate as a result of reporting deferrals—rather than assets and liabilities—for grants with time restrictions, unavailable revenue, and other items that are not resources owned or amounts owed. Financial statements after the introduction of deferrals better inform users' analyses, decisions, and accountability efforts.



Take a deeper dive:

- See the sections “Misidentifying assets and liabilities” and “Accuracy of financial ratios” on pages [21](#) and [22](#)

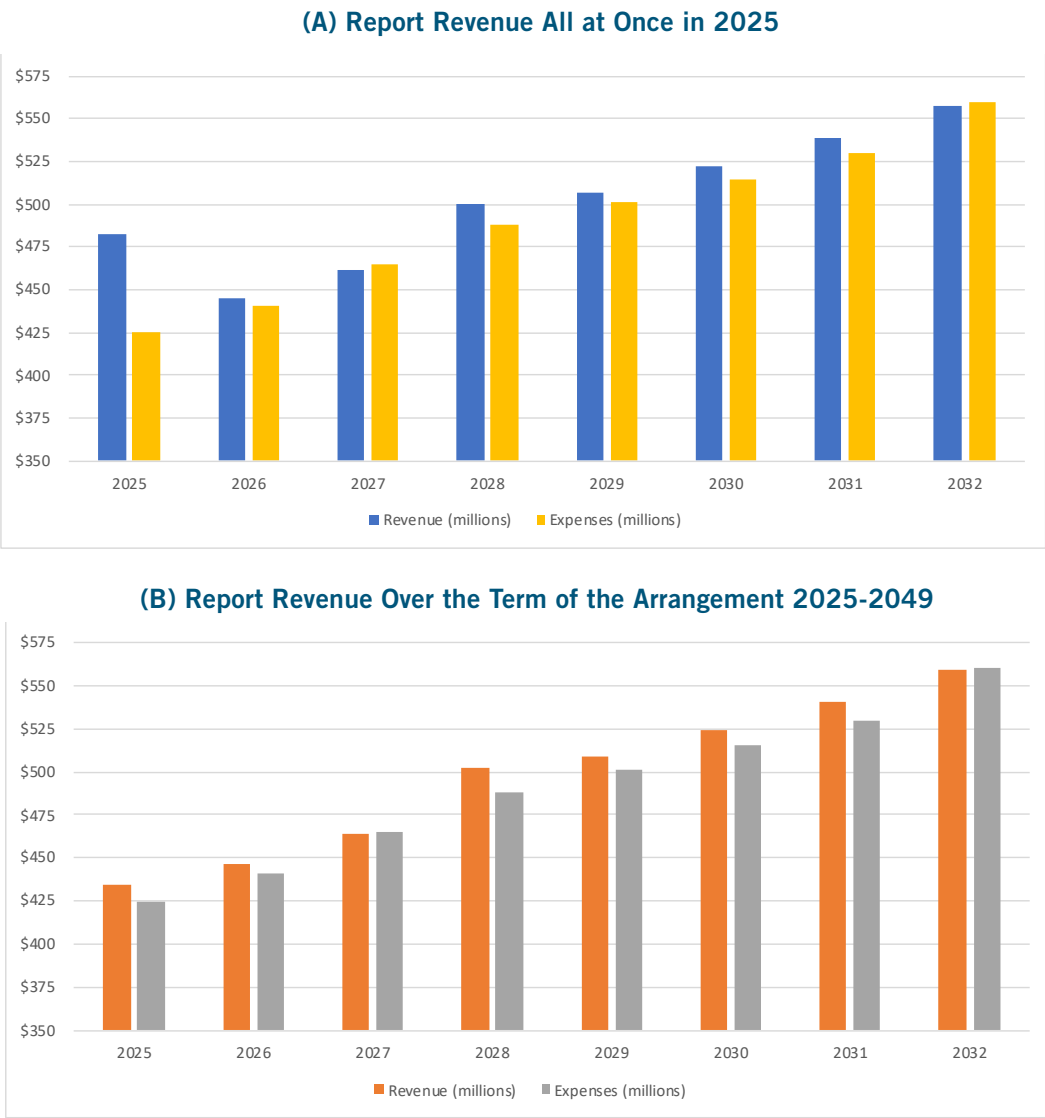
Comparing Revenues and Expenses (Expenditures)

Imagine that a city hires a company to build a public sports and entertainment venue and operate it on the city's behalf for 25 years. As part of the deal, the company pays the city \$50 million when the contract is signed, before construction has even begun. The decision about when that up-front payment should be reported by the city as revenue will directly affect users' analyses, decisions, and assessments of accountability related to the city's finances.

If the entire \$50 million is reported at once—for example, in the year when the contract is signed or in first of the 25 years the company operates the facility—revenues may look substantially greater than expenses in that year but be unaffected in the rest of the years. From a user's perspective, would that be an accurate depiction of the city's interperiod equity—whether it is making ends meet in each of next 25 or more years?

GASB standards view the \$50 million up-front payment as part of the compensation the company is paying the city for the right to operate the venue (and, conceivably, to collect revenue of its own by doing so). Even though the city received the money all at once, it is “earning” the money over the 25 years during which the company has the right to operate the venue. That argues for reporting the up-front payment as revenue over the 25-year period, as the city earns it. When it receives the \$50 million, it reports the cash and a deferred inflow of resources in that amount. It then reports the revenue in each of the 25 years, likely in equal amounts of \$2 million, and reduces the deferral by the same amount.

Viewing the two graphs below illustrates how reporting the revenue all at once would distort comparisons of annual revenue and expenses.



A user examining the information in (A) might interpret the larger-than-usual cash inflow in 2025 from the up-front payment as an extraordinarily good financial performance. With seven additional years of revenue and expense information for 2026-2032, we can see that it was a one-time occurrence. However, a user in 2026 who is first seeing the audited financial statements for 2025 does not benefit from that hindsight. To them, it may seem like the government’s financial fortunes have greatly improved, and they may base analytical conclusions or decisions on that perception. A credit officer at a bank may conclude that the government has a greater capacity to repay its loans or to take out additional loans. A county legislator or a taxpayer association member may believe their county can afford to expand services, add new programs, or cut tax rates.

Deferrals play a similar role in other multiyear transactions, ensuring that revenue is appropriately assigned to the years in which it is earned, regardless of when cash changes hands or when a government reports a long-term receivable. For instance, when a government signs a contract as a lessor, leasing public facilities to companies or not-for-profit organizations for multiple years, it can record a receivable for the payments it will receive over the lease term. Rather than record an equivalent amount of lease revenue simultaneously, the government initially reports a deferred inflow and then reports revenue annually during the lease term, reducing the deferral simultaneously.

▶ Take a deeper dive:

- See the sections “Leases” and “Interperiod Equity” on pages [16](#) and [24](#)
- See slides 71-86 of the [technical resources and requirements slide deck](#)

Other Uses of Deferral Information

Deferral information is valuable to users for purposes beyond calculating accurate financial ratios and evaluating interperiod equity. Broadly, deferral information is useful and relevant in any circumstance in which it is important that revenues and expenses/expenditures be reported in the correct years and in the correct amounts.

▶ Take a deeper dive:

- See slides 36-42 and 56-70 of the [technical resources and requirements slide deck](#)

For example, several types of deferrals relate to governments’ liabilities for pensions and OPEB and are useful for understanding why those liabilities increase or decrease over time and how it will impact future expenses.

▶ Take a deeper dive:

- See the sections “Pension and OPEB liabilities” and “Trends in Future Pension and OPEB Expenses” on page [18](#) and [23](#)
- See slides 87-94 of the [technical resources and requirements slide deck](#)

Tracking *deferrals for unavailable revenue* relative to related amounts receivable—like *unavailable revenue–grants* and *grants receivable*—over time can be insightful; it could inform a government’s ability or inability to collect the money it is owed over time.

▶ Take a deeper dive:

- See the section “Ability to Collect Receivables” on page [23](#)
- See slides 56-58 of the [technical resources and requirements slide deck](#)

Notes to financial statements disclose deferral balances related to transactions called “hedging derivative instruments.” That information is valuable for assessing the risk that a government will have to make a substantial payment to the bank or other party in the transaction should a hedging derivative instrument with a sizeable deferred outflow balance terminate unexpectedly.

▶ Take a deeper dive:

- See slides 12,13, and 18-27 of the [technical resources and requirements slide deck](#)



Demystifying Deferrals:

Discussion Questions and Exercises

The realm of governmental accounting is complex and multifaceted, demanding a nuanced understanding of its unique principles and practices. This complexity is particularly evident when dealing with deferrals, encompassing some of governmental finance's most intricate aspects. It is entirely normal, and even expected, to have questions about deferrals, as they represent a significant component of governmental accounting that requires careful analysis and understanding.

Whether the context is classroom instruction, professional education, academic research, or individual self-study, it is imperative to approach the topic of deferrals in a manner that is both accessible to learners and yet thorough in its coverage. Striking this balance ensures that the concept is understood in its current form and appreciated for its impact on the broader scope of governmental financial reporting. These discussion questions and exercises are an additional learning resource and a tool for assessing one's comprehension of the articles in this ebook and the multimedia resources the articles link to.

Tips on answering the discussion questions and solutions to the exercises are available from CRI by emailing dmead@criadv.com.

Discussion Questions

1. Your colleague says they want the GASB to “put the deferrals back where they belong, with the assets and liabilities.” How would you explain (succinctly and in plain language) why that would not be practicable to do?
2. In what ways are deferred inflows of resources similar to unearned income? How do they differ?
3. In what ways are deferred outflows of resources similar to prepaid assets? How do they differ?
4. Describe a reason that deferrals should not be a separate financial statement element. Then, describe the best counterargument to that reason.
5. Of the reasons why information about deferrals is important to financial statement users, which reason is the best argument for reporting deferrals separately from assets and liabilities? Why?
6. How would you describe the concept of interperiod equity to someone who has an interest in government but is not knowledgeable about accounting (such as a city council member, a member of a taxpayer association, or a student in a public administration program)? Be certain to include examples or analogies that are relevant to them.
7. Ten of the 21 types of deferrals identified in [Demystifying Deferrals: What They Are, What They Mean, and Why They Are Important](#), are not discussed further. Review the slides about one of those 10 types of deferrals in [Demystifying Deferrals: Technical Requirements & Resources](#). Describe the purpose of that deferral and how it functions, balancing technical accuracy with brevity and plain language.

Exercises

A. Prepaid Property Taxes

Each year, no later than August 31, a city with a fiscal year beginning October 1 adopts its annual budget and property tax levy for the following fiscal year. On August 31, 2023, the city levies \$10 million in property taxes for the fiscal year beginning October 1, 2023. The property tax levy takes into account a historical collection rate of 99%. The city has an enforceable legal claim to the property taxes starting September 1, 2023, at which time it sends out property tax bills. During the month of September, the city receives payments on those bills of \$500,000.

- a. On what date should the city report property taxes receivable? In what amount?
- b. What financial statement item should be reported at the same time as the property taxes receivable? In what amount?
- c. What financial statement item amount(s) change as a result of the receipt of the \$500,000 of tax payments? Do they increase or decrease?
- d. On what date should the city report property tax revenue? In what amount?
- e. What other financial statement item amount(s) change when the property tax revenue is reported? Do they increase or decrease? By how much?

B. Unavailable Revenue

A school district adopts an availability period of 120 days for federal grants. During the fiscal year ending June 30, 2023, the school district incurs \$5,250,000 in reimbursable costs under U.S. Department of Education (USDOE) grant programs, as shown in the timeline below, and submits the required grant requests. On average, it takes the USDOE six months to approve and make payment on the school district's grant requests.

Reimbursable Costs Incurred (\$ in thousands)											
July	Aug.	Sep.	Oct.	Nov.	Dec.	Jan.	Feb.	Mar.	Apr.	May	June
\$100	\$125	\$350	\$530	\$525	\$450	\$510	\$490	\$500	\$550	\$520	\$600

As of June 30, 2023, how much should the school district report for each of the following items in the governmental fund financial statements?

- FY 2023 grants receivable
- FY 2023 grant revenue
- Deferred inflows of resources—unavailable grant revenue

C. Debt Refunding

A county had a general obligation (GO) bond issue with \$12 million outstanding as of December 31, 2023, its fiscal year-end. Those bonds will be fully repaid by December 31, 2038. On January 2, 2024, the county uses the proceeds of \$10 million of refunding bonds with a final maturity of December 31, 2035, to fully pay off the \$12 million GO bond issue.

- Should the county report an economic gain or an economic loss? In what amount?
- Over how many years should the county divide the deferral related to the economic gain/loss?
- In each of those years, would interest expense increase or decrease as a result of the refunding?
- Presuming the deferral is divided evenly over the number of years identified in b, what would be the amount of the annual increase/decrease in interest expense?

D. Pension-Related Deferrals

A city with a single-employer defined benefit pension plan for its firefighters disclosed the following in its related note to financial statements:

Changes in the Net Pension Liability

	Increase (Decrease)		
	Total Pension Liability (a)	Plan Fiduciary Net Position (b)	Net Pension Liability (a)-(b)
Balances at June 30, 2022	\$ 878,328	\$ 558,868	\$ 319,460
Service cost	26,921	-	26,921
Interest	46,105	-	46,105
Difference between expected and actual experience	16,673	-	16,673
Changes in assumptions	315,693	-	315,693
Contributions—employer	-	11,450	(11,450)
Contributions—employee	-	10,770	(10,770)
Net investment income	-	17,216	(17,216)
Benefit payments, including refunds	(39,529)	(39,529)	-
Administrative expense	-	(735)	735
Balances at June 30, 2023	\$ 1,244,191	\$ 558,040	\$ 686,151

Other pertinent facts:

- The average remaining service period of all members of the firefighters’ plan is eight years.
- Based on the plan’s long-term expected rate of return, investment income for the fiscal year ending June 30, 2023, should have been \$39,121.
- City contributions to the plan after the measurement date were \$12,768.

Required: Fill in the missing information from the following required disclosures of pension-related deferrals and their subsequent reporting in pension expense:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience		
Changes in assumptions		
Net difference between projected and actual earnings on pension plan investments		
City contributions after the measurement date		
Total		

\$_____ reported as deferred _____ of resources related to pensions resulting from contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ending June 30, 2024. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Year Ending June 30
2024
2025
2026
2027
2028
Thereafter

E. Financial Analysis

Illustrated below is a general fund from a parks and recreation district's governmental funds balance sheet. The left-hand column presents the balance sheet information as it would have appeared prior to GASB Statements 63 and 65. The right-hand column presents the same balance sheet information in conformity with Statements 63 and 65.

	General Fund	
	Without Deferrals	With Deferrals
Assets:		
Cash and cash equivalents	\$34,234	\$34,234
Investments	152,054	152,054
Receivables, net:		
Property taxes	8,449	8,449
Accounts	4,388	4,388
Due from other governments	51,004	51,004
Due from other funds	1,586	1,586
Prepaid assets	13	13
Total assets	\$251,728	\$251,728
Liabilities, deferred inflows of resources, and fund balances		
Liabilities:		
Accounts payable	\$31,252	\$31,252
Deferred revenue	12,474	
Deposits and retainage payable	10,638	10,638
Due to other funds	350	350
Total liabilities	54,714	42,240
Deferred inflows of resources:		
Prepaid property taxes		91
Unavailable tax revenues		1,125
Unavailable grant revenues		11,258
Total deferred inflows of resources		12,474
Fund balances:		
Nonspendable	13	13
Restricted	68,577	68,577
Committed	8,309	8,309
Unassigned	120,115	120,115
Total fund balances	197,014	197,014
Total liabilities, deferred inflows of resources, and fund balances	\$251,728	\$251,728

Calculate the following three ratios for each column:

1. Liquidity: $(\text{cash \& cash equivalents} + \text{investments} + \text{receivables}) \div (\text{accounts payable} + \text{deferred revenue})$ - Generally, the higher a liquidity ratio, the more assets a government has that can be readily converted to cash to pay for short-term liabilities.
2. Leverage: $(\text{total assets} \div \text{total liabilities}) \times 100$ - Generally, the lower this ratio, the less leveraged a government is; in other words, the smaller the percentage of its assets that are financed through borrowing.
3. Leverage: $(\text{total liabilities} \div \text{unassigned fund balance}) \times 100$ - Generally, the lower this ratio, the less leveraged a government is; in other words, the smaller the percentage of its unassigned fund balance that would be needed to repay its short-term liabilities.

In comparison with the ratios calculated without deferrals, do the ratios calculated with deferrals make the government's general fund appear more or less financially healthy? Explain your conclusion.

CLOSING

Deferrals are critical components of governmental financial statements, impacting how we perceive and analyze the financial health of government entities. They may appear mystifying at first but ultimately are comprehensible by anyone, regardless of their knowledge of and experience with governmental accounting—or lack thereof.

Throughout this journey, we've uncovered the intricate nature of deferrals and their pivotal role in financial reporting. We've seen how these elements, though complex, are essential for an accurate representation of a government's financial position. This understanding is crucial not just for accountants and auditors but also for a broad range of stakeholders, including educators, policymakers, and citizens who rely on transparent and accountable financial reporting.