CRI CARR RIGGS & INGRAM
CPAs and Advisors

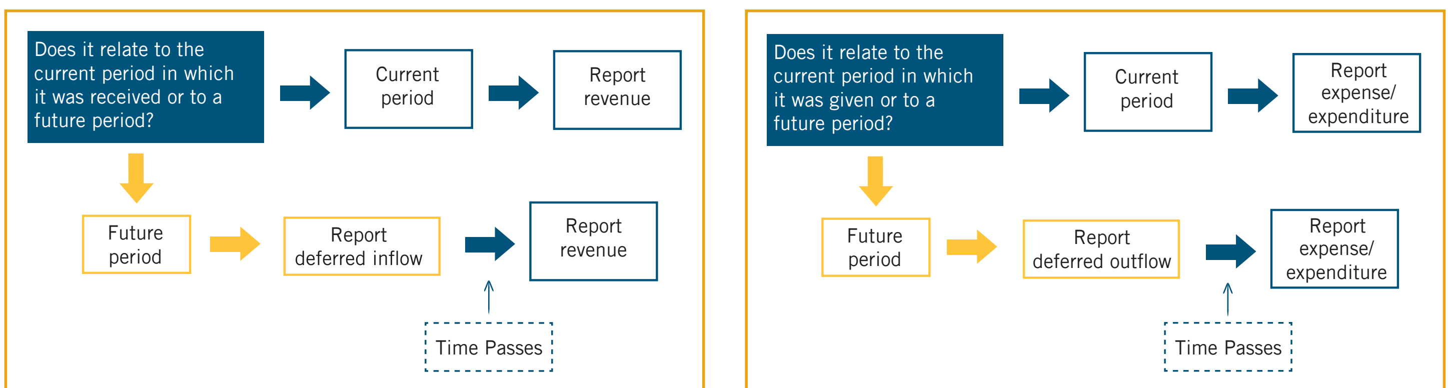
DEFERRED OUTFLOWS AND DEFERRED INFLOWS OF RESOURCES IN A NUTSHELL

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 recent **webinar** conducted by **Carr, Riggs & Ingram** (CRI) provided 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.

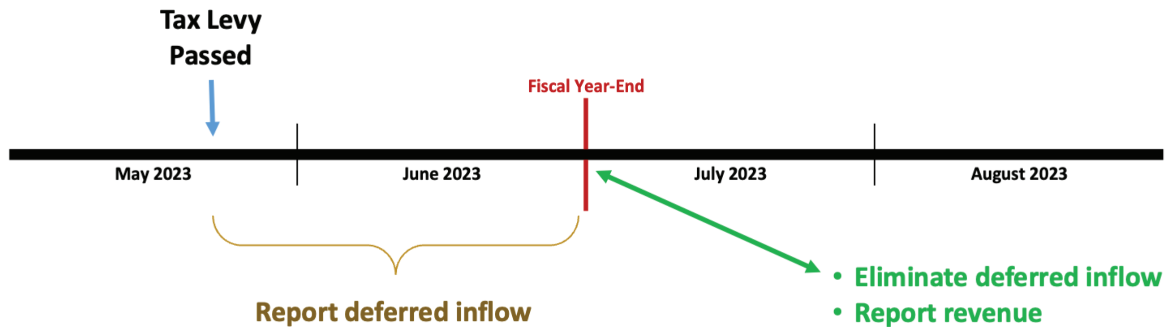
When a government receives resources, it generally reports revenue in its income statement. When it provides resources, it generally reports expenses (or expenditures in its governmental funds). Occasionally, the resources a government receives or provides during the year are related to a future period. 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.



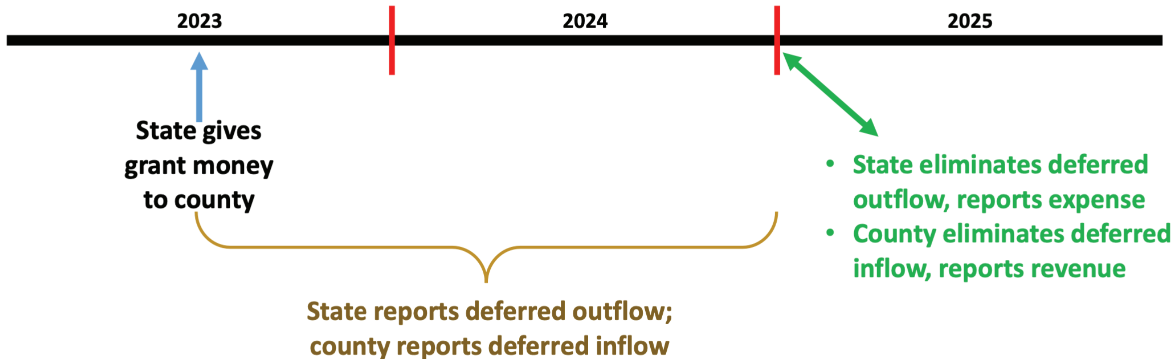
Common Examples of Deferrals

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. It often is the case that 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 report 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 a government has met a 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 2023 that it is not allowed to spend until 2025. 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 2025 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 2025, the state reports the grant payment as a *deferred outflow*. When 2025 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.

The reporting of deferrals by governments helps to 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 recording of the webinar, **Demystifying Deferrals**, is available online, and the **slide deck can be downloaded**.
- **A longer article** – *Demystifying Deferrals: What They Are, What They Mean, and Why They Are Important* – 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.
- **A two-page brochure** containing all of those resources, as well as discussion questions and exercises and a podcast recording discussion the top five challenges that deferrals pose to governments, is available for use in graduate and undergraduate courses that teach governmental accounting and financial reporting.

You also can reach out to your **CRI advisor** at any time to get answers to your questions about deferrals.