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Governmental Accounting Standards Series

Statement No. 34 of the Governmental Accounting Standards Board

Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments

GASB

GOVERNMENTAL ACCOUNTING STANDARDS BOARD

OF THE FINANCIAL ACCOUNTING FOUNDATION

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Preface

This Statement establishes new financial reporting requirements for state and local governments throughout the United States. When implemented, it will create new information and will restructure much of the information that governments have presented in the past. We developed these new requirements to make annual reports more comprehensive and easier to understand and use.

The GASB's first concepts Statement,* issued in 1987 after extensive due process, identifies what we believe are the most important objectives of financial reporting by governments. Some of those objectives reaffirm the importance of information that governments already include in their annual reports. Other objectives point to a need for new information. For this reason, this Statement requires governments to retain some of the information they currently report, but also requires them to reach beyond the familiar to new and different information. This Statement will result in reports that accomplish many of the objectives we emphasized in that concepts Statement.

Retaining the Familiar

Annual reports currently provide information about funds. Most funds are established by governing bodies (such as state legislatures, city councils, or school boards) to show restrictions on the planned use of resources or to measure, *in the short term,* the revenues and expenditures arising from certain activities. Concepts Statement 1 noted that annual reports should allow users to assess a government's accountability by assisting them in determining compliance with finance-related laws, rules, and regulations. For this reason and others, this Statement requires governments to continue to present financial statements that provide information about funds. The focus of these statements has been sharpened, however, by requiring governments to report information about their most important, or "major," funds, including a government's general fund. In current annual reports, fund information is reported in the aggregate by fund type, which often makes it difficult for users to assess accountability.

Fund statements also will continue to measure and report the "operating results" of many funds by measuring cash on hand and other assets that can easily be converted to cash. These statements show the performance—*in the short term*—of individual funds using the same measures that many governments use when financing their current operations. For example, if a government issues fifteen-year debt to build a school, it does not collect taxes in the first year sufficient to repay the *entire* debt; it levies and collects what is needed to make

*GASB Concepts Statement No. 1, *Objectives of Financial Reporting*.

that year's required payments. On the other hand, when governments charge a fee to users for services—as is done for most water or electric utilities—fund information will continue to be based on accrual accounting (discussed below) so that all costs of providing services are measured.

Showing budgetary compliance is an important component of government's accountability. Many citizens—regardless of their profession—participate in the process of establishing the original annual operating budgets of state and local governments. Governments will be required to continue to provide budgetary comparison information in their annual reports. An important change, however, is the requirement to add the government's *original* budget to that comparison. Many governments revise their original budgets over the course of the year for a variety of reasons. Requiring governments to report their original budget in addition to their *revised* budget adds a new analytical dimension and increases the usefulness of the budgetary comparison. Budgetary changes are not, by their nature, undesirable. However, we believe that the information will be important—in the interest of accountability—to those who are aware of, and perhaps made decisions based on, the original budget. It will also allow users to assess the government's ability to estimate and manage its general resources.

Bringing in New Information

The financial managers of governments are knowledgeable about the transactions, events, and conditions that are reflected in the government's financial report and of the fiscal policies that govern its operations. For the first time, those financial managers will be asked to share their insights in a required management's discussion and analysis (referred to as MD&A) by giving readers an objective and easily readable analysis of the government's *financial* performance for the year. This analysis should provide users with the information they need to help them assess whether the government's financial position has improved or deteriorated as a result of the year's operations.

Financial managers also will be in a better position to provide this analysis because for the first time the annual report will also include new government-wide financial statements, prepared using accrual accounting for all of the government's activities. Most governmental utilities and private-sector companies use accrual accounting. It measures not just current assets and liabilities but also long-term assets and liabilities (such as capital assets, including infrastructure, and general obligation debt). It also reports *all* revenues and *all* costs of providing services each year, not just those received or paid in the current year or soon after year-end.

These government-wide financial statements will help users:

- Assess the finances of the government in its entirety, including the year's operating results
- Determine whether the government's overall financial position improved or deteriorated
- Evaluate whether the government's current-year revenues were sufficient to pay for current-year services
- See the cost of providing services to its citizenry
- See how the government finances its programs—through user fees and other program revenues versus general tax revenues
- Understand the extent to which the government has invested in capital assets, including roads, bridges, and other infrastructure assets
- Make better comparisons between governments.

In short, the new annual reports should give government officials a new and more comprehensive way to demonstrate their stewardship in the long term *in addition to* the way they currently demonstrate their stewardship in the short term and through the budgetary process.

* * *

The GASB expresses its thanks to the thousands of preparers, auditors, academics, and users of governmental financial statements who have participated during the past decade in the research, consideration, and deliberations that have preceded the publication of this Statement. We especially appreciate the input of those who participated by becoming members of our various task forces, which began work on this and related projects as early as 1985.

The GASB is responsible for developing standards of state and local governmental accounting and financial reporting that will (a) result in useful information for users of financial reports and (b) guide and educate the public, including issuers, auditors, and users of those financial reports. We have an open decision-making process that encourages broad public participation.

Summary

This Statement establishes financial reporting standards for state and local governments, including states, cities, towns, villages, and special-purpose governments such as school districts and public utilities. It establishes that the basic financial statements and required supplementary information (RSI) for general purpose governments should consist of:

- *Management's discussion and analysis (MD&A).* MD&A should introduce the basic financial statements and provide an analytical overview of the government's financial activities. Although it is RSI, governments are required to present MD&A *before* the basic financial statements.
- *Basic financial statements*. The basic financial statements should include:
  – *Government-wide financial statements,* consisting of a statement of net assets and a statement of activities. Prepared using the economic resources measurement focus and the accrual basis of accounting, these statements should report all of the assets, liabilities, revenues, expenses, and gains and losses of the government. Each statement should distinguish between the governmental and business-type activities of the primary government and between the total primary government and its discretely presented component units by reporting each in separate columns. Fiduciary activities, whose resources are not available to finance the government's programs, should be excluded from the government-wide statements.
  – *Fund financial statements* consist of a series of statements that focus on information about the government's major governmental and enterprise funds, including its blended component units. Fund financial statements also should report information about a government's fiduciary funds and component units that are fiduciary in nature. *Governmental* fund financial statements (including financial data for the general fund and special revenue, capital projects, debt service, and permanent funds) should be prepared using the current financial resources measurement focus and the modified accrual basis of accounting. *Proprietary* fund financial statements (including financial data for enterprise and internal service funds) and *fiduciary* fund financial statements (including financial data for fiduciary funds and similar component units) should be prepared using the economic resources measurement focus and the accrual basis of accounting.
  – *Notes to the financial statements* consist of notes that provide information that is *essential* to a user's understanding of the basic financial statements.

- *Required supplementary information* (RSI). In addition to MD&A, this Statement requires budgetary comparison schedules to be presented as RSI along with other types of data as required by previous GASB pronouncements. This Statement also requires RSI for governments that use the modified approach for reporting infrastructure assets.

Special-purpose governments that are engaged in only governmental activities (such as some library districts) or that are engaged in both governmental and business-type activities (such as some school districts) generally should be reported in the same manner as general purpose governments. Special-purpose governments engaged only in business-type activities (such as utilities) should present the financial statements required for enterprise funds, including MD&A and other RSI.

Important Aspects of MD&A

MD&A should provide an objective and easily readable analysis of the government's financial activities based on currently known facts, decisions, or conditions. MD&A should include comparisons of the current year to the prior year based on the government-wide information. It should provide an analysis of the government's overall financial position and results of operations to assist users in assessing whether that financial position has improved or deteriorated as a result of the year's activities. In addition, it should provide an analysis of significant changes that occur in funds and significant budget variances. It should also describe capital asset and long-term debt activity during the year. MD&A should conclude with a description of currently known facts, decisions, or conditions that are expected to have a significant effect on financial position or results of operations.

Important Aspects of the Government-wide Financial Statements

Governments should report all capital assets, including infrastructure assets, in the government-wide statement of net assets and generally should report depreciation expense in the statement of activities. Infrastructure assets that are part of a network or subsystem of a network are not required to be depreciated as long as the government manages those assets using an asset management system that has certain characteristics and the government can document that the assets are being preserved approximately at (or above) a condition level established and disclosed by the government.

The net assets of a government should be reported in three categories—invested in capital assets net of related debt, restricted, and unrestricted. This Statement provides a definition of the term *restricted*. Permanent endowments or permanent fund principal amounts included in restricted net assets should be displayed in two additional components—expendable and nonexpendable.

The government-wide statement of activities should be presented in a format that reports expenses reduced by program revenues, resulting in a measurement of “net (expense) revenue” for each of the government’s functions. Program expenses should include all direct expenses. General revenues, such as taxes, and special and extraordinary items should be reported separately, ultimately arriving at the change in net assets for the period. Special items are significant transactions or other events that are either unusual or infrequent and are within the control of management.

Important Aspects of the Fund Financial Statements

To report additional and detailed information about the primary government, separate fund financial statements should be presented for governmental and proprietary funds. Required governmental fund statements are a balance sheet and a statement of revenues, expenditures, and changes in fund balances. Required proprietary fund statements are a statement of net assets; a statement of revenues, expenses, and changes in fund net assets; and a statement of cash flows. To allow users to assess the relationship between fund and government-wide financial statements, governments should present a summary reconciliation to the government-wide financial statements at the bottom of the fund financial statements or in an accompanying schedule.

Each of the fund statements should report separate columns for the general fund and for other major governmental and enterprise funds. Major funds are funds whose revenues, expenditures/expenses, assets, or liabilities (excluding extraordinary items) are at least 10 percent of corresponding totals for all governmental or enterprise funds and at least 5 percent of the aggregate amount for all governmental and enterprise funds. Any other fund may be reported as a major fund if the government’s officials believe that fund is particularly important to financial statement users. Nonmajor funds should be reported in the aggregate in a separate column. Internal service funds also should be reported in the aggregate in a separate column on the proprietary fund statements.

Fund balances for governmental funds should be segregated into reserved and unreserved categories. Proprietary fund net assets should be reported in the same categories required for the government-wide financial statements. Proprietary fund statements of net assets should distinguish between current and noncurrent assets and liabilities and should display restricted assets.

Proprietary fund statements of revenues, expenses, and changes in fund net assets should distinguish between operating and nonoperating revenues and expenses. These statements should also report capital contributions, contributions to permanent and term endowments, special and extraordinary items, and transfers separately at the bottom of the statement to arrive at the all-inclusive change in fund net assets. Cash flows statements should be prepared using the direct method.

Separate fiduciary fund statements (including component units that are fiduciary in nature) also should be presented as part of the fund financial statements. Fiduciary funds should be used to report assets that are held in a trustee or agency capacity for others and that cannot be used to support the government's own programs. Required fiduciary fund statements are a statement of fiduciary net assets and a statement of changes in fiduciary net assets.

Interfund activity includes interfund loans, interfund services provided and used, and interfund transfers. This activity should be reported separately in the fund financial statements and generally should be eliminated in the aggregated government-wide financial statements.

Required Supplementary Information

To demonstrate whether resources were obtained and used in accordance with the government's legally adopted budget, RSI should include budgetary comparison schedules for the general fund and for each major special revenue fund that has a legally adopted annual budget. The budgetary comparison schedules should present both (a) the original and (b) the final appropriated budgets for the reporting period as well as (c) actual inflows, outflows, and balances, stated on the government's budgetary basis. This Statement also requires RSI for governments that use the modified approach for reporting infrastructure assets.

Effective Date and Transition

The requirements of this Statement are effective in three phases based on a government's total annual revenues in the first fiscal year ending after June 15, 1999. Governments with total annual revenues (excluding extraordinary items) of $100 million or more (phase 1) should apply this Statement for periods beginning after June 15, 2001. Governments with at least $10 million but less than $100 million in revenues (phase 2) should apply this Statement for periods beginning after June 15, 2002. Governments with less than $10 million in revenues (phase 3) should apply this Statement for periods beginning after June 15, 2003. Earlier application is encouraged. Governments that elect early implementation of this Statement for periods beginning before June 15, 2000, should also implement GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions,* at the same time. If a primary government chooses early implementation of this Statement, all of its component units also should implement this standard early to provide the financial information required for the government-wide financial statements.

Prospective reporting of general infrastructure assets is required at the effective dates of this Statement. Retroactive reporting of all major general governmental infrastructure assets is encouraged at that date. For phase 1 and phase 2 governments, retroactive reporting is *required* four years after the effective date on the basic provisions for all major general infrastructure assets that were acquired or significantly reconstructed, or that received significant improvements, in fiscal years ending after June 30, 1980. Phase 3 governments are encouraged to report infrastructure retroactively, but may elect to report general infrastructure prospectively only.

Components of This Statement

This Statement consists of several components. The detailed authoritative standards established by this Statement are presented in paragraphs 3 through 166. Appendix C provides nonauthoritative illustrations of MD&A; the basic financial statements required for a variety of types of governments, such as towns, school districts, fire districts, and utilities; notes to those financial statements required by this Statement; and RSI other than MD&A. The reasons for the Board's conclusions on the major issues are discussed in the Basis for Conclusions (Appendix B). Appendix D summarizes how the new standards would be incorporated into the GASB's June 30, 1999, *Codification of Governmental Accounting and Financial Reporting Standards*.

Unless otherwise specified, pronouncements of the GASB apply to financial reports of all state and local governmental entities, including general purpose governments, public benefit corporations and authorities, public employee retirement systems, and public utilities, hospitals and other healthcare providers, and colleges and universities. Paragraph 3 discusses the applicability of this Statement.

Statement No. 34 of the
Governmental Accounting
Standards Board

Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments

June 1999

Governmental Accounting Standards Board
of the Financial Accounting Foundation
401 Merritt 7, P.O. Box 5116, Norwalk, Connecticut 06856-5116

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June 1999

CONTENTS

Paragraph Numbers

Paragraph Numbers

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Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments

June 1999

INTRODUCTION

1. The objective of this Statement is to enhance the understandability and usefulness of the general purpose external financial reports of state and local governments to the citizenry, legislative and oversight bodies, and investors and creditors. GASB Concepts Statement No. 1, *Objectives of Financial Reporting,* recognizes these groups as the primary intended users of governmental financial reports and establishes financial reporting objectives to meet their information needs. Those objectives are the foundation for the standards in this Statement.

2. Accountability is the paramount objective of governmental financial reporting—the objective from which all other financial reporting objectives flow.[1] Governments' duty to be accountable includes providing financial information that is useful for economic, social, and political decisions. Financial reports that contribute to these decisions include information useful for (a) comparing actual financial results with the legally adopted budget, (b) assessing financial condition and results of operations, (c) assisting in determining compliance with finance-related laws, rules, and regulations, and (d) assisting in evaluating efficiency and effectiveness.[2]

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[1]Concepts Statement 1, paragraphs 56 and 76.

[2]Concepts Statement 1, paragraph 32.

STANDARDS OF GOVERNMENTAL ACCOUNTING AND FINANCIAL REPORTING

Scope and Applicability

3. This Statement establishes accounting and financial reporting standards for general purpose external financial reporting by state and local governments.[3] It is written from the perspective of *general purpose* governments—states, cities, counties, towns, and villages. Specific financial reporting standards for *special-purpose* governments are established in paragraphs 134 through 141.

4. This Statement establishes specific standards for the basic financial statements, management's discussion and analysis (MD&A), and certain required supplementary information (RSI) other than MD&A.

5. This Statement supersedes NCGA Statement 1, *Governmental Accounting and Financial Reporting Principles,* Summary Statement of Principles nos. 3, 6, and 7, paragraphs 19, 20, 34–41, 47–56, 60, 71, 74, 101–106, 122, 131, 136, 137, 140–142, 144, 146–154, 162–164, and 166–171, and footnote 4; NCGA Statement 2, *Grant, Entitlement, and Shared Revenue Accounting by State and Local Governments,* paragraphs 15, 16, and 18; NCGA Statement 4, *Accounting and Financial Reporting Principles for Claims and Judgments and Compensated Absences,* paragraphs 5–7 and 32–42; NCGA Statement 5, *Accounting and Financial Reporting Principles for Lease Agreements of State and Local Governments,* paragraphs 7–9; NCGA Interpretation 2, *Segment Information for Enterprise Funds;* NCGA Interpretation 5, *Authoritative Status of Governmental Accounting, Auditing, and Financial Reporting (1968);* NCGA Interpretation 6, *Notes to the Financial Statements Disclosure,* paragraph 3; NCGA Interpretation 10, *State and Local Government Budgetary Reporting,* paragraph 12; AICPA Statement of Position 77-2, *Accounting for Interfund Transfers of State and Local Governments;* AICPA Statement of Position 78-7, *Financial Accounting and Reporting by Hospitals Operated by a Governmental Unit;* GASB Statement No. 7, *Advance Refundings Resulting in Defeasance of Debt,* paragraph 9 and footnote 1; GASB Statement No. 11, *Measurement Focus and Basis of Accounting—Governmental Fund Operating Statements,* paragraphs 1–39, 62–76, and 81–99; GASB Statement No. 14, *The Financial Reporting Entity,* paragraphs 45–47, 49,

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[3]The scope of this Statement excludes public colleges and universities. A revised Exposure Draft, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities,* issued June 30, 1999, proposes standards for public colleges and universities.

56, and 57; GASB Statement No. 17, *Measurement Focus and Basis of Accounting—Governmental Fund Operating Statements: Amendment of the Effective Dates of GASB Statement No. 11 and Related Statements,* paragraphs 1–3 and 5; GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting,* footnote 1; GASB Statement No. 21, *Accounting for Escheat Property,* paragraph 6; and GASB Statement No. 29, *The Use of Not-for-Profit Accounting and Financial Reporting Principles by Governmental Entities,* paragraphs 1, 3, 4, and 6. In addition, this Statement amends NCGA Statement 1, Summary Statement of Principles nos. 1, 2, 5, 8–10, and 12 and paragraphs 2–4, 16–18, 22, 25–27, 30, 32, 33, 42–44, 46, 57, 59, 61, 72, 99, 100, 107, 128, 129, 135, 138, 139, 145, 155–159, 173, and 175; NCGA Statement 4, paragraphs 6, 13, 16, and 17; NCGA Statement 5, paragraphs 5, 6, 10, 11, and 14–17; NCGA Interpretation 3, *Revenue Recognition—Property Taxes,* paragraph 3; NCGA Interpretation 6, paragraphs 2, 4, 5, and 8; NCGA Interpretation 8, *Certain Pension Matters,* paragraph 12; NCGA Interpretation 9, *Certain Fund Classifications and Balance Sheet Accounts,* paragraphs 9 and 12; NCGA Interpretation 10, paragraphs 11, 14, 15, and 25; GASB Statement No. 1, *Authoritative Status of NCGA Pronouncements and AICPA Industry Audit Guide,* paragraph 8; GASB Statement No. 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements,* paragraphs 64 and 65; GASB Statement No. 6, *Accounting and Financial Reporting for Special Assessments,* paragraphs 13, 15, 17, 19, and 23; GASB Statement 7, paragraphs 1, 3, 7, 8, 10, 11, and 14; GASB Statement No. 8, *Applicability of FASB Statement No. 93, "Recognition of Depreciation by Not-for-Profit Organizations," to Certain State and Local Governmental Entities,* paragraphs 10 and 11 and footnote 3; GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting,* paragraphs 1, 5, 17, 18, 21, 22, and 31–34; GASB Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues,* paragraphs 52, 53, 61, 63–65, 67–69, and 78 and footnote 12; GASB Statement No. 12, *Disclosure of Information on Postemployment Benefits Other Than Pension Benefits by State and Local Governmental Employers,* paragraph 12; GASB Statement No. 13, *Accounting for Operating Leases with Scheduled Rent Increases,* paragraphs 1, 4, 7, and 9; GASB Statement 14, paragraphs 9, 11, 12, 19, 42, 44, 50–52, 54, 58, 63, 73, 74, and 131; GASB Statement No. 16, *Accounting for Compensated Absences,* paragraph 13; GASB Statement 17, paragraphs 4 and 6; GASB Statement No. 18, *Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Costs,* paragraphs 3, 7, 10, 11, and 16 and footnote 2; GASB Statement 20, paragraphs 7–9; GASB Statement 21, paragraphs 3–5; GASB Statement No. 23, *Accounting and*

Financial Reporting for Refundings of Debt Reported by Proprietary Activities, paragraphs 1, 3, 4, and 6; GASB Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans,* paragraph 13 and footnote 9; GASB Statement No. 26, *Financial Reporting for Postemployment Healthcare Plans Administered by Defined Benefit Pension Plans,* paragraph 4 and footnote 4; GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers,* paragraphs 15–17, 19, 23, and 25 and footnote 14; GASB Statement No. 28, *Accounting and Financial Reporting for Securities Lending Transactions,* paragraphs 3, 4, and 10 and footnotes 3, 6, and 9; GASB Statement 29, paragraph 7; GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools,* paragraphs 7, 14, 18, and 19; GASB Statement No. 32, *Accounting and Financial Reporting for Internal Revenue Code Section 457 Deferred Compensation Plans*, paragraph 4; GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions,* paragraph 11; GASB Interpretation No. 1, *Demand Bonds Issued by State and Local Governmental Entities,* paragraphs 6, 10, and 13 and footnote 2; and GASB Interpretation No. 4, *Accounting and Financial Reporting for Capitalization Contributions to Public Entity Risk Pools,* paragraph 6.

Minimum Requirements for Basic Financial Statements and Required Supplementary Information

6. The minimum requirements for management's discussion and analysis (MD&A), basic financial statements, and required supplementary information other than MD&A are:

a. *Management's discussion and analysis.* MD&A, a component of RSI, should introduce the basic financial statements and provide an analytical overview of the government's financial activities. (See paragraphs 8–11.)
b. *Basic financial statements.* The basic financial statements should include:
   (1) *Government-wide financial statements.* The government-wide statements should display information about the reporting government as a whole, except for its fiduciary activities. The statements should include separate columns for the governmental and business-type activities of the primary government[4] as well as for its component units. Government-wide financial statements should be prepared using the economic resources measurement focus and the accrual basis of accounting. (See paragraphs 12–62.)

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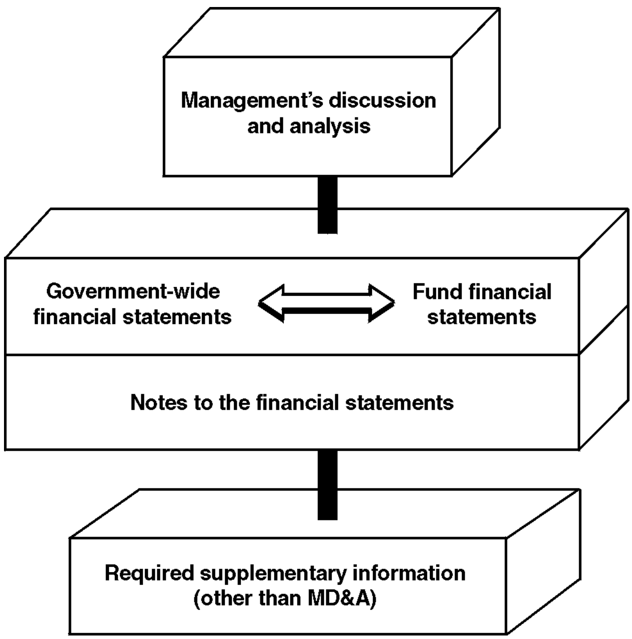
[4]Unless otherwise noted, the term *primary government* includes the primary government and its blended component units, as defined in Statement 14.

(2) *Fund financial statements.* Fund financial statements for the primary government's governmental, proprietary, and fiduciary funds should be presented after the government-wide statements. These statements display information about major funds individually and nonmajor funds in the aggregate for governmental and enterprise funds. Fiduciary statements should include financial information for fiduciary funds and similar component units. Each of the three fund categories should be reported using the measurement focus and basis of accounting required for that category. (See paragraphs 63–112.)

(3) *Notes to the financial statements.* (See paragraphs 113–123.)

c. *Required supplementary information other than MD&A.* Except for MD&A, required supplementary information, including the required budgetary comparison information, should be presented immediately following the notes to the financial statements.[5] (See paragraphs 129–133.)

7. The following diagram illustrates the minimum requirements for general purpose external financial statements.



[5]This paragraph does not modify the provisions of GASB Statement No. 30, *Risk Financing Omnibus,* paragraph 7.

Management's Discussion and Analysis (MD&A)

8. The basic financial statements should be preceded by MD&A, which is required supplementary information (RSI). MD&A should provide an objective and easily readable analysis of the government's financial activities based on currently known[6] facts, decisions, or conditions. The financial managers of governments are knowledgeable about the transactions, events, and conditions that are reflected in the government's financial report and of the fiscal policies that govern its operations. MD&A provides financial managers with the opportunity to present both a short- and a long-term analysis of the government's activities.[7]

9. MD&A should discuss the current-year results in comparison with the prior year, with emphasis on the current year. This fact-based analysis should discuss the positive and negative aspects of the comparison with the prior year. The use of charts, graphs, and tables is encouraged to enhance the understandability of the information.

10. MD&A should focus on the primary government. Comments in MD&A should distinguish between information pertaining to the primary government and that of its component units. Determining whether to discuss matters related to a component unit is a matter of professional judgment and should be based on the individual component unit's significance to the total of all discretely presented component units and that component unit's relationship with the primary government. When appropriate, the reporting entity's MD&A should refer readers to the component unit's separately issued financial statements.

11. MD&A requirements established by this Statement are general rather than specific to encourage financial managers to effectively report only the most relevant information and avoid "boilerplate" discussion. At a minimum, MD&A should include:

a. A brief discussion of the basic financial statements, including the relationships of the statements to each other, and the significant differences in the information they provide. This discussion should include analyses that assist

[6]For purposes of MD&A, *currently known facts* are information that management is aware of as of the date of the auditor's report.

[7]If a letter of transmittal is presented in the introductory section of a comprehensive annual financial report (CAFR), governments are encouraged not to duplicate information contained in MD&A.

readers in understanding why measurements and results reported in fund financial statements either reinforce information in government-wide statements or provide additional information.

b. Condensed financial information derived from government-wide financial statements comparing the current year to the prior year. At a minimum, governments should present the information needed to support their analysis of financial position and results of operations required in c, below, including these elements:
   (1) Total assets, distinguishing between capital and other assets
   (2) Total liabilities, distinguishing between long-term liabilities and other liabilities
   (3) Total net assets, distinguishing among amounts invested in capital assets, net of related debt; restricted amounts; and unrestricted amounts
   (4) Program revenues, by major source
   (5) General revenues, by major source
   (6) Total revenues
   (7) Program expenses, at a minimum by function
   (8) Total expenses
   (9) Excess (deficiency) before contributions to term and permanent endowments or permanent fund principal, special and extraordinary items, and transfers
   (10) Contributions
   (11) Special and extraordinary items
   (12) Transfers
   (13) Change in net assets
   (14) Ending net assets

c. An analysis of the government's overall financial position and results of operations to assist users in assessing whether financial position has improved or deteriorated as a result of the year's operations. The analysis should address both governmental and business-type activities as reported in the government-wide financial statements and should include *reasons* for significant changes from the prior year, not simply the amounts or percentages of change. In addition, important economic factors, such as changes in the tax or employment bases, that significantly affected operating results for the year should be discussed.

d. An analysis of balances and transactions of individual funds. The analysis should address the reasons for significant changes in fund balances or fund net assets and whether restrictions, commitments, or other limitations significantly affect the availability of fund resources for future use.

e. An analysis of significant variations between original and final budget amounts and between final budget amounts and actual budget results for the general fund (or its equivalent). The analysis should include any currently known reasons for those variations that are expected to have a significant effect on future services or liquidity.
f. A description of significant capital asset and long-term debt activity[8] during the year, including a discussion of commitments made for capital expenditures, changes in credit ratings, and debt limitations that may affect the financing of planned facilities or services.
g. A discussion by governments that use the modified approach (paragraphs 23–25) to report some or all of their infrastructure assets including:
   (1) Significant changes in the assessed condition of eligible infrastructure assets from previous condition assessments
   (2) How the current assessed condition compares with the condition level the government has established
   (3) Any significant differences from the estimated annual amount to maintain/preserve eligible infrastructure assets compared with the actual amounts spent during the current period.
h. A description of currently known facts,[9] decisions, or conditions that are expected to have a significant effect on financial position (net assets) or results of operations (revenues, expenses, and other changes in net assets).

Government-wide Financial Statements

12. The government-wide financial statements consist of a statement of net assets and a statement of activities. Those statements should:

a. Report information about the overall government without displaying individual funds or fund types
b. Exclude information about fiduciary activities, including component units that are fiduciary in nature (such as certain public employee retirement systems)
c. Distinguish between the primary government and its discretely presented component units
d. Distinguish between governmental activities and business-type activities of the primary government

[8]Paragraphs 116 through 120 require certain disclosures about capital assets and long-term debt. It is sufficient for purposes of this discussion in MD&A to summarize that information and refer to it for additional details.

[9]See footnote 6.

e. Measure and report all assets (both financial and capital), liabilities, revenues, expenses, gains, and losses using the economic resources measurement focus and accrual basis of accounting.

Focus of the Government-wide Financial Statements

13. The statement of net assets and the statement of activities should display information about the reporting government as a whole. The statements should include the primary government and its component units, except for the fiduciary funds of the primary government and component units that are fiduciary in nature. Those funds and component units should be reported only in the statements of fiduciary net assets and changes in fiduciary net assets. (See paragraphs 106–111.)

14. The focus of the government-wide financial statements should be on the primary government, as defined in Statement 14. Separate rows and columns should be used to distinguish between the total primary government and its discretely presented component units. A total column should be presented for the primary government. A total column for the entity as a whole may be presented but is not required. Prior-year data may be presented in the government-wide statements but also are not required.

15. Separate rows and columns also should be used to distinguish between the governmental and business-type activities[10] of the primary government. Governmental activities generally are financed through taxes, intergovernmental revenues, and other nonexchange revenues. These activities are usually reported in governmental funds and internal service funds. Business-type activities are financed in whole or in part by fees charged to external parties for goods or services. These activities are usually reported in enterprise funds.

Measurement Focus and Basis of Accounting

16. The statement of net assets and the statement of activities should be prepared using the economic resources measurement focus and the accrual basis of accounting. Revenues, expenses, gains, losses, assets, and liabilities resulting from exchange and exchange-like transactions should be recognized

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[10]This paragraph is not intended to require segregation of activities into governmental and proprietary funds beyond what is currently reported by management of the government unless the activity is required to be reported as an enterprise fund, as discussed in paragraph 67.

when the exchange takes place.[11] Revenues, expenses, gains, losses, assets, and liabilities resulting from nonexchange transactions should be recognized in accordance with the requirements of Statement 33. (Additional guidance on reporting capital assets is discussed in paragraphs 18 through 29, below.)

17. Reporting for governmental and business-type activities should be based on all applicable GASB pronouncements as well as the following pronouncements issued on or before November 30, 1989, *unless* those pronouncements conflict with or contradict GASB pronouncements:

a. Financial Accounting Standards Board (FASB) Statements[12] and Interpretations
b. Accounting Principles Board (APB) Opinions[13]
c. Accounting Research Bulletins (ARBs) of the Committee on Accounting Procedure.

Business-type activities may also apply FASB pronouncements issued after November 30, 1989, as provided in paragraph 7 of GASB Statement 20, as amended by this Statement.

Reporting Capital Assets

18. Capital assets should be reported at historical cost. The cost of a capital asset should include capitalized interest and ancillary charges necessary to place the asset into its intended location and condition for use. Ancillary charges

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[11]In this Statement, the terms *transaction* and *transactions* refer only to *external* events in which something of value (benefit) passes between two or more parties. The difference between exchange and exchange-like transactions is a matter of degree. In contrast to a "pure" exchange transaction, an exchange-like transaction is one in which the values exchanged, though related, may not be quite equal or in which the direct benefits may not be exclusively for the parties to the transaction. Nevertheless, the exchange characteristics of the transaction are strong enough to justify treating the transaction as an exchange for accounting recognition.

[12]The provisions of FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation,* only apply to governments that have *qualifying* enterprise funds.

[13]Changes in accounting principles, addressed in APB Opinion No. 20, *Accounting Changes,* as amended, should be reported as restatements of beginning net assets/fund equity, not as a separately identified cumulative effect in the current-period statement of activities or proprietary fund statement of revenues, expenses, and changes in fund net assets.

include costs that are directly attributable to asset acquisition—such as freight and transportation charges, site preparation costs, and professional fees. Donated capital assets should be reported at their estimated fair value at the time of acquisition plus ancillary charges, if any.

19. As used in this Statement, the term *capital assets* includes land, improvements to land, easements, buildings, building improvements, vehicles, machinery, equipment, works of art and historical treasures, infrastructure, and all other tangible or intangible assets that are used in operations and that have initial useful lives extending beyond a single reporting period. *Infrastructure assets* are long-lived capital assets that normally are stationary in nature and normally can be preserved for a significantly greater number of years than most capital assets. Examples of infrastructure assets include roads, bridges, tunnels, drainage systems, water and sewer systems, dams, and lighting systems. Buildings, except those that are an ancillary part of a network of infrastructure assets, should not be considered infrastructure assets for purposes of this Statement.

20. Capital assets that are being or have been depreciated (paragraph 22) should be reported net of accumulated depreciation in the statement of net assets. (Accumulated depreciation may be reported on the face of the statement or disclosed in the notes.) Capital assets that are not being depreciated, such as land or infrastructure assets reported using the modified approach (paragraphs 23 through 25), should be reported separately if the government has a significant amount of these assets. Capital assets also may be reported in greater detail, such as by major class of asset (for example, infrastructure, buildings and improvements, vehicles, machinery and equipment). Required disclosures are discussed in paragraphs 116 and 117.

21. Capital assets should be depreciated over their estimated useful lives unless they are either inexhaustible or are infrastructure assets reported using the modified approach in paragraphs 23 through 25. Inexhaustible capital assets such as land and land improvements should not be depreciated.

22. Depreciation expense should be reported in the statement of activities as discussed in paragraphs 44 and 45. Depreciation expense should be measured by allocating the net cost of depreciable assets (historical cost less estimated salvage value) over their estimated useful lives in a systematic and rational manner. It may be calculated for (a) a class of assets, (b) a network of

assets,[14] (c) a subsystem of a network,[15] or (d) individual assets. (Composite methods may be used to calculate depreciation expense. See paragraphs 161 through 166 for a more complete discussion of depreciation.)

Modified approach

23. Infrastructure assets that are part of a network or subsystem of a network[16] (hereafter, eligible infrastructure assets) are not required to be depreciated as long as two requirements are met. First, the government manages the eligible infrastructure assets using an asset management system that has the characteristics set forth below; second, the government documents that the eligible infrastructure assets are being preserved approximately at (or above) a condition level established and disclosed by the government.[17] To meet the first requirement, the asset management system should:

a. Have an up-to-date inventory of eligible infrastructure assets
b. Perform condition assessments[18] of the eligible infrastructure assets and summarize the results using a measurement scale
c. Estimate each year the annual amount to maintain and preserve the eligible infrastructure assets at the condition level established and disclosed by the government.

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[14] A network of assets is composed of all assets that provide a particular type of service for a government. A network of infrastructure assets may be only one infrastructure *asset* that is composed of many *components*. For example, a network of infrastructure assets may be a dam composed of a concrete dam, a concrete spillway, and a series of locks.

[15] A subsystem of a network of assets is composed of all assets that make up a similar portion or segment of a network of assets. For example, all the roads of a government could be considered a network of infrastructure assets. Interstate highways, state highways, and rural roads could each be considered a subsystem of that network.

[16] If a government chooses not to depreciate a subsystem of infrastructure assets based on the provisions of this paragraph, the characteristics of the asset management system required by this paragraph and the documentary evidence required by paragraph 24 should be for that *subsystem* of infrastructure assets.

[17] The condition level should be established and documented by administrative or executive policy, or by legislative action.

[18] Condition assessments should be documented in such a manner that they can be replicated. Replicable condition assessments are those that are based on sufficiently understandable and complete measurement methods such that different measurers using the same methods would reach substantially similar results. Condition assessments may be performed by the government itself or by contract.

24. Determining what constitutes adequate documentary evidence to meet the second requirement in paragraph 23 for using the modified approach requires professional judgment because of variations among governments' asset management systems and condition assessment methods. These factors also may vary within governments for different eligible infrastructure assets. However, governments should document that:

a. Complete condition assessments of eligible infrastructure assets are performed in a consistent manner at least every three years.[19]
b. The results of the three most recent complete condition assessments provide reasonable assurance that the eligible infrastructure assets are being preserved approximately at (or above) the condition level[20] established and disclosed by the government.

25. If eligible infrastructure assets meet the requirements of paragraphs 23 and 24 and are not depreciated, all expenditures made for those assets (except for additions and improvements) should be expensed in the period incurred. Additions and improvements to eligible infrastructure assets should be capitalized. Additions or improvements increase the capacity or efficiency of infrastructure assets rather than preserve the useful life of the assets.

26. If the requirements of paragraphs 23 and 24 are no longer met, the depreciation requirements of paragraphs 21 and 22 should be applied for subsequent reporting periods.[21]

Reporting works of art and historical treasures

27. Except as discussed in this paragraph, governments should capitalize works of art, historical treasures, and similar assets at their historical cost or fair value at date of donation (estimated if necessary) whether they are held as individual

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[19]Condition assessments may be performed using statistical samples that are representative of the eligible infrastructure assets being preserved. Governments may choose to assess their eligible infrastructure assets on a cyclical basis. For example, one-third may be assessed each year. If a cyclical basis is used, a condition assessment is considered *complete* for a network or subsystem only when condition assessments have been performed for all (or statistical samples of) eligible infrastructure assets in that network or subsystem.

[20]For example, condition could be measured either by a condition index or as the percentage of a network of infrastructure assets in good or poor condition.

[21]This change should be reported as a change in accounting estimate.

items or in a collection. Governments are encouraged, but not required, to capitalize a collection (and all additions to that collection) whether donated or purchased that meets all of the following conditions.[22] The collection is:

a. Held for public exhibition, education, or research in furtherance of public service, rather than financial gain
b. Protected, kept unencumbered, cared for, and preserved
c. Subject to an organizational policy that requires the proceeds from sales of collection items to be used to acquire other items for collections.

Governments should disclose information about their works of art and historical collections as required by paragraph 118.

28. Recipient governments should recognize as revenues donations of works of art, historical treasures, and similar assets, in accordance with Statement 33. When donated collection items are added to *noncapitalized* collections, governments should recognize program expense equal to the amount of revenues recognized.

29. Capitalized collections or individual items that are exhaustible, such as exhibits whose useful lives are diminished by display or educational or research applications, should be depreciated over their estimated useful lives. Depreciation is not required for collections or individual items that are inexhaustible.

Required Financial Statements—Statement of Net Assets

30. The statement of net assets should report all financial and capital resources. Governments are encouraged to present the statement in a format that displays *assets less liabilities equal net assets,* although the traditional balance sheet format (assets equal liabilities plus net assets) may be used. Regardless of the format used, however, the statement of net assets should report the difference between assets and liabilities as *net assets,* not fund balances or equity.

[22]Collections already capitalized at June 30, 1999, should remain capitalized and all additions to those collections should be capitalized, even if they meet the conditions for exemption from capitalization.

31. Governments are encouraged to present assets and liabilities in order of their relative liquidity.[23] An asset's liquidity should be determined by how readily it is expected to be converted to cash and whether restrictions limit the government's ability to use the resources. A liability's liquidity is based on its maturity, or when cash is expected to be used to liquidate it. The liquidity of an asset or liability may be determined by assessing the average liquidity of the class of assets or liabilities to which it belongs, even though individual balances may be significantly more or less liquid than others in the same class and some items may have both current and long-term elements. Liabilities whose average maturities are greater than one year should be reported in two components—the amount due within one year and the amount due in more than one year. Additional disclosures concerning long-term liabilities are discussed in paragraph 119.

32. The difference between a government's assets and its liabilities is its *net assets*. Net assets should be displayed in three components—*invested in capital assets, net of related debt; restricted* (distinguishing between major categories of restrictions); and *unrestricted*.

Invested in Capital Assets, Net of Related Debt

33. This component of net assets consists of capital assets (see paragraph 19), including *restricted* capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. If there are significant unspent related debt proceeds at year-end, the portion of the debt attributable to the unspent proceeds should *not* be included in the calculation of *invested in capital assets, net of related debt*. Rather, that portion of the debt should be included in the same net assets component as the unspent proceeds—for example, *restricted for capital projects*.

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[23]Use of a *classified* statement of net assets, which distinguishes between all current and long-term assets and liabilities, is also acceptable. (Paragraphs 97 through 99 provide guidance on presenting classified balance sheets, including reporting on restricted assets.)

Restricted Net Assets

34. Net assets should be reported as restricted when constraints placed on net asset use are either:[24]

a. Externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments
b. Imposed by law through constitutional provisions or enabling legislation.

Enabling legislation,[25] as the term is used in this Statement, authorizes the government to assess, levy, charge, or otherwise mandate payment of resources (from external resource providers) *and* includes a legally enforceable requirement that those resources be used only for the specific purposes stipulated in the legislation.

35. When permanent endowments or permanent fund principal amounts are included, "restricted net assets" should be displayed in two additional components—expendable and nonexpendable. Nonexpendable net assets are those that are required to be retained in perpetuity.

Unrestricted Net Assets

36. Unrestricted net assets consist of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt."

37. In the governmental environment, net assets often are *designated* to indicate that management does not consider them to be available for general operations. In contrast to *restricted* net assets, these types of constraints on resources are *internal* and management can remove or modify them. As described in paragraph 34, however, *enabling legislation* established by the reporting government should not be construed as an *internal constraint*. Designations of net assets should not be reported on the face of the statement of net assets.

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[24]Because different measurement focuses and bases of accounting are used in the statement of net assets than in governmental fund statements, and because the definition of *reserved* includes more than resources that are *restricted* (as discussed in this paragraph), amounts reported as *reserved fund balances* in governmental funds will generally be different from amounts reported as *restricted net assets* in the statement of net assets.

[25]Enabling legislation also includes restrictions on asset use established by a governmental utility's own governing board when that utility reports based on FASB Statement 71.

38. The operations of the reporting government should be presented in a format that reports the *net (expense) revenue* of its individual functions. An objective of using the net (expense) revenue format is to report the relative financial burden of each of the reporting government's functions on its taxpayers. This format identifies the extent to which each function of the government draws from the general revenues of the government or is self-financing through fees and intergovernmental aid. As discussed in paragraph 47, this notion of burden on the reporting government's taxpayers is important in determining what is program or general revenue. General revenues, contributions to term and permanent endowments, contributions to permanent fund principal, special and extraordinary items, and transfers should be reported separately after the total net expenses of the government's functions, ultimately arriving at the "change in net assets" for the period. An example of a format that meets these requirements is illustrated in paragraph 54.[26]

39. The statement of activities should present *governmental* activities at least at the level of detail required in the governmental fund statement of revenues, expenditures, and changes in fund balances—at a minimum by *function,*[27] as discussed in NCGA Statement 1, paragraphs 111 through 116. Governments should present *business-type* activities at least by *segment,* as discussed in paragraph 122.

40. Governments are encouraged to provide data in the statement of activities at a more detailed level if the additional detail provides more useful information without significantly reducing readers' ability to understand the statement. No specific level of detail is appropriate for all governments; some have hundreds of programs and others have only a few. Therefore, reporting in greater detail than the minimum requirements in paragraph 39 may be practical for some governments but not for others.

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[26]Some governments may modify the standard format of the statement of activities or use an alternative format. See paragraph 136.

[27]The term *function* is used in this Statement to refer to the minimum level of detail for *both* governmental *and* business-type activities required to be presented in the statement of activities.

Expenses

41. Governments should report all expenses by function except for those that meet the definitions of special or extraordinary items, discussed in paragraphs 55 and 56. As a minimum, governments should report direct expenses for each function. *Direct* expenses are those that are specifically associated with a service, program, or department and, thus, are clearly identifiable to a particular function.

42. Some functions, such as general government, support services, or administration, include expenses that are, in essence, *indirect* expenses of other functions. Governments are not required to allocate those indirect expenses to other functions. However, some governments may prefer to allocate some indirect expenses or use a full-cost allocation approach[28] among functions. If indirect expenses are allocated, direct and indirect expenses should be presented in separate columns to enhance comparability of direct expenses between governments that allocate indirect expenses and those that do not. A column totaling direct and indirect expenses may be presented but is not required.

43. Some governments charge funds or programs (through internal service funds or the general fund) for "centralized" expenses, which may include an administrative overhead component. Governments are not required to identify and eliminate these administrative overhead charges, but the summary of significant accounting policies should disclose that they are included in direct expenses.

44. Depreciation expense for capital assets that can specifically be identified with a function should be included in its direct expenses. Depreciation expense for "shared" capital assets (for example, a facility that houses the police department, the building inspection office, and the water utility office) should be ratably included in the direct expenses of the appropriate functions. Depreciation expense for capital assets such as a city hall or a state office building that essentially serves all functions is not required to be included in the *direct* expenses of the various functions. This depreciation expense may be included as a separate line in the statement of activities or as part of the "general government" (or its counterpart) function (and in either case, may be allocated to other functions as discussed in paragraph 42). If a government uses a

[28]As used in this Statement, a *full-cost allocation approach* means allocating indirect expenses among functions with the objective of allocating *all* expenses, including certain general government expenses.

separate line in the statement of activities to report *unallocated* depreciation expense, it should clearly indicate on the face of the statement that this line item excludes *direct* depreciation expenses of the various programs. Required disclosures about depreciation expense are discussed in paragraph 117.

45. Depreciation expense for general infrastructure assets should not be allocated to the various functions. It should be reported as a direct expense of the function (for example, public works or transportation) that the reporting government normally associates with capital outlays for, and maintenance of, infrastructure assets or as a separate line in the statement of activities.

46. *Interest on general long-term liabilities* generally should be considered an indirect expense. However, interest on long-term debt should be *included* in direct expenses in those limited instances when borrowing is essential to the creation or continuing existence of a program and it would be misleading to exclude the interest from direct expenses of that program (for example, a new program that is highly leveraged in its early stages). Excluding the cost of the borrowing when it is necessary to establish or maintain the program would significantly understate its direct program expenses. Most interest on general long-term liabilities, however, does not qualify as a direct expense and should be reported in the statement of activities as a separate line that clearly indicates that it excludes direct interest expenses, if any, reported in other functions. The amount excluded should be disclosed in the notes or presented on the face of the statement.

Revenues

47. Programs are financed from essentially four sources:

a. Those who purchase, use, or directly benefit from the goods or services of the program (This group may extend beyond the boundaries of the reporting government's taxpayers or citizenry or be a subset of it.)
b. Parties outside the reporting government's citizenry (This group includes other governments and nongovernmental entities or individuals.)
c. The reporting government's taxpayers (This is all taxpayers, regardless of whether they benefit from a particular program.)
d. The governmental institution itself (for example, through investing).

For the purposes of the statement of activities:

- Type a is always a program revenue.
- Type b is a program revenue, if restricted to a specific program or programs. If unrestricted, type b is a general revenue.

- Type c is always a general revenue, even if restricted to a specific program.
- Type d is usually a general revenue.

Program revenues

48. Program revenues derive directly from the program itself or from parties outside the reporting government's taxpayers or citizenry, as a whole; they reduce the net cost of the function to be financed from the government's general revenues. The statement of activities should separately report three categories of program revenues: (a) charges for services, (b) program-specific *operating* grants and contributions, and (c) program-specific *capital* grants and contributions.

49. *Charges for services* include revenues based on exchange or exchange-like transactions. These revenues arise from charges to customers or applicants who purchase, use, or directly benefit from the goods, services, or privileges provided. Revenues in this category include fees charged for specific services, such as water use or garbage collection; licenses and permits, such as dog licenses, liquor licenses, and building permits; operating special assessments, such as for street cleaning or special street lighting; and any other amounts charged to service recipients. Payments from other governments that are exchange transactions—for example, when County A reimburses County B for boarding County A's prisoners—also should be reported as charges for services.

50. *Program-specific grants and contributions (operating and capital)* include revenues arising from mandatory and voluntary nonexchange transactions with other governments, organizations, or individuals that are restricted[29] for use in a particular program. Some grants and contributions consist of capital assets or resources that are restricted for capital purposes—to purchase, construct, or renovate capital assets associated with a specific program. These should be reported separately from grants and contributions that may be used *either* for operating expenses *or* for capital expenditures of the program at the discretion of the reporting government. These categories of program revenue are specifically attributable to a program and reduce the net expense of that program to the reporting government. For example, a state may provide an operating grant to a county sheriff's department for a drug-awareness-and-enforcement program or a capital grant to finance construction of a new jail. Multipurpose grants (those that provide financing for more than one program) should be reported as program revenue if the amounts restricted to each program are specifically

[29]Paragraph 34 discusses the meaning of the term *restricted*.

identified in either the grant award or the grant application.[30] Multipurpose grants that do not provide for specific identification of the programs and amounts should be reported as general revenues.

51. Earnings on endowments or permanent fund investments should be reported as program revenues if restricted to a program or programs specifically identified in the endowment or permanent fund agreement or contract. Earnings from endowments or permanent funds that finance "general fund programs" or "general operating expenses," for example, should not be reported as program revenue. Similarly, earnings on investments not held by permanent funds also may be legally restricted to specific functions or programs. For example, interest earnings on state grants may be required to be used to support a specific program. When earnings on the *invested accumulated resources* of a program are *legally restricted* to be used for that program, the net cost to be financed by the government's general revenues is reduced, and those investment earnings should be reported as program revenues.

General revenues

52. All revenues are *general revenues* unless they are required to be reported as program revenues, as discussed in paragraphs 48 through 51. All taxes, even those that are levied for a specific purpose, are general revenues and should be reported by type of tax—for example, sales tax, property tax, franchise tax, income tax. All other nontax revenues (including interest, grants, and contributions) that do not meet the criteria to be reported as program revenues should also be reported as general revenues. General revenues should be reported after total net expense of the government's functions.

Reporting contributions to term and permanent endowments, contributions to permanent fund principal, special and extraordinary items, and transfers

53. Contributions to term and permanent endowments, contributions to permanent fund principal, special and extraordinary items (defined in paragraphs 55 and 56), and transfers (defined in paragraph 112) between governmental and business-type activities should each be reported separately from, but in the same manner as, general revenues. That is, these sources of financing the net cost of the government's programs should be reported at the bottom of the statement of activities to arrive at the all-inclusive change in net assets for the period.

[30]The grant application should be used for this purpose only if the grant award was based on that application.

Statement of Activities Format

54. For most governments, the following format provides the most appropriate method[31] for displaying the information required to be reported in the statement of activities:

		Program Revenues			Net (Expense) Revenue and Changes in Net Assets			
					Primary Government			
Functions	**Expenses**	**Charges for Services**	**Operating Grants and Contributions**	**Capital Grants and Contributions**	**Governmental Activities**	**Business-type Activities**	**Total**	**Component Units**
Primary government								
Governmental activities								
Function #1	XXX	XX	X	X	(XX)	—	(XX)	—
Function #2	XXX	XX	X	—	(XX)	—	(XX)	—
Function #3	XXX	XX	X	X	(X)	—	(X)	—
Total governmental activities	XXXX	XXX	XX	XX	(XX)	—	(XX)	—
Business-type activities								
BTA #1	XXXX	XXXX	—	X	—	XX	XX	—
BTA #2	XXXXX	XXXX	—	XX	—	XXX	XXX	—
Total business-type activities	XXXXX	XXXX	—	XX	—	XXX	XXX	—
Total primary government	XXXXXX	XXXXX	XX	XXX	(XXX)	XXX	XX	—
Component units								
CU #1	XXXX	XXXX	XX	XX	—	—	—	XX
		General revenues—detailed			XXX	X	XXX	XX
		Contributions to permanent funds			XX	—	XX	—
		Special items			X	—	X	—
		Transfers			XX	(XX)	—	—
		Total general revenues, contributions, special items, and transfers			XXX	X	XXX	XX
		Change in net assets			X	XX	XX	XX
		Net assets—beginning			XXXXX	XXXXX	XXXXXX	XXXXX
		Net assets—ending			XXXXX	XXXXX	XXXXXX	XXXXX

[31] See paragraph 136.

Special and Extraordinary Items

55. *Extraordinary items* are transactions or other events that are *both* unusual in nature *and* infrequent in occurrence. APB Opinion No. 30, *Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions,* as amended and interpreted, defines the terms *unusual in nature* and *infrequency of occurrence*. As discussed in paragraph 53, extraordinary items should be reported separately at the bottom of the statement of activities.

56. Significant transactions or other events *within the control of management* that are *either* unusual in nature *or* infrequent in occurrence are *special items.* Special items should also be reported separately in the statement of activities, before extraordinary items, if any. In addition, governments should disclose in the notes to financial statements any significant transactions or other events that are either unusual or infrequent but not within the control of management.

Eliminations and Reclassifications

57. In the process of aggregating data for the statement of net assets and the statement of activities, some amounts reported as interfund activity and balances in the funds should be eliminated or reclassified.

Internal balances—statement of net assets

58. Eliminations should be made in the statement of net assets to minimize the "grossing-up" effect on assets and liabilities within the governmental and business-type activities columns of the primary government. As a result, amounts reported in the funds as interfund receivables and payables should be eliminated in the governmental and business-type activities columns of the statement of net assets, except for the net residual amounts due between governmental and business-type activities, which should be presented as internal balances. Amounts reported in the funds as receivable from or payable to fiduciary funds should be included in the statement of net assets as receivable from and payable to external parties (consistent with the nature of fiduciary funds), rather than as internal balances. All internal balances should be eliminated in the total primary government column.

Internal activities—statement of activities

59. Eliminations should be made in the statement of activities to remove the "doubling-up" effect of internal service fund activity. The effect of similar internal events (such as allocations of accounting staff salaries) *that are, in effect, allocations of overhead expenses* from one function to another or within the same function also should be eliminated, so that the allocated expenses are reported only by the function to which they were allocated.

60. The effect of interfund services provided and used (see paragraph 112) between functions—for example, the sale of water or electricity from a utility to the general government—should not be eliminated in the statement of activities. To do so would misstate both the expenses of the purchasing function and the program revenues of the selling function.

Intra-entity activity

61. Resource flows between the primary government and *blended* component units should be reclassified in accordance with the provisions of paragraph 112 as internal activity in the financial statements of the reporting entity. Resource flows (except those that affect the balance sheet only, such as loans and repayments) between a primary government and its discretely presented component units should be reported as if they were external transactions—that is, as revenues and expenses. However, amounts payable and receivable between the primary government and its discretely presented component units or between those components should be reported on a separate line.

Reporting Internal Service Fund Balances

62. Internal service fund asset and liability balances that are not eliminated in the statement of net assets should normally be reported in the *governmental* activities column. Although internal service funds are reported as proprietary funds, the activities accounted for in them (the financing of goods and services for other funds of the government) are usually more governmental than business-type in nature. If enterprise funds are the predominant or only participants in an internal service fund, however, the government should report that internal service fund's residual assets and liabilities within the business-type activities column in the statement of net assets.

Fund Financial Statements

Funds—Overview and Definitions

63. Fund financial statements should be used to report additional and detailed information about the primary government. Governments should report governmental, proprietary, and fiduciary funds to the extent that they have activities that meet the criteria for using those funds. (See paragraphs 64–73.)

a. Governmental funds (emphasizing major funds)
   (1) The general fund
   (2) Special revenue funds
   (3) Capital projects funds
   (4) Debt service funds
   (5) Permanent funds
b. Proprietary funds
   (6) Enterprise funds (emphasizing major funds)
   (7) Internal service funds
c. Fiduciary funds and similar component units
   (8) Pension (and other employee benefit) trust funds
   (9) Investment trust funds
   (10) Private-purpose trust funds
   (11) Agency funds.

Governmental Funds

64. Governmental fund reporting focuses primarily on the sources, uses, and balances of current financial resources and often has a budgetary orientation. The governmental fund category includes the general fund, special revenue funds, capital projects funds, debt service funds, and permanent funds. With the exception of permanent funds, those governmental funds are defined in NCGA Statement 1, as amended.

65. *Permanent funds* should be used to report resources that are legally restricted to the extent that only earnings, and not principal, may be used for purposes that support the reporting government's programs—that is, for the benefit of the government or its citizenry.[32] (Permanent funds do not include *private-purpose*

[32]An example is a cemetery perpetual-care fund, which provides resources for the ongoing maintenance of a public cemetery.

trust funds, defined in paragraph 72, which should be used to report situations in which the government is required to use the principal or earnings for the benefit of *individuals, private organizations, or other governments*.)

Proprietary Funds

66. Proprietary fund reporting focuses on the determination of operating income, changes in net assets (or cost recovery), financial position, and cash flows. The proprietary fund category includes enterprise and internal service funds.

67. *Enterprise funds* may be used to report any activity for which a fee is charged to external users for goods or services. Activities are *required* to be reported as enterprise funds if any one of the following criteria is met. Governments should apply each of these criteria in the context of the activity's *principal revenue sources.*[33]

a. The activity is financed with debt that is secured solely by a pledge of the net revenues from fees and charges of the activity. Debt that is secured by a pledge of net revenues from fees and charges *and* the full faith and credit of a related primary government or component unit—even if that government is not expected to make any payments—is not payable solely from fees and charges of the activity. (Some debt may be secured, in part, by a portion of its own proceeds but should be considered as payable "solely" from the revenues of the activity.)
b. Laws or regulations require that the activity's costs of providing services, including capital costs (such as depreciation or debt service), be recovered with fees and charges, rather than with taxes or similar revenues.[34]

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[33]These criteria do not require insignificant activities of governments to be reported as enterprise funds. For example, state law may require a county's small claims court to assess plaintiffs a fee to cover the cost of frivolous claims. However, taxes, not fees, are the principal revenue source of the county's court system, and the fees in question cover only the cost of frivolous small claims court cases. In this case, the county would not be required to remove its court system or the small claims court activity from its general fund and report it in an enterprise fund. Conversely, a state department of environmental protection regulation may require a water utility to recover the costs of operating its water plant, including debt service costs, through charges to its customers—the utility's principal revenue source. Because these charges are the activity's principal revenue source and because the water utility is required to recover its costs, the utility should be reported as an enterprise fund.

[34]Based on this criterion, state unemployment compensation funds should be reported in enterprise funds.

c. The pricing policies of the activity establish fees and charges designed to recover its costs, including capital costs (such as depreciation or debt service).

68. *Internal service funds* may be used to report any activity that provides goods or services to other funds, departments, or agencies of the primary government and its component units, or to other governments, on a cost-reimbursement basis. Internal service funds should be used only if the reporting government is the predominant participant in the activity. Otherwise, the activity should be reported as an enterprise fund.

Fiduciary Funds

69. Fiduciary fund reporting focuses on net assets and changes in net assets. Fiduciary funds should be used to report assets held in a trustee or agency capacity for others and therefore cannot be used to support the government's own programs. The fiduciary fund category includes pension (and other employee benefit) trust funds, investment trust funds, private-purpose trust funds, and agency funds. The three types of trust funds should be used to report resources held and administered by the reporting government when it is acting in a fiduciary capacity for individuals, private organizations, or other governments. These funds are distinguished from agency funds generally by the existence of a trust agreement that affects the degree of management involvement and the length of time that the resources are held.

70. *Pension (and other employee benefit) trust funds* should be used to report resources that are required to be held in trust for the members and beneficiaries of defined benefit pension plans, defined contribution plans, other postemployment benefit plans, or other employee benefit plans.

71. *Investment trust funds* should be used to report the external portion of investment pools reported by the sponsoring government, as required by Statement 31, paragraph 18.

72. *Private-purpose trust funds,* such as a fund used to report escheat property, should be used to report all other trust arrangements under which principal and income benefit individuals, private organizations, or other governments.

73. *Agency funds* should be used to report resources held by the reporting government in a purely custodial capacity (assets equal liabilities). Agency funds typically involve only the receipt, temporary investment, and remittance of fiduciary resources to individuals, private organizations, or other governments.

Governmental and Proprietary Fund Financial Statements

74. Separate financial statements should be presented for the primary government's governmental and proprietary funds.

Focus on Major Funds

75. The focus of governmental and proprietary fund financial statements is on *major* funds.[35] Fund statements should present the financial information of each major fund in a separate column. Nonmajor funds should be aggregated and displayed in a single column.[36]

76. The reporting government's main operating fund (the general fund or its equivalent) should always be reported as a major fund. Other individual governmental and enterprise funds should be reported in separate columns as major funds based on these criteria:

a. Total assets, liabilities, revenues, or expenditures/expenses[37] of that individual governmental or enterprise fund are at least 10 percent of the corresponding total (assets, liabilities, and so forth) for all funds of that category or type (that is, total governmental or total enterprise funds), *and*
b. Total assets, liabilities, revenues, or expenditures/expenses of the individual governmental fund or enterprise fund are at least 5 percent of the corresponding total for all governmental and enterprise funds combined.

In addition to funds that meet the major fund criteria, any other governmental or enterprise fund that the government's officials believe is particularly important to financial statement users (for example, because of public interest or consistency) may be reported as a major fund.

[35]Major fund reporting requirements do not apply to internal service funds.

[36]Combining statements for nonmajor funds are not required, but may be presented as supplementary information.

[37]Excluding revenues and expenditures/expenses reported as extraordinary items.

Required Reconciliation to Government-wide Statements

77. Governments should present a summary reconciliation to the government-wide financial statements at the bottom of the fund financial statements or in an accompanying schedule. In many cases, brief explanations presented on the face of the statements will be sufficient to allow users to assess the relationship between the statements. However, if aggregated information in the summary reconciliation obscures the nature of the individual elements of a particular reconciling item, governments should provide a more detailed explanation in the notes to financial statements. (See paragraphs 85, 90, and 104.)

Required Financial Statements—Governmental Funds

78. The financial statements required for governmental funds are:

a. Balance sheet
b. Statement of revenues, expenditures, and changes in fund balances.

Measurement focus and basis of accounting

79. Financial statements for governmental funds should be presented using the *current financial resources measurement focus* and the *modified accrual basis of accounting,* as the terms are discussed in NCGA Statement 1, as amended.

Reporting general capital assets

80. General capital assets are capital assets of the government that are not specifically related to activities reported in proprietary or fiduciary funds. General capital assets are associated with and generally arise from governmental activities. Most often, they result from the expenditure of governmental fund financial resources. They should not be reported as assets in governmental funds but should be reported in the governmental activities column in the government-wide statement of net assets.

Reporting general-long term liabilities

81. NCGA Statement 1, paragraph 32, provides that "a clear distinction should be made between . . . fund long-term liabilities and general long-term debt." That Statement, as amended, requires recognition of *governmental fund liabilities* using the modified accrual basis of accounting. Paragraph 43 of that

Statement states that "general long-term debt is the *unmatured principal* of bonds, warrants, notes, or other forms of noncurrent or long-term *general obligation* indebtedness. . . . General long-term debt is not limited to liabilities arising from debt issuances *per se,* but may also include noncurrent liabilities on lease-purchase agreements and other commitments that are not current liabilities properly recorded in governmental funds." Subsequent NCGA and GASB pronouncements also define the noncurrent portion of capital leases, operating leases with scheduled rent increases, compensated absences, claims and judgments, pensions, special termination benefits, and landfill closure and postclosure care liabilities as general long-term liabilities. Liabilities arising from interfund activities (see paragraph 112) do not constitute general long-term liabilities and therefore should be reported in governmental funds.

82. General long-term liabilities should not be reported as liabilities in governmental funds but should be reported in the governmental activities column in the government-wide statement of net assets.

Balance sheet

83. The balance sheet should report information about the current financial resources (assets, liabilities, and fund balances) of each major governmental fund and for nonmajor governmental funds in the aggregate. A total column should be presented. Assets, liabilities, and fund balances of governmental funds should be displayed in a balance sheet format (assets equal liabilities plus fund balances).

Separate display of reserved and unreserved fund balance

84. Governmental fund balances should be segregated into *reserved* and *unreserved* amounts. (See paragraphs 118–121 of NCGA Statement 1.) Reserved fund balances of the combined nonmajor funds should be displayed in sufficient detail to disclose the purposes of the reservations (for example, reserved for debt service or reserved for encumbrances). Unreserved fund balances of nonmajor funds should be displayed by fund type on the face of the balance sheet.

Required reconciliation

85. Paragraph 77 requires governments to present a summary reconciliation at the bottom of the fund financial statements or in an accompanying schedule. Items that typically will be required to reconcile total governmental fund balances to net assets of governmental activities in the statement of net assets include, but are not limited to, the effects of:

- Reporting capital assets at their historical cost and depreciating them instead of reporting capital acquisitions as expenditures when incurred
- Adding general long-term liabilities not due and payable in the current period
- Reducing deferred revenue for those amounts that were not available to pay current-period expenditures
- Adding internal service fund net asset balances (see paragraph 62).

Statement of revenues, expenditures, and changes in fund balances

86. The statement of revenues, expenditures, and changes in fund balances should report information about the inflows, outflows, and balances of current financial resources of each major governmental fund and for the nonmajor governmental funds in the aggregate. A total column should be presented. The statement should present the following information, in the format and sequence indicated:

Revenues (detailed)
Expenditures (detailed)
  Excess (deficiency) of revenues over expenditures
Other financing sources and uses, including transfers (detailed)
Special and extraordinary items (detailed)
  Net change in fund balances
Fund balances[38]—beginning of period
Fund balances—end of period

Classification of revenues and expenditures

87. Governmental fund revenues should be classified in the statement of revenues, expenditures, and changes in fund balances by major revenue source as discussed in NCGA Statement 1, paragraph 110. Governmental fund

[38]Fund balances should consist of both reserved and unreserved amounts as described in paragraph 84.

expenditures should be classified at a minimum by function, as discussed in paragraphs 111 through 116 of that Statement. Debt issue costs paid out of debt proceeds, such as underwriter fees, should be reported as expenditures. Issue costs, such as attorney and rating agency fees or bond insurance, paid from existing resources should be reported as expenditures when the related liability is incurred.

Other financing sources and uses

88. Items that should be reported as other financing sources and uses include proceeds of long-term debt, issuance premium or discount, certain payments to escrow agents for bond refundings, transfers, and sales of capital assets (unless the sale meets the criteria, as defined in paragraph 56, for reporting as a special item).

Special and extraordinary items

89. Special and extraordinary items, defined in paragraphs 55 and 56, should be reported separately after "other financing sources and uses." If both occur during the same period, special and extraordinary items should be reported separately within a "special and extraordinary items" classification. Significant transactions or other events that are either unusual or infrequent but are not within the control of management should be separately identified within the appropriate revenue or expenditure category in the statement of revenues, expenditures, and changes in fund balances or be disclosed in the notes to financial statements. (Because other financing sources and uses, rather than *gains* or *losses,* are reported for debt refundings in governmental funds, these transactions should not be reported as extraordinary items.)

Required reconciliation

90. Paragraph 77 requires governments to present a summary reconciliation at the bottom of the fund financial statements or in an accompanying schedule. Items that typically will be required to reconcile the total change in governmental fund balances to the change in net assets of governmental activities in the statement of activities include, but are not limited to, the effects of:

- Reporting revenues on the accrual basis
- Reporting annual depreciation expense instead of expenditures for capital outlays

- Reporting long-term debt proceeds in the statement of net assets as liabilities instead of other financing sources; also, reporting debt principal payments in the statement of net assets as reductions of liabilities instead of expenditures
- Reporting other expenses on the accrual basis
- Adding the net revenue (expense) of internal service funds, as discussed in paragraph 62.

Required Financial Statements—Proprietary Funds

91. Required financial statements for proprietary funds are:

a. Statement of net assets or balance sheet[39]
b. Statement of revenues, expenses, and changes in fund net assets or fund equity[40]
c. Statement of cash flows.

Measurement focus and basis of accounting

92. Proprietary fund statements of net assets and revenues, expenses, and changes in fund net assets should be presented using the economic resources measurement focus and the accrual basis of accounting.

93. Based on the provisions of Statement 20, paragraph 6, proprietary funds should be reported based on all applicable GASB pronouncements as well as applicable FASB Statements and Interpretations, APB Opinions, and ARBs of the Committee on Accounting Procedure issued on or before November 30, 1989, *unless* those pronouncements conflict with or contradict GASB pronouncements.

94. For *enterprise* funds, governments may elect to apply *all* FASB Statements and Interpretations issued after November 30, 1989, *except for* those that conflict with or contradict GASB pronouncements, based on the provisions of paragraph 7 of Statement 20, as amended by this Statement. Governments are encouraged to use the same application of FASB pronouncements for all enterprise funds.

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[39]Either a *balance sheet* or a *net assets* format may be used. For convenience, *only* the statement of net assets is referred to in this Statement.

[40]Either *fund net assets* or *fund equity* may be used as the label for the difference between proprietary fund assets and liabilities; for convenience, only the term *fund net assets* is used in this Statement.

95. FASB Statement 71 and related pronouncements issued on or before November 30, 1989, may be applied to qualifying *enterprise* funds as discussed in paragraph 9 of Statement 20, as amended by this Statement.

Separate presentation of internal service funds

96. As discussed in paragraph 75, proprietary fund statements should present the financial information for each major enterprise fund in a separate column. Nonmajor enterprise funds should be aggregated and displayed in a single column, and a combined total column should be presented for all enterprise funds. Major fund reporting requirements do not apply to internal service funds. The combined totals for all internal service funds should be reported in separate columns on the face of the proprietary fund financial statements to the right of the total enterprise funds column.

Statement of net assets

97. Assets and liabilities of proprietary funds should be presented in a *classified* format to distinguish between current and long-term assets and liabilities as discussed in Chapter 3 of ARB 43, *Restatement and Revision of Accounting Research Bulletins*.

98. Governments may use either a net assets format—*assets less liabilities equal net assets*—or a balance sheet format—*assets equal liabilities plus net assets*—to report their proprietary funds. Net assets should be displayed in three broad components—*invested in capital assets, net of related debt; restricted* (distinguishing between major categories of restrictions); and *unrestricted*. Paragraphs 33 through 37 define these terms for purposes of determining the amount to be reported in the various components of net assets. Capital contributions should not be displayed as a separate component of net assets. Designations of net assets should not be reported on the face of the financial statements. (See paragraph 37.)

Reporting restrictions on asset use

99. Restricted assets should be reported when restrictions (as defined in paragraph 34) on asset use change the nature or normal understanding of the availability of the asset. For example, cash and investments normally are classified as current assets, and a normal understanding of these assets presumes that restrictions do not limit the government's ability to use the resources to pay current liabilities. But cash and investments held in a separate

account that can be used to pay debt principal and interest only (as required by the debt covenant) and that cannot be used to pay other current liabilities should be reported as restricted assets. Because restricted assets may include temporarily invested debt proceeds or other resources that are not generated through operations (such as customer deposits), the amount reported as restricted assets will not necessarily equal restricted net assets.

Statement of revenues, expenses, and changes in fund net assets

100. The operating statement for proprietary funds is the statement of revenues, expenses, and changes in fund net assets. Revenues should be reported by major source[41] and should identify revenues used as security for revenue bonds. This statement should also distinguish between operating and nonoperating revenues and expenses (as discussed in paragraph 102) and should present a separate subtotal for *operating revenues, operating expenses,* and *operating income*. Nonoperating revenues and expenses should be reported after operating income. Revenues from capital contributions and additions to the principal of permanent and term endowments, special and extraordinary items, and transfers should be reported separately, after nonoperating revenues and expenses as illustrated below.

101. The statement of revenues, expenses, and changes in fund net assets should be presented in the following sequence using the all-inclusive format:

Operating revenues (detailed)
  Total operating revenues
Operating expenses (detailed)
  Total operating expenses
    Operating income (loss)
Nonoperating revenues and expenses (detailed)
  Income before other revenues, expenses, gains, losses, and transfers
Capital contributions (grant, developer, and other), additions to permanent and term endowments, special and extraordinary items (detailed), and transfers
  Increase (decrease) in net assets
Net assets—beginning of period
Net assets—end of period

[41]Revenues should be reported net of discounts and allowances with the discount or allowance amount parenthetically disclosed on the face of the statement or in a note to the financial statements. Alternatively, revenues may be reported gross with the related discounts and allowances reported directly beneath the revenue amount.

Defining operating revenues and expenses

102. Governments should establish a policy that defines operating revenues and expenses that is appropriate to the nature of the activity being reported, disclose it in the summary of significant accounting policies, and use it consistently from period to period. A consideration for defining a proprietary fund's operating revenues and expenses is how individual transactions would be categorized for purposes of preparing a statement of cash flows using Statement 9. Transactions for which cash flows are reported as capital and related financing activities, noncapital financing activities, or investing activities normally would *not* be reported as components of operating income.[42] This includes most revenues considered to be nonexchange and exchange-like, such as tax revenues and, in some cases, fees and charges (such as passenger facilities charges).

Reporting capital contributions and additions to permanent and term endowments

103. All proprietary fund revenues, including capital contributions and additions to permanent and term endowments, should be reported in the statement of revenues, expenses, and changes in fund net assets. As discussed in paragraphs 100 and 101, capital contributions and additions to permanent and term endowments should be reported after nonoperating revenues and expenses. Revenue recognition for these and all other nonexchange revenues should be based on the requirements of Statement 33. Net assets resulting from certain capital contributions may be required to be reported as invested in capital assets net of related debt, as discussed in paragraph 33. Paragraph 35 provides that restricted net assets should be separated into expendable and nonexpendable subcategories when net assets arise from additions to permanent endowments.

Required reconciliations

104. Generally, the amounts reported as net assets and changes in net assets in the proprietary fund financial statements for total enterprise funds will be the same as net assets and changes in net assets of business-type activities in the government-wide statement of activities. However, if there are differences (for

[42]Revenue and expense transactions normally classified as other than operating cash flows from operations in most proprietary funds may be classified as operating revenues and expenses if those transactions constitute the reporting proprietary fund's principal ongoing operations. For example, interest revenue and expense transactions should be reported as operating revenue and expense by a proprietary fund established to provide loans to first-time homeowners.

example, if reclassification of internal service fund transactions, as discussed in paragraph 62, affects enterprise funds), they should be explained on the face of the fund statement (or in an accompanying schedule) as discussed in paragraph 77.

Statement of cash flows

105. Governments should present a statement of cash flows for proprietary funds based on the provisions of Statement 9, as amended by this Statement. The direct method of presenting cash flows from operating activities (including a reconciliation of operating cash flows to operating income) should be used.

Required Financial Statements—Fiduciary Funds and Similar Component Units

106. Required financial statements for fiduciary funds are the statement of fiduciary net assets and the statement of changes in fiduciary net assets.[43] Fiduciary fund financial statements should include information about all fiduciary funds of the primary government, as well as component units that are fiduciary in nature. The statements should provide a separate column for each fund type—pension (and other employee benefit) trust funds, investment trust funds, private-purpose trusts, agency funds. Financial statements for individual pension plans and postemployment healthcare plans[44] should be presented in the notes to the financial statements of the primary government if separate, GAAP financial reports have not been issued. If separate, GAAP financial reports have been issued, the notes should include information about how to obtain those separate reports.

Measurement Focus and Basis of Accounting

107. Financial statements of fiduciary funds should be reported using the *economic resources measurement focus* and the *accrual basis of accounting,* except for the recognition of certain liabilities of defined benefit pension plans and certain postemployment healthcare plans. Paragraph 26 of Statement 25 and paragraph 7 of Statement 26 provide guidance on recognition of these liabilities.

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[43]For defined benefit pension plans, the statement of fiduciary net assets and statement of changes in fiduciary net assets required by this Statement are equivalent to the statement of *plan* net assets and statement of changes in *plan* net assets, respectively, required by Statement 25.

[44]See paragraph 19 of Statement 25 and paragraph 7 of Statement 26, respectively.

Statement of Fiduciary Net Assets

108. The statement of fiduciary net assets should include information about the assets, liabilities, and net assets for each fiduciary fund type. The detailed display requirements of Statements 25 and 26 apply to the statements of plan net assets of pension and other employee benefit trust funds. Statement 31 provides detailed guidance for investment trust funds. The components of net assets, discussed in paragraphs 32 through 37, are not required to be presented in the statement of fiduciary net assets.

Statement of Changes in Fiduciary Net Assets

109. The statement of changes in fiduciary net assets should include information about the additions to, deductions from, and net increase (or decrease) for the year in net assets for each fiduciary fund type. The statement should provide information about significant year-to-year changes in net assets. The detailed display requirements of Statements 25 and 26 apply to the statements of changes in plan net assets for pension and other employee benefit trust funds.

Reporting Agency Funds

110. In the statement of net assets, agency fund assets should equal liabilities. Agency funds should not be reported in the statement of changes in fiduciary net assets.

111. Sometimes an agency fund is used as a *clearing account* to distribute financial resources to other funds of the government, as well as other entities. For example, county property tax collectors customarily collect and distribute property taxes to the county's funds as well as to other governments within the county. When this occurs, the portion of the clearing account balance that pertains to other funds of the county should not be reported in agency funds. Rather, it should be reported as assets in the appropriate funds.

Reporting Interfund Activity

112. Interfund activity within and among the three fund categories (governmental, proprietary, and fiduciary) should be classified and reported as follows:

a. *Reciprocal interfund activity* is the internal counterpart to exchange and exchange-like transactions. It includes:
   (1) *Interfund loans*—amounts provided with a requirement for repayment. Interfund loans should be reported as interfund receivables in lender

funds and interfund payables in borrower funds. This activity should not be reported as other financing sources or uses in the fund financial statements. If repayment is not expected within a reasonable time, the interfund balances should be reduced and the amount that is not expected to be repaid should be reported as a transfer from the fund that made the loan to the fund that received the loan.

(2) *Interfund services provided and used*—sales and purchases of goods and services between funds for a price approximating their external exchange value. Interfund services provided and used should be reported as revenues in seller funds and expenditures or expenses in purchaser funds.[45] Unpaid amounts should be reported as interfund receivables and payables in the fund balance sheets or fund statements of net assets.

b. *Nonreciprocal interfund activity* is the internal counterpart to nonexchange transactions. It includes:

(1) *Interfund transfers*—flows of assets (such as cash or goods) without equivalent flows of assets in return and without a requirement for repayment. This category includes payments in lieu of taxes that are not payments for, and are not reasonably equivalent in value to, services provided. In governmental funds, transfers should be reported as other financing uses in the funds making transfers and as other financing sources in the funds receiving transfers. In proprietary funds, transfers should be reported after nonoperating revenues and expenses as discussed in paragraphs 100 and 101.

(2) *Interfund reimbursements*—repayments from the funds responsible for particular expenditures or expenses to the funds that initially paid for them. Reimbursements should not be displayed in the financial statements.

Basic Financial Statements—Notes to the Financial Statements

113. The notes to the financial statements should communicate information essential for fair presentation of the financial statements that is not displayed on the face of the financial statements. As such, the notes are an integral part of the basic financial statements. The notes should focus on the primary government—specifically, its governmental activities, business-type activities, major funds, and nonmajor funds in the aggregate. Information about the

[45]However, Statement 10, paragraph 64, requires that when the general fund is used to account for risk-financing activity, interfund charges to other funds should be accounted for as reimbursements.

government's discretely presented component units should be presented as discussed in Statement 14, paragraph 63, as amended by this Statement.

General Disclosure Requirements

114. Guidance pertaining to existing note disclosures is found in NCGA Interpretation 6, as amended.[46]

115. Governments should provide these additional disclosures (if applicable) in their summary of significant accounting policies based on the requirements of this Statement:

a. A description of the government-wide financial statements, noting that neither fiduciary funds nor component units that are fiduciary in nature are included. (See paragraph 13.)
b. The measurement focus and basis of accounting used in the government-wide statements. (See paragraph 16.)
c. The policy for eliminating internal activity in the statement of activities. (See paragraphs 57–61.)
d. The policy for applying FASB pronouncements issued after November 30, 1989, to business-type activities and to enterprise funds of the primary government. (See paragraphs 17 and 94.)
e. The policy for capitalizing assets and for estimating the useful lives of those assets (used to calculate depreciation expense). (See paragraphs 20 and 23.) Governments that choose to use the modified approach for reporting eligible infrastructure assets should describe that approach.
f. A description of the types of transactions included in program revenues (see paragraph 48) and the policy for allocating indirect expenses to functions in the statement of activities. (See paragraphs 41–46.)
g. The government's policy for defining operating and nonoperating revenues of proprietary funds. (See paragraph 102.)
h. The government's policy regarding whether to first apply restricted or unrestricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available. (See paragraph 34.)

[46]The GASB has a project on its agenda to review the appropriateness of existing note disclosure requirements. The disclosures in paragraphs 115 through 123 are those most directly related to the new requirements of this Statement. Other changes in note disclosure requirements may be proposed or required before implementation of this Statement is required.

Required Note Disclosures about Capital Assets and Long-term Liabilities

116. Governments should provide detail in the notes to the financial statements about capital assets and long-term liabilities of the primary government reported in the statement of net assets. The information disclosed should be divided into major classes of capital assets and long-term liabilities as well as between those associated with governmental activities and those associated with business-type activities. Capital assets that are not being depreciated should be disclosed separately from those that are being depreciated. (See paragraph 20.)

117. Information presented about major classes of capital assets should include:

a. Beginning- and end-of-year balances (regardless of whether beginning-of-year balances are presented on the face of the government-wide financial statements), with accumulated depreciation presented separately from historical cost
b. Capital acquisitions
c. Sales or other dispositions
d. Current-period depreciation expense, with disclosure of the amounts charged to each of the functions in the statement of activities.

118. For collections not capitalized (see paragraphs 27–29), disclosures should provide a description of the collection and the reasons these assets are not capitalized. For collections that are capitalized, governments should make the disclosures required by paragraphs 116 and 117.

119. Information about long-term liabilities should include both long-term debt (such as bonds, notes, loans, and leases payable) and other long-term liabilities[47] (such as compensated absences, and claims and judgments). Information presented about long-term liabilities should include:

a. Beginning- and end-of-year balances (regardless of whether prior-year data are presented on the face of the government-wide financial statements)
b. Increases and decreases (separately presented)
c. The portions of each item that are due within one year of the statement date
d. Which governmental funds typically have been used to liquidate other long-term liabilities (such as compensated absences and pension liabilities) in prior years.

[47]Information about net pension obligations should be reported in a separate pension note, as required by Statement 27.

120. Determining whether to provide similar disclosures about capital assets and long-term liabilities of discretely presented component units is a matter of professional judgment. The decision to disclose should be based on the individual component unit's significance to the total of all discretely presented component units and that component unit's relationship with the primary government.

Disclosures about Donor-restricted Endowments

121. Note disclosures should include the following information about donor-restricted endowments:

a. The amounts of net appreciation on investments of donor-restricted endowments that are available for authorization for expenditure by the governing board, and how those amounts are reported in net assets
b. The state law regarding the ability to spend net appreciation
c. The policy for authorizing and spending investment income, such as a spending-rate or total-return policy.

Segment Information

122. Governments that report enterprise funds or that use enterprise fund accounting and reporting standards to report their activities are required to present segment information for those activities in the notes to the financial statements. For purposes of this disclosure, a segment is an identifiable activity reported as or within an enterprise fund or an other stand-alone entity for which one or more revenue bonds or other revenue-backed debt instruments (such as certificates of participation) are outstanding.[48] A segment has a specific identifiable revenue stream pledged in support of revenue bonds or other revenue-backed debt and has related expenses, gains and losses, assets, and liabilities that can be identified. Segment disclosure requirements should by met by providing condensed financial statements in the notes:

a. Type of goods or services provided by the segment.
b. Condensed statement of net assets:
    (1) Total assets—distinguishing between current assets, capital assets, and other assets. Amounts receivable from other funds or component units should be reported separately.

[48]Segment disclosures are not required for an activity whose only outstanding debt is conduit debt for which the government has no obligation beyond the resources provided by related leases or loans. In addition, segment reporting is not required when an individual fund both is a segment and is reported as a major fund.

(2) Total liabilities—distinguishing between current and long-term amounts. Amounts payable to other funds or component units should be reported separately.
(3) Total net assets—distinguishing among restricted (separately reporting expendable and nonexpendable components); unrestricted; and amounts invested in capital assets, net of related debt.

c. Condensed statement of revenues, expenses, and changes in net assets:
   (1) Operating revenues (by major source).
   (2) Operating expenses. Depreciation (including any amortization) should be identified separately.
   (3) Operating income (loss).
   (4) Nonoperating revenues (expenses)—with separate reporting of major revenues and expenses.
   (5) Capital contributions and additions to permanent and term endowments.
   (6) Special and extraordinary items.
   (7) Transfers.
   (8) Change in net assets.
   (9) Beginning net assets.
   (10) Ending net assets.

d. Condensed statement of cash flows:
   (1) Net cash provided (used) by:
      (a) Operating activities.
      (b) Noncapital financing activities.
      (c) Capital and related financing activities.
      (d) Investing activities.
   (2) Beginning cash and cash equivalent balances.
   (3) Ending cash and cash equivalent balances.

Determining whether to provide segment disclosures about component units that use enterprise fund accounting and reporting standards is a matter of professional judgment. The decision to disclose should be based on the individual component unit's significance to the total of all discretely presented component units and that component unit's relationship with the primary government.

123. Governments that want to present disaggregated data for their multiple-function enterprise funds beyond what is required for segment reporting (for example, net program cost information) are encouraged to present (as supplementary information) a statement of activities (as discussed in paragraphs 38–60). Special-purpose governments engaged only in business-type activities (paragraph 138) also are encouraged to present this information.

Reporting Component Units

124. Paragraph 42 of Statement 14 requires that "financial statements of the reporting entity should provide an overview of the entity based on financial accountability, yet allow users to distinguish between the primary government and its component units." Paragraph 11 states that ". . . the reporting entity's financial statements should . . . provide an overview of the discretely presented component units."

125. These financial reporting requirements are met by discrete presentation of component unit financial data in the statement of net assets and the statement of activities. Component units that are fiduciary in nature, however, should be included only in the fund financial statements with the primary government's fiduciary funds. Blended component units should be reported in accordance with Statement 14, paragraphs 52 through 54.

126. Paragraph 51 of Statement 14, as amended by this Statement, requires information about each major component unit to be provided in the basic financial statements of the reporting entity. Governments can satisfy that requirement by (a) presenting each major component unit[49] in a separate column in the reporting entity's statements of net assets and activities, (b) including combining statements of major component units[50] in the reporting entity's basic statements after the fund financial statements, or (c) presenting condensed financial statements in the notes to the reporting entity's financial statements. If the combining statement approach is used, the "aggregated total" component unit information, as discussed in Statement 14, should be taken from the total columns in the component units' statements of net assets and activities[51] so that the details support the totals reported in the reporting entity's government-wide statements.

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[49]Major component unit information is not required for component units that are fiduciary in nature.

[50]Nonmajor component units should be aggregated in a single column. A combining statement for the nonmajor component units is not required, but may be presented as supplementary information.

[51]Because component units that are engaged only in business-type activities are not required to prepare a statement of activities, this disclosure should be taken from the information provided in the component unit's statement of revenues, expenses, and changes in fund net assets.

127. If governments choose to present component unit information in the notes, these details should be presented, at a minimum:

a. Condensed statement of net assets:
   (1) Total assets—distinguishing between capital assets and other assets. Amounts receivable from the primary government or from other component units should be reported separately.
   (2) Total liabilities—distinguishing between long-term debt outstanding and other liabilities. Amounts payable to the primary government or to other component units should be reported separately.
   (3) Total net assets—distinguishing between restricted, unrestricted, and amounts invested in capital assets, net of related debt.
b. Condensed statement of activities:[52]
   (1) Expenses (by major functions and for depreciation expense, if separately reported).
   (2) Program revenues (by type).
   (3) Net program (expense) revenue.
   (4) Tax revenues.
   (5) Other nontax general revenues.
   (6) Contributions to endowments and permanent fund principal.
   (7) Special and extraordinary items.
   (8) Change in net assets.
   (9) Beginning net assets.
   (10) Ending net assets.

128. In addition to the financial statement information required by paragraph 126, the notes to the financial statements should disclose, for each major component unit, the nature and amount of significant transactions with the primary government and other component units.

Required Supplementary Information Other Than MD&A

129. Statement 10, as amended, and Statements 25 and 27 require governments to present certain data as RSI. In addition to those presentations, this Statement requires governments to present as RSI MD&A (paragraphs 8–11), budgetary comparison schedules for governmental funds (discussed below), and information about infrastructure assets reported using the modified approach (paragraphs 23–25).

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[52]See footnote 51.

Budgetary Comparison Schedules

130. Budgetary comparison schedules should be presented as RSI[53] for the general fund and for each major special revenue fund that has a legally adopted annual budget. The budgetary comparison schedule should present both (a) the original and (b) the final appropriated budgets for the reporting period as well as (c) actual inflows, outflows, and balances, stated on the government's budgetary basis.[54] A separate column to report the variance between the final budget and actual amounts is encouraged, but not required. Governments may also report the variance between original and final budget amounts.

a. The *original budget* is the first complete appropriated budget.[55] The original budget may be adjusted by reserves, transfers, allocations, supplemental appropriations, and other legally authorized legislative and executive changes *before* the beginning of the fiscal year. The original budget should also include actual appropriation amounts automatically carried over from prior years by law. For example, a legal provision may require the automatic rolling forward of appropriations to cover prior-year encumbrances.
b. The *final budget* is the original budget adjusted by all reserves, transfers, allocations, supplemental appropriations, and other legally authorized legislative and executive changes applicable to the fiscal year, whenever signed into law or otherwise legally authorized.

131. Governments may present the budgetary comparison schedule using the same format, terminology, and classifications as the budget document, or using the format, terminology, and classifications in a statement of revenues, expenditures, and changes in fund balances. Regardless of the format used, the schedule should be accompanied by information (either in a separate schedule or in notes to RSI) that reconciles budgetary information to GAAP information,

[53]Governments may elect to report the budgetary comparison information in a budgetary comparison *statement* as part of the basic financial statements, rather than as RSI. If presented, the additional statement should include the same items of information that paragraphs 130 and 131 require to be displayed or disclosed.

[54]The budgetary basis of accounting is discussed in NCGA Statement 1, paragraph 154.

[55]NCGA Interpretation 10, paragraph 11, as amended by this Statement, defines *appropriated budget* as "the expenditure authority created by the appropriation bills or ordinances which are signed into law and related estimated revenues."

as discussed in NCGA Interpretation 10, as amended by this Statement. Notes to RSI should disclose any excess of expenditures over appropriations in individual funds, as discussed in NCGA Interpretation 6, paragraph 4, as amended by this Statement.[56]

Modified Approach for Reporting Infrastructure

132. Governments should present the following schedules, derived from asset management systems, as RSI for all eligible infrastructure assets[57] that are reported using the modified approach:

a. The assessed condition, performed at least every three years, for at least the three most recent complete condition assessments, indicating the dates of the assessments
b. The estimated annual amount calculated at the beginning of the fiscal year to maintain and preserve at (or above) the condition level established and disclosed by the government compared with the amounts actually expensed (as discussed in paragraph 25) for each of the past five reporting periods.

133. The following disclosures[58] should accompany the schedules required by paragraph 132:

a. The basis for the condition measurement and the measurement scale used to assess and report condition. For example, a basis for *condition measurement* could be distresses found in pavement surfaces. A *scale* used to assess and report condition could range from zero for a failed pavement to 100 for a pavement in perfect condition.
b. The condition level at which the government intends to preserve its eligible infrastructure assets reported using the modified approach.

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[56]If the budgetary comparison information is included in the basic statements, as described in footnote 53, these disclosures should be in the notes to the financial statements, rather than as notes to RSI.

[57]If a government applies the provisions of paragraphs 23 and 24 to a subsystem of infrastructure assets (for example, interstate highways), then the RSI disclosures required by this paragraph should be for that *subsystem*.

[58]Governments with asset management systems for infrastructure assets that gather the information required by paragraphs 132 and 133 and that do not use the modified approach are encouraged to provide the information as supplementary information.

c. Factors that significantly affect trends in the information reported in the required schedules, including any changes in the measurement scale, the basis for the condition measurement, or the condition assessment methods used during the periods covered by the schedules. If there is a change in the condition level at which the government intends to preserve eligible infrastructure assets, an estimate of the effect of the change on the estimated annual amount to maintain and preserve those assets for the current period also should be disclosed.

Basic Financial Statements Required for Special-purpose Governments

134. This Statement is written from the perspective of general purpose governments—states, cities, counties, towns, and villages. However, many governments are *special-purpose* governments. Those governments are legally separate entities, as discussed in Statement 14, and may be component units[59] or other stand-alone governments.[60] Paragraphs 135 through 141 describe the effects of this Statement on GAAP reporting by special-purpose governments.

Reporting by Special-purpose Governments Engaged in Governmental Activities

135. Special-purpose governments engaged in more than one governmental program or that have both governmental and business-type activities[61] should provide both fund financial statements and government-wide financial statements. For these governments, all the requirements for basic financial statements and RSI in paragraphs 8 through 131 apply.

136. For special-purpose governments engaged in a single governmental program (for example, some cemetery districts, levee districts, assessment districts, drainage districts), the fund financial statements and the government-wide state-

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[59]As defined in Statement 14, *component units* are legally separate organizations for which the elected officials of the primary government are financially accountable. In addition, a component unit can be another organization for which the nature and significance of its relationship with a primary government are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete.

[60]As defined in Statement 14, an *other stand-alone government* is a legally separate governmental organization that (a) does not have a separately elected governing body and (b) does not meet the definition of a component unit. Other stand-alone governments include some special-purpose governments, joint ventures, jointly governed organizations, and pools.

[61]See paragraph 15 for a discussion of governmental and business-type activities.

ments may be combined using a columnar format that reconciles individual line items of fund financial data to government-wide data in a separate column on the face of the financial statements rather than at the bottom of the statements or in an accompanying schedule.[62] Or the single-program government may present separate government-wide and fund financial statements and may present its government-wide statement of activities using a different format. For example, the statement of activities may be presented in a single column that reports expenses first followed by revenues (by major sources). The difference between these amounts is net revenue (expense) and should be followed by contributions to permanent and term endowments, special and extraordinary items, transfers, and beginning and ending net assets.

137. For the purpose of applying the provisions of paragraph 136, a government should not be considered "single-program" if it budgets, manages, or accounts for its activities as multiple programs. For example, "programs" within the *education* functional category for a typical school district might include regular instruction, special instruction, vocational education, and adult education.

Reporting by Special-purpose Governments Engaged Only in Business-type Activities

138. Governments engaged only in business-type activities should present only the financial statements required for enterprise funds. (See paragraphs 91–105.) For these governments, basic financial statements and RSI consist of:

a. MD&A (paragraphs 8–11, as appropriate)
b. Enterprise fund financial statements (paragraphs 91–105), consisting of:
   (1) Statement of net assets or balance sheet
   (2) Statement of revenues, expenses, and changes in fund net assets
   (3) Statement of cash flows
c. Notes to financial statements (paragraphs 113–123)
d. RSI other than MD&A, if applicable (paragraphs 132–133).

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[62]If a columnar format is used, single-program governments should provide the reconciliation information required by paragraphs 85 and 90 between the fund financial data and the government-wide data. Descriptions of the reconciling items should be presented either on the face of the financial statements, in an accompanying schedule, or in the notes to the financial statements, as discussed in paragraph 77.

Reporting by Special-purpose Governments Engaged Only in Fiduciary Activities

139. A special-purpose government engaged only in fiduciary activities should present only the financial statements required for fiduciary funds. For those governments, basic financial statements and RSI consist of:

a. MD&A (paragraphs 8–11, as appropriate)
b. Statement of fiduciary net assets (paragraph 108)
c. Statement of changes in fiduciary net assets (paragraph 109)
d. Notes to financial statements (paragraphs 113–123).

140. A *public employee retirement system (PERS)* is a special-purpose government that administers one or more defined benefit pension plans and sometimes other types of employee benefit plans, including defined contribution, deferred compensation, and postemployment healthcare plans.[63] Statements 25 and 26 require a PERS that administers more than one defined benefit pension plan or postemployment healthcare plan to present in its financial report combining financial statements for all plans administered by the system and, if applicable, required schedules for each plan.[64] A PERS should meet this financial statement requirement by (a) presenting a separate column for each plan administered on the statement of fiduciary net assets and the statement of changes in fiduciary net assets or (b) presenting combining statements for those plans as part of the basic financial statements.

141. For all plans *other than* defined benefit pension plans and postemployment healthcare plans, a PERS should apply the requirements of this Statement for measurement focus, basis of accounting, and display. Combining financial statements are encouraged, but not required, for those plans.

EFFECTIVE DATE AND TRANSITION

142. The requirements of this Statement are effective in three phases based on total annual revenues, as discussed in paragraph 143, below. Earlier application is encouraged. Governments that elect early implementation of this Statement

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[63]See Statement 25, paragraphs 14 and 44.

[64]As stated in paragraph 15 of Statement 25, if a PERS administers one or more agent multiple-employer plans, the requirements of that Statement apply at the aggregate plan level; the PERS is not required to present financial statements and schedules for the individual plans of the participating employers.

for periods beginning before June 15, 2000, should also implement Statement 33 at the same time. If a primary government chooses early implementation of this Statement, all of its component units also should implement this standard early to provide the financial information required for the government-wide financial statements.

143. The requirements of this Statement are effective in three phases based on a government's total annual revenues in the first fiscal year ending after June 15, 1999:

- Phase 1 governments—with total annual revenues of $100 million or more—should apply the requirements of this Statement in financial statements for periods beginning after June 15, 2001.
- Phase 2 governments—with total annual revenues of $10 million or more but less than $100 million—should apply the requirements of this Statement in financial statements for periods beginning after June 15, 2002.
- Phase 3 governments—with total annual revenues of less than $10 million—should apply the requirements of this Statement in financial statements for periods beginning after June 15, 2003.

For purposes of identifying the appropriate implementation phase, *revenues* includes all revenues (not other financing sources) of the primary government's governmental and enterprise funds, except for extraordinary items as defined in paragraph 55. Special-purpose governments engaged only in fiduciary activities should use total annual *additions,* rather than *revenues,* to determine the appropriate implementation phase. All component units should implement the requirements of this Statement no later than the same year as their primary government, regardless of the amount of each component unit's total revenues. Paragraphs 148 through 153 provide additional phase-in provisions for reporting general infrastructure assets.

144. Adjustments to governmental, proprietary, and fiduciary funds resulting from a change to comply with this Statement should be treated as adjustments of prior periods, and financial statements presented for the periods affected should be restated. If restatement of the financial statements for prior periods is not practical, the cumulative effect of applying this Statement should be reported as a restatement of beginning fund balance or fund net assets, as appropriate, for the earliest period restated (generally, the current period). In the first period that this Statement is applied, the financial statements should disclose the nature of the restatement and its effect.

145. In the first period that this Statement is applied, governments are not required to restate prior periods for purposes of providing the comparative data for MD&A as required in paragraph 11. However, governments are encouraged to provide comparative analyses of key elements of total governmental funds and total enterprise funds in MD&A for that period. Also in the first year of implementation, MD&A should include a statement that, in future years, when prior-year information is available, a comparative analysis of government-wide data will be presented.

146. The requirements of APB Opinions No. 12, *Omnibus Opinion—1967,* and No. 21, *Interest on Receivables and Payables,* as amended, require deferral and amortization of debt issue premium or discount. These Opinions may be applied prospectively to governmental activities in the statement of net assets and the statement of activities, except for governmental activity debt that is deep-discount or zero-coupon debt.[65] Similarly, FASB Statement No. 34, *Capitalization of Interest Cost,* as amended, which requires capitalization of interest cost as a component of the historical cost of capital assets, also may be applied prospectively by governmental activities. Finally, Statement 23, which requires deferral and amortization of the difference between the reacquisition price and the net carrying amount of old debt in debt-refunding transactions, may be applied prospectively by governmental activities. The retroactive effect of applying those standards is not required to be considered in determining beginning net assets for governmental activities.

Governmental Entities That Use the AICPA Not-for-Profit Model

147. Governmental entities that report as of the date of this Statement using the AICPA Not-for-Profit model, as defined in Statement 29, but that do not meet the criteria in paragraph 67 may use enterprise fund accounting and financial reporting.

[65]For purposes of this Statement, deep-discount debt is debt that is sold at a discount of 20 percent or more from its face or par value at the time it is issued. Zero-coupon debt is originally sold at far below par value and pays no interest until it matures.

Reporting General Infrastructure Assets at Transition

148. Prospective reporting of general infrastructure assets in the statement of net assets is required beginning at the effective dates of this Statement. Retroactive reporting of all *major* general infrastructure assets[66] is encouraged at that date. Phase 1 governments as described in paragraph 143 should retroactively report all major general infrastructure assets for fiscal years beginning after June 15, 2005. Phase 2 governments should retroactively report all major general infrastructure assets for fiscal years beginning after June 15, 2006. Phase 3 governments are encouraged but are not required to report major general infrastructure assets retroactively.

149. If determining the actual historical cost of general infrastructure assets is not practical because of inadequate records, governments should report the estimated historical cost for major general infrastructure assets that were acquired or significantly reconstructed, or that received significant improvements, in fiscal years ending after June 30, 1980. (See paragraphs 155 through 166 for a more complete discussion of methods of estimating the cost of infrastructure assets and, if appropriate, accumulated depreciation on infrastructure assets.)

150. If, during the transition period, information is not available for all networks of infrastructure assets, those networks for which information is available may be reported.

151. While governments are applying the transition provisions, they should make these disclosures:

a. A description of the infrastructure assets being reported and of those that are not
b. A description of any eligible infrastructure assets that the government has decided to report using the modified approach (paragraphs 23–25).

[66]*Major* general infrastructure assets are assets that (a) meet the definition of a major asset as described in paragraph 156, (b) are associated with and generally arise from governmental activities, and (c) are long-lived capital assets that normally are stationary in nature and normally can be preserved for a significantly greater number of years than most capital assets, as described in paragraph 19. The transition period does not apply to proprietary funds and special-purpose governments engaged in business-type activities.

Modified Approach for Reporting Infrastructure Assets

152. Governments may begin to use the modified approach for reporting eligible infrastructure assets (as described in paragraphs 23–25) as long as at least one complete condition assessment is available and the government documents that the eligible infrastructure assets are being preserved approximately at (or above) the condition level the government has established and disclosed.

153. The three most recent complete condition assessments and the estimated and actual amounts to maintain and preserve the infrastructure assets for the previous five reporting periods required by paragraph 132 may not be available initially. In these cases, the information required by that paragraph should be presented for as many complete condition assessments and years of estimated and actual expenses as are available.

Initial Capitalization of General Infrastructure Assets

Determining Major General Infrastructure Assets

154. At the applicable general infrastructure transition date, phase 1 and 2 governments are required to capitalize and report major general infrastructure assets that were acquired (purchased, constructed, or donated)[67] in fiscal years ending after June 30, 1980, or that received major renovations, restorations, or improvements during that period.

155. The approaches in paragraphs 158 through 160 may be used to estimate the costs of existing general infrastructure assets when actual historical cost data are not available. These approaches are examples only; governments may use any approach that complies with the intent of this Statement. General infrastructure assets acquired after the effective dates of this Statement should be reported using historical costs.

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[67]For purposes of this Statement, governments that have the primary responsibility for managing an infrastructure asset should report the asset. A government should report an asset even if it has contracted with a third party to maintain the asset.

156. The determination of major general infrastructure assets should be at the network or subsystem level and should be based on these criteria:

a. The cost or estimated cost of the subsystem is expected to be at least 5 percent of the total cost of all general capital assets reported in the first fiscal year ending after June 15, 1999, *or*
b. The cost or estimated cost of the network is expected to be at least 10 percent of the total cost of all general capital assets reported in the first fiscal year ending after June 15, 1999.

Reporting of nonmajor networks is encouraged but not required.

Establishing Capitalization at Transition

157. The initial capitalization amount should be based on historical cost. If determining historical cost is not practical because of inadequate records, estimated historical cost may be used.

Estimated Historical Cost—Current Replacement Cost

158. A government may estimate the historical cost of general infrastructure assets by calculating the current replacement cost of a similar asset and deflating this cost through the use of price-level indexes to the acquisition year (or estimated acquisition year if the actual year is unknown). There are a number of price-level indexes that may be used, both private- and public-sector, to remove the effects of price-level changes from current prices. Accumulated depreciation would be calculated based on the deflated amount, except for general infrastructure assets reported according to the modified approach.

159. The following example illustrates the calculation of estimated historical cost. In 1998, a government has sixty-five lane-miles of roads in a secondary road subsystem, and the current construction cost of similar roads is $1 million per lane-mile. The estimated total current replacement cost of the secondary road subsystem of a highway network, therefore, is $65 million ($1 million × 65). The roads have an estimated weighted-average age of fifteen years; therefore, 1983 is considered to be the acquisition year. Based on the U.S. Department of Transportation, Federal Highway Administration's *Price Trend Information for Federal-Aid Highway Construction* (publication number FHWA-IF-99-001) for 1983 and 1998, 1983 construction costs were 69.03 percent of 1998 costs. The estimated historical cost of the subsystem, therefore, is $44,869,500

($65 million × 0.6903). In 1998, the government would have reported the subsystem in its financial statements at an estimated historical cost of $44,869,500 less accumulated depreciation for fifteen years based on that deflated amount.

Estimated Historical Cost from Existing Information

160. Other information may provide sufficient support for establishing initial capitalization. This information includes bond documents used to obtain financing for construction or acquisition of infrastructure assets, expenditures reported in capital project funds or capital outlays in governmental funds, and engineering documents.

Methods for Calculating Depreciation

161. Governments may use any established depreciation method. Depreciation may be based on the estimated useful life of a class of assets, a network of assets, a subsystem of a network, or individual assets. For estimated useful lives, governments can use (a) general guidelines obtained from professional or industry organizations, (b) information for comparable assets of other governments, or (c) internal information. In determining estimated useful life, a government also should consider an asset's present condition and how long it is expected to meet service demands.

162. Continuing the example from paragraph 159, assume that, in 1998, the road subsystem had a total estimated useful life of twenty-five years from 1983 and therefore has an estimated remaining useful life of ten years. Assuming no residual value at the end of that time, straight-line depreciation expense would be $1,794,780 per year ($44,869,500 ÷ 25), and accumulated depreciation in 1998 would be $26,921,700 ($1,794,780 × 15).

Composite Methods

163. Governments also may use composite methods to calculate depreciation expense. Composite methods refer to depreciating a grouping of similar assets (for example, interstate highways in a state) or dissimilar assets of the same class (for example, all the roads and bridges of a state) using the same depreciation rate. Initially, a depreciation rate for the composite is determined. Annually, the determined rate is multiplied by the cost of the grouping of assets to calculate depreciation expense.

164. A composite depreciation rate can be calculated in different ways. The rate could be calculated based on a weighted average or on an unweighted-average estimate of useful lives of assets in the composite. For example, the composite depreciation rate of three interstate highways with estimated remaining useful lives of sixteen, twenty, and twenty-four years could be calculated using an unweighted average estimated as follows:

$$\frac{1}{(16 + 20 + 24)/3} = 5\% \text{ annual depreciation rate}$$

A composite depreciation rate may also be calculated based on an assessment of the useful lives of the grouping of assets. This assessment could be based on condition assessments or experience with the useful lives of the grouping of assets. For example, based on experience, engineers may determine that interstate highways generally have estimated remaining useful lives of approximately twenty years. In this case, the annual depreciation rate would be 5 percent.

165. The composite depreciation rate is generally used throughout the life of the grouping of assets. However, it should be recalculated if the composition of the assets or the estimate of average useful lives changes significantly. The average useful lives of assets may change as assets are capitalized or taken out of service.

166. The annual depreciation expense is calculated by multiplying the annual depreciation rate by the cost of the assets. For example, if the interstate highway subsystem cost $100 million and the annual depreciation rate was 10 percent, then the annual depreciation charge would be $10 million. Accumulated depreciation should not exceed the reported cost of the assets.

The provisions of this Statement need not be applied to immaterial items.

This Statement was adopted by unanimous vote of the seven members of the Governmental Accounting Standards Board:

Tom L. Allen, *Chairman*
Robert J. Freeman, *Vice-chairman*
Cynthia B. Green
Barbara A. Henderson
Edward M. Klasny
Edward J. Mazur
Paul R. Reilly

Appendix A

BACKGROUND

167. The reexamination of the governmental financial reporting model (referred to as the "Reporting Model project") is the fourth phase of the Financial Reporting project—one of the projects on the Board's original 1984 agenda. The previous three phases of the project were completed with the publication of the GASB Research Report, *The Needs of Users of Governmental Financial Reports,* by David B. Jones and Others (1985); Concepts Statement 1; and Statement 14.

168. Additionally, five other Research Reports directly relating to financial reporting model issues have been published: *A Study of the Usefulness of Disclosures Required by GASB Standards* by Leon E. Hay (1988), *Financial Reporting by State and Local Governments: A Survey of Preferences among Alternative Formats* by Earl R. Wilson (1990), *Popular Reporting: Local Government Financial Reports to the Citizenry* by Frances H. Carpenter and Florence C. Sharp (1992), *The Relationships between Financial Reporting and the Measurement of Financial Condition* by Robert Berne (1992), and *Small Government Financial Reporting* by Rhoda C. Icerman (1996).

169. After the issuance of Statement 11, in 1990, the Board deliberated on a variety of financial reporting model issues, including how to display the long-term assets and liabilities arising from the use of an accrual basis of accounting in the governmental funds and what effect, if any, those assets and liabilities should have on fund balances. However, because of the contentiousness of the issues involved, the overall Reporting Model project did not progress as expected. As a result, the Board concluded that it could complete a narrow-scope project that would address the balance sheet display issues deferred from Statement 11 and certain operating statement issues in time to implement Statement 11 by its intended effective date of periods beginning after June 15, 1994.

170. In 1992, the Board issued a Preliminary Views document (PV), *Implementation of GASB Statement No. 11, "Measurement Focus and Basis of Accounting—Governmental Fund Operating Statements,"* on the narrow-scope project issues. That PV included both a preliminary and an alternative view that presented models for addressing the Statement 11 balance sheet display issues. However, the majority of respondents preferred that the effective date of

Statement 11 be deferred until the Reporting Model project was completed, or at least until substantial progress was made in determining the direction the Board would follow in completing that project. The Board agreed with the respondents and in 1993 issued Statement 17.

171. After the issuance of Statement 17, the Board again directed its efforts to some of the major issues in the Reporting Model project. As part of this broad-scope approach, the Board considered the possibility of applying accrual accounting at different levels of the financial reporting pyramid, reviewed a variety of aggregated reporting approaches, and discussed the relationship between the financial reporting objectives in Concepts Statement 1 and an aggregated, top-of-the-pyramid reporting approach. The Board also held several meetings throughout the process with the project task force comprising individuals from state and local governments, the financial statement user community, public accounting, and academia. Based on the information the Board obtained through these extensive efforts, it ultimately agreed to develop alternative models to expose through an Invitation to Comment (ITC), *Governmental Financial Reporting Model,* released in June 1994.

172. The ITC presented two alternative models that differed in many ways, but also included common features that represented modifications to the then-current model. Both models included a requirement for an additional level of aggregated statements to provide "government-as-a-whole" financial reporting. The two models also included a requirement to display financial statement data for *major individual funds,* and a provision for cash flow reporting for governmental funds. Enhancements to the budgetary comparison and changes in the reporting for fiduciary funds were also key features of the models in the ITC. Despite these similarities, the models were significantly different in many areas, including levels of aggregation, the measurement focus and basis of accounting used at the different levels of reporting, and the methods used for reporting capital outlay, assets, and debt for governmental activities.

173. The GASB received over 150 responses to the ITC, held 4 public hearings, and conducted 8 user focus group sessions. There was support for both models presented in the ITC. Many respondents favored some aspects of one model and other aspects of the other. Based on the analysis of the constituents' reactions to the issues proposed in the ITC, the Board developed the basic (or "core") financial statement requirements that formed the basis of the next due process document—a PV, *Governmental Financial Reporting Model: Core Financial Statements,* issued in June 1995.

174. The PV also considered certain issues included in other Board projects. To an extent, the basic financial statements addressed in the PV included issues developed in four Discussion Memorandums:

- *Accounting and Financial Reporting for Capital Assets of Governmental Entities,* issued in 1987
- *Measurement Focus of Governmental Business-type Activities or Entities,* issued in 1988
- *Capital Reporting,* issued in 1989
- *Reporting Contributions, Subsidies, Tap Fees, and Similar Inflows to Enterprise and Internal Service Funds and to Entities Using Proprietary Fund Accounting,* issued in 1993.

175. The PV model proposed that to best meet the different needs of diverse user groups, basic financial statements for governments should include both a fund perspective and an entity-wide perspective. The *fund perspective* would preserve the nature of fund accounting and, to a large extent, the display characteristics of the current model. The *entity-wide perspective* was intended to satisfy users' needs for aggregated information about the government to help assess the longer-term effects of current-period transactions and events associated with governmental activities.

176. The Board received 230 responses to the PV, held 6 public hearings, and conducted 17 user focus groups to provide the Board with constituent opinions about the various provisions of the PV. In addition, twenty state and local governments participated in a field test of the PV model. The Board's consideration of the input from all of those sources helped form the basis for the financial reporting model set forth in an Exposure Draft (ED), *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments,* issued in January 1997.

177. Much of the PV proposal, including the overall "dual-perspective" approach, was carried over to the ED. Several significant changes were made, however, including:

a. The addition of a requirement in MD&A to reconcile the major differences between key amounts reported in the two perspectives
b. A modification to require separate columns for governmental activities and business-type activities in the entity-wide statements
c. Changes to the infrastructure reporting requirements (including retroactive reporting) and elimination of a "planned maintenance" option

d. Changes to the methods for reporting discretely presented component units
e. The addition of a provision that would impose additional requirements on governments that issued less than the full financial section of a CAFR, primarily with regard to information about major funds
f. Changes to the reporting requirements for transfers.

178. The Board received 400 responses to the ED, held 5 public hearings and 2 meetings with an expanded task force, and, on several occasions, met with representatives from major constituent groups to discuss various aspects of the ED. As explained in Appendix B, “Basis for Conclusions,” the comments and suggestions from all of these sources contributed to the Board’s deliberations and helped form the basis for the reporting model in this Statement.

Appendix B

BASIS FOR CONCLUSIONS

Contents

Paragraph Numbers

Paragraph
Numbers

Appendix B

BASIS FOR CONCLUSIONS

INTRODUCTION

179. This appendix summarizes factors considered significant by Board members in reaching the conclusions in this Statement. It includes discussion of the alternatives considered and the Board's reasons for accepting some and rejecting others. Individual Board members gave greater weight to some factors than to others.

180. This Statement is part of an ongoing effort to improve financial reporting by governments to meet the accountability and other objectives established in Concepts Statement 1. For example, recognition criteria for nonexchange transactions are an important element of the financial reporting model established by this Statement. The Board established those recognition criteria in Statement 33, issued in December 1998. Also, the Board is reviewing all current requirements for note disclosures with a view to issuing revised standards before this Statement becomes effective. Because of this, the discussion of note disclosures in this Statement is limited to disclosure issues that are most directly related to the new requirements of this Statement. The Board also intends to continue its research into alternative methods of accounting and financial reporting of infrastructure assets and may issue a future Statement on that issue in the future. The Board will add further issues to its agenda as the need for new or revised standards to enhance the effectiveness of this Statement becomes apparent.

181. Research also is being conducted on how best to achieve the objectives in Concepts Statement 1 that can be only partially addressed in financial statements, including, for example, reporting on financial condition and service efforts and accomplishments. The standards in this Statement provide the foundation for these and other potential future kinds of reporting, whether they are incorporated into a comprehensive annual financial report (CAFR) or other financial report that includes the basic financial statements required by this Statement or are issued in one or more separate reports.

182. This appendix is divided into two parts. Part I (paragraphs 183–277) addresses the *concepts* that underlie the new financial reporting model. It discusses (a) why the Board believes that the basic financial statements of governments should include government-wide and fund financial statements, (b) why different measurement focuses and bases of accounting (MFBA) are needed to report governmental activities as a whole versus the activities of governmental funds, (c) the financial reporting objectives established in Concepts Statement 1 that the basic financial statements are designed to address, and (d) why the Board selected the conceptual approach adopted in this Statement instead of certain alternatives. Part II of this appendix (paragraphs 278–476) discusses the Board's conclusions with respect to *specific standards and certain implementation issues,* including the reasons for the changes that have been made to some of the standards proposed in the 1997 ED.

PART I

Objective of This Statement

183. The Board's objective with this Statement is to establish a basic financial reporting model that will result in greater accountability by state and local governments by providing more useful information to a wider range of users than did the previous model. The new model also improves on earlier standards and proposals for modifying the previous model, including Statement 11, the 1994 ITC, the 1995 PV, and the 1997 ED. (Appendix A includes a brief history of those standards and proposals.) As part of the deliberations leading to this Statement, the Board reexamined and reaffirmed the objectives of financial reporting established in Concepts Statement 1. Those objectives are the foundation for the requirements of this Statement.

Primary User Groups

184. In Concepts Statement 1, paragraph 30, the Board identified three groups of primary users of a government's general purpose external financial reports: (a) those to whom government is primarily accountable (the citizenry), (b) those who directly represent the citizens (legislative and oversight bodies), and (c) those who lend or who participate in the lending process (investors and creditors). The Board also established *accountability* as the principal objective of governmental financial reporting and the provision of *useful information* as critical to meeting governments' obligation to be accountable. The objectives

were developed based on the kinds of activities that governments perform, the environments that surround and influence governments' activities, and the kinds of information about those activities that users in the three primary user groups need.[68]

185. Governments' duty to be accountable requires that they provide financial information that is *relevant* to users and is *reliable*. The information provided also should be *understandable* to reasonably knowledgeable users. Efforts to fulfill this responsibility should include providing more than one kind of financial information when a significant number of users legitimately need different kinds for different purposes. The general purpose external financial reports of governments cannot meet *all* information needs of *all* users. However, the principal needs of a variety of users should be addressed, even if this means including information that not all users need or that some may not fully understand, and measuring and displaying certain information in more than one way. The Board has not established an order of priority for the primary user groups because it believes that their information needs are equally important. Instead, the Board has consistently sought to make financial reporting more accessible and more useful to a wide range of users in all three groups.

Users' Needs Vary

186. Research conducted both before and since establishing the Concepts Statement 1 objectives indicates that users need different kinds of financial information for different purposes. Sometimes the most important needs of different users—or even those of the same users—conflict. Some decisions focus on resource allocation and compliance in the *short term.* These decisions benefit primarily from current financial information, including a government's short-term financial position and liquidity, current-year resource outflows compared with inflows, compliance with budgetary and other legal limitations on the sources and uses of financial resources, and amounts available for appropriation. Financial statements that include the long-term effects of current-period transactions may obscure some of the information needed for short-term decisions. On the other hand, many users have an equal or greater interest in information with a *medium- to long-term* outlook. Part of the reason that they seek financial information is to help them predict the effect that current-period legislative and management decisions may have on the demand for taxes and

[68]Paragraphs 12 through 29 and 43 through 50 of Concepts Statement 1 discuss the environment surrounding governments' activities and its influence on the objectives of financial reporting.

other resources needed to maintain service levels and meet all obligations, not only for the next fiscal year but for several years into the future. Financial statements designed to focus on current financial resource flows and balances and compliance with legal requirements do not adequately meet these information needs.

187. The scope of financial information sought by users also varies. Some users are looking primarily for *summary information* about a government's net resources and activities. They either do not need or are less interested in detailed information, including information about the funds or fund types that governments use to manage resources. Reporting financial information only by fund or fund type, as previously required, makes it difficult for these users to obtain a clear picture of the entire government's finances because the parts tend to obscure the whole. Other users, in contrast, need *detailed information* for various reasons. Some of these users are primarily interested in a particular fund or funds. Others need information about how a government's resources are managed, how its various activities are financed, and whether the government is complying with legal restrictions on the inflows and outflows of financial resources.

188. In Concepts Statement 1, the Board acknowledged that users' needs are diverse and developed a broad set of financial reporting objectives for meeting them. In assessing users' needs and developing the objectives, the Board examined the characteristics and needs of different groups of users and the qualities that information should have to be useful to them. The Board also examined the role of funds and fund-based reporting, the environment and characteristics of governmental activities and business-type activities, and the need for information not previously included in general purpose external financial reports, including information about the government as a whole and about its financial condition and service efforts and accomplishments.

189. The Board believes that most of the objectives established in Concepts Statement 1 can be met, at least partially, in a single financial report, but they cannot all be adequately met with a single balance sheet and operating statement. This is especially so for general purpose governments and other governments whose activities are supported predominantly by taxes, intergovernmental revenues, and other nonexchange revenues. The Board believes that some of the Concepts Statement 1 objectives are best addressed by reporting information for *individual funds or fund types;* other objectives require information that focuses on the *entire government as an economic entity.* Some of the objectives focus on providing information required for decisions about

short-term financing needs and legal compliance; other objectives address users' needs for *information with a longer-term focus* from an *economic* viewpoint. Because of these differences in the focus and scope of information needed to meet a broad range of user needs, the Board believes that the basic financial statements of most governments should include—and this Statement requires—financial statements both for the government as a whole (government-wide statements) and for the individual major funds (fund statements) that are used to control or manage the government's assets. In addition, because many governments act as trustees or agents for certain assets of their employees or other entities, the basic financial statements also should include financial statements that report the government's fiduciary activities.

User Needs and the 1997 Exposure Draft

190. In the ED, the Board proposed a "dual-perspective" approach for the general purpose external financial statements. Most governments would have been required to present two sets of financial statements—one set from an "entity-wide perspective" and one set from a "fund perspective." The entity-wide perspective focused on the government as an economic unit, with separate display of governmental activities, business-type activities, and discretely presented component units, and required use of the economic resources measurement focus and the accrual basis of accounting. The fund perspective, in contrast, focused on the government's fund types, including governmental, proprietary, and fiduciary funds, as the primary vehicles used by most governments to manage and control resources. The required MFBAs at the fund perspective were consistent with the purpose of and existing standards for each fund type—current financial resources measurement focus and modified accrual basis of accounting for governmental funds and economic resources and accrual basis for proprietary and fiduciary funds (as redefined).

191. Many respondents to the ED acknowledged that financial statements from both an entity-wide and a fund perspective are needed to meet the diversity of user needs and objectives established in Concepts Statement 1. A majority of respondents, however, were concerned about what they perceived to be "inconsistent stories" about the government's activities as well as the complexity and potential for confusion of the proposed dual-perspective model. Some of these respondents thought that the Board had overemphasized the *separateness* of the financial statements at each perspective. In their view, a reconciliation between the two perspectives should have been required, and its addition would help alleviate concerns about "two stories" or "two sets of books." Others simply rejected the dual-perspective approach as an attempt by the Board to

make general purpose external financial statements “be all things to all users.” These respondents said that two perspectives would not be necessary if the Board concentrated on the “common needs of users.” According to these respondents, the Board should narrow the range of user needs to be addressed. It then would be possible, in their view, to develop a single set of basic financial statements that would focus on a single perspective and, preferably, use a single MFBA.

192. Based on the comments of all respondents who disagreed with the dual-perspective approach, some thought that the entity-wide perspective alone would meet most users’ needs, whereas others thought the fund perspective alone would be enough. Still other respondents said that they would prefer a single perspective but would accept the two sets of financial statements proposed in the ED if both sets used a single MFBA or, at most, one MFBA for governmental activities at both perspectives and another for business-type activities. However, as discussed in paragraph 241 of this appendix, the respondents who preferred a single MFBA did not all choose the same one. The Board believes that these responses are based on different views about what users need and how financial reports should address their needs. This diversity of views is not unique to the specific proposals in the ED. None of the underlying research and due process that the Board has conducted over many years, including the responses to previous standards or proposals for the financial reporting model and consultations with users through surveys and focus group sessions, has revealed a simple set of “common needs of users” or a simple set of financial statements that would meet those needs.

193. Some ED respondents acknowledged that governments and user needs are complex and that it is difficult, if not impossible, to adequately address that complexity with a simple set of financial statements or a single MFBA. Their suggestion was that the Board should narrow the range of user needs to be addressed in the model by setting a priority order for the three user groups established in Concepts Statement 1. Most of these respondents did not indicate which group should have priority. However, some suggested that citizens’ needs should have low or no priority (except, perhaps, in a popular report) because, in these respondents’ experience, citizens do not read financial reports. Other respondents made similar comments about legislators and members of governing or oversight boards. Still others said that the Board should clearly focus on the information needs of investors and creditors. The principal reasons given were that investors and creditors have a greater and more homogeneous need for financial information and a better understanding

of it than other users, and governmental financial reporting standards should follow the example of private-sector financial reporting standards, which emphasize investors' and creditors' needs.

194. The Board acknowledges that, currently, many individual citizens and legislators do not read governmental external financial reports. However, some do. Furthermore, the fact that few citizens or legislators *currently* read their governments' financial reports does not mean that they *never will,* especially if financial reports can be made more understandable and more useful to them. In addition, the "citizenry group" identified in Concepts Statement 1 extends beyond individual citizens. Paragraph 31 of that Statement explains that the citizenry group includes intermediaries, such as the media, advocate groups, and public finance researchers, as well as individual taxpayers, voters, and service recipients. The Board specifically included the media, citizen/taxpayer organizations and other advocate groups, and researchers because the Board believed that financial reporting should address their professional needs for relevant and reliable financial information about the activities of governments. These users provide an important service through their analysis, synthesis, and subsequent reporting of relevant information to members of the general public. Similarly, the legislative and oversight officials group that was established as a primary user group in Concepts Statement 1 is not limited to individual legislators. It includes governing boards and agencies that make oversight decisions for which financial information is essential.

195. The Board points out that, if governmental financial reporting were designed to meet primarily the particular needs of investors and creditors, the usefulness of the financial statements of the many governments that have no outstanding or planned debt issues, or that generally have few liabilities other than current accounts payable, would be limited or nonexistent.

196. The Board believes that the information needs of members of the citizenry and the legislative and oversight officials groups, as defined in Concepts Statement 1, are as important as those of the investors and creditors group. Governments, represented by elected and appointed officials, are accountable to *all* resource providers, including the citizenry, investors, creditors, and others, for the efficient and effective use of the resources they provide. Legislators and members of oversight bodies need financial information to fulfill the duties they were elected or appointed to perform. The other groups need financial information to hold governments accountable for their actions. All three groups need relevant, reliable, and understandable financial information. The fact that they

do not all need the same information in the same form for the same purposes is not sufficient reason to give priority to one group's needs over another's. Rather, it is a challenge for financial reporting that the Board believes can and should be met.

Objectives of Financial Reporting

Primacy of Accountability

197. The Board stated in Concepts Statement 1 that "accountability is the cornerstone of all financial reporting in government" and is "the paramount objective from which all other objectives must flow" (paragraphs 56 and 76, respectively). Accountability and financial reporting are linked as follows:

> . . . Accountability requires governments to answer to the citizenry—to justify the raising of public resources and the purposes for which they are used. Governmental accountability is based on the belief that the citizenry has a "right to know," a right to receive openly declared facts that may lead to public debate by the citizens and their elected representatives. Financial reporting plays a major role in fulfilling government's duty to be publicly accountable in a democratic society. [paragraph 56]

198. As this quotation indicates, accountability includes providing financial information that citizens and others can use to hold governments accountable for their actions and to enlighten public discussion of *all* aspects of the role and activities of governments, not just their financial activities. Indeed, the Board emphasized in Concepts Statement 1 that "governmental financial reporting should provide information to assist users in . . . making economic, social, and political decisions" (paragraph 76). Concepts Statement 1 includes numerous references to the need for reported information to be useful for different kinds of decisions, as well as a discussion of the characteristics that information should have in order to be useful. Thus, the foundation for the objectives of financial reporting established in Concepts Statement 1 is the belief that providing financial information that is useful for a variety of decisions by a broad range of users is a critical part of meeting governments' duty to be accountable.

Providing Accountability through Financial Reporting

199. Accountability is a far-reaching goal because governments engage in many different kinds of activities. Most activities have a financial component, but for some of them it is difficult to provide adequate information in traditional financial statements. For that reason, the Board stated in Concepts Statement 1 that ". . . applying the broad concept of public accountability to financial reporting by state and local governments creates the potential to extend reporting beyond current practice" (paragraph 57). In the Board's view, the amount and kinds of useful financial information that governments should provide are limited only by cost–benefit considerations and the state of the art of financial reporting.

200. Consistent with these considerations, Concepts Statement 1 defines a *lower* limit for the information that governments should provide, but it does not define an *upper* limit. At a minimum, governments should provide information "to assist in evaluating whether the government was operated within the legal constraints imposed by the citizenry" (paragraph 58). The Board established this lower limit—and has maintained it as a basic premise throughout the Financial Reporting Model project—because, in a democracy, it is critically important for governments to communicate information that will help users evaluate compliance with laws and regulations governing the raising and spending of public moneys.

201. Several of the Concepts Statement 1 objectives have their origins in this basic premise and in the importance to users of related information about the sources, uses, and balances of current financial resources in compliance with budgetary and other fiscal requirements. Financial statements traditionally have focused on providing these kinds of information for governmental activities. The Board believes that this information continues to be very important to many users; indeed, it is fundamental to holding governments accountable.

202. However, the Board also recognized in Concepts Statement 1 that users need additional information to hold governments fully accountable for their activities—information that includes the cost of services, whether sufficient revenues are being raised for the services provided, and the financial position of the government. This kind of information previously has not been required by generally accepted accounting principles for governmental activities. Indeed, much of it is difficult or impossible to provide within the constraints of the traditional financial reporting model, as restated in NCGA Statement 1.

Forms of Accountability

203. The financial statements of governments traditionally have focused on two different forms of accountability—*fiscal accountability* for governmental activities and *operational accountability* for business-type and certain fiduciary activities.[69] Fiscal accountability is the responsibility of governments to justify that their actions in the current period have complied with public decisions concerning the raising and spending of public moneys in the short term (usually one budgetary cycle or one year). In contrast, operational accountability is governments' responsibility to report the extent to which they have met their operating objectives efficiently and effectively, using all resources available for that purpose, and whether they can continue to meet their objectives for the foreseeable future. The accountability focus of each fund or fund type has depended primarily on the principal objectives and sources of financing of the activities being reported.

Fiscal Accountability

Why Have the Financial Statements for Governmental Activities Traditionally Focused on Fiscal Accountability?

204. A primary objective of governmental activities is to provide services demanded and authorized by the citizenry within the constraints of available (current, spendable) financial resources. The resources needed to achieve this objective for the current period are obtained primarily from taxes, intergovernmental revenues, and other nonexchange revenues, rather than from charges specifically related to the cost of providing a service. In the absence of market mechanisms (such as cost and exchange price) to control the amount of services provided and consumed, governmental activities are governed by public decisions, including numerous laws and regulations that affect the sources and uses of public resources. These laws and regulations are designed in large measure to ensure the provision of the basic services that the community believes are necessary, while at the same time protecting the citizenry from excessive taxation.

[69]The terms *fiscal accountability* and *operational accountability* are used, for example, in American Accounting Association, "Report of the Committee on Concepts of Accounting Applicable to the Public Sector, 1970–71," *Accounting Review,* Supplement to Vol. 47 (1972), pp. 81 and 86. In this context, *fiscal* means "having to do with the public treasury or revenues," rather than simply "financial."

205. Decisions about which services to provide, how much should be spent on them, and how resources should be raised to finance them are made collectively by interested parties outside as well as within the government—through the public budgetary process, voter referendums, and other control mechanisms. These decisions generally are incorporated into a legally adopted budget or spending plan, and into authorizations to raise specified amounts of taxes and other financial resources from identified sources to finance specific current-period activities. The financial statements for governmental activities traditionally have fulfilled the role of completing the budgetary cycle by reporting whether these duly authorized plans were achieved—whether resources were in fact raised and spent in the amounts and for the purposes intended. That information, together with information about fund balances, is important for decision makers involved in the future allocation of resources. Those decision makers include the financial community and the citizenry as well as legislative and oversight bodies.

206. Key information for these purposes includes the inflows and outflows of current financial resources by source and use; whether aggregate inflows were sufficient to cover aggregate outflows; comparisons between budgeted and actual inflows and outflows; and year-end balances of current financial resources, outstanding claims against those resources (claims payable in the short term), and net current financial resources available for appropriation (or a net deficit requiring additional financing). Governments traditionally have provided this information in three financial statements: a statement of revenues, expenditures, and changes in fund balances; a budgetary comparison statement; and a balance sheet.

207. Other practices that help demonstrate fiscal accountability include the use of fund accounting—separate financial statements for each governmental fund or fund type—and the reporting within the financial statements of specific sources and uses of current financial resources (taxes, intergovernmental revenues, capital outlay, debt service, and so forth). These practices help governments control current financial resources and demonstrate to the citizenry and other resource providers that the resources raised for a particular purpose were used for that purpose, as required by law, regulation, and legally adopted budgets.

208. A fund is defined in paragraph 16 of NCGA Statement 1 as:

> A fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with all related liabilities and residual equities or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations.

209. As indicated by this definition, the use of fund accounting and fund-based reporting is consistent with and an extension of the reasoning underlying the fiscal accountability model. Indeed, it has been an integral part of the reporting model for governmental activities for many decades. In contrast, reporting by funds is generally not required when an operational accountability model is used. That is, a business-type activity, such as a utility, is reported as a fund of a primary government, but there generally is no segregation by fund within the activity.

Why Should the Financial Statements for Governmental Activities Continue to Provide Fiscal Accountability Information?

210. Fiscal accountability reporting for governmental activities was developed in response to constituents' demands for control of and accountability for the raising and spending of public moneys. The Board believes that this basic objective continues to be critically important to many users. Members of the citizenry and investors and creditors groups, in particular, continue to express a strong interest in the control and purposes of public spending and revenue raising at all levels of government.

211. In Concepts Statement 1, the Board emphasized the importance of the public budget as the expression of public policy, financial intent, and control, as well as the usefulness of reporting budgetary performance (paragraphs 19 and 20). The Board also emphasized the usefulness of the governmental fund structure and the use of fund accounting as a control mechanism and a means of reporting compliance with legal and other restrictions on the use of financial resources (paragraphs 21 and 22). Consistent with these views, the Board included the following as one of the financial reporting objectives: "Financial reporting should demonstrate whether resources were obtained and used in accordance with the entity's legally adopted budget; it should also demonstrate compliance with other finance-related legal or contractual requirements" (paragraph 77b, footnote reference omitted). Based on its research and due process

throughout the Financial Reporting Model project, the Board believes that the governmental fund structure and the fiscal accountability focus of the governmental funds are an important means of achieving that objective for many governments and users of their financial statements.

212. Users consistently have expressed a strong interest in current financial resource flows, budgetary and fiscal compliance, and fund-based financial reporting, as evidenced by the results of the Board's 1985 user needs survey,[70] 1990 financial reporting study,[71] and other studies and articles by independent researchers.[72] Similar views have been expressed by many respondents to several Board due process documents, including the 1994 ITC, the 1995 PV, and the 1997 ED, and by many of the participants in focus group sessions held from 1994 through 1996 with members of all three primary user groups. Based on these sources, the Board believes that many users have a strong interest in detailed fiscal accountability information about the general fund and other major governmental funds, and that many governments support a continuation of the requirement to provide that information.

213. The Board has concluded, therefore, that the traditional focus of governmental fund financial statements on fiscal accountability should continue. Governmental activities should be reported by fund (major funds and an aggregation of all nonmajor funds) and should continue to use the current financial resources measurement focus and the modified accrual basis of accounting. However, to meet users' needs for longer-term information, the basic financial statements also should include operational accountability information for the government as a whole. This will enable users to begin to assess the government's cost of services for governmental activities as well as business-type activities, without losing the fiscal accountability information that has proved useful in the past.

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[70]GASB Research Report (Jones and Others).

[71]GASB Research Report (Wilson).

[72]An overview of the results of various studies and articles related to users' information needs, including their preferences for, respectively, consolidated, aggregated but not consolidated, and disaggregated (fund-based) financial statements, is included in Chapter 1, paragraphs 5 through 15, of the GASB's 1994 ITC on the governmental financial reporting model.

Operational Accountability

Why Have the Financial Statements for Business-type Activities and Certain Fiduciary Activities Traditionally Focused on Operational Accountability?

214. Governments are established to provide services. Legislative and oversight bodies are authorized by the citizenry to obtain and consume both capital and financial resources for that purpose. These bodies, as well as the financial community and the citizenry—including voters, taxpayers and other resource providers, service recipients and beneficiaries, and the media—should be informed about how efficiently resources have been used and what has been accomplished. These groups also should be informed about the resources available for future use and whether they are expected to be sufficient to maintain or enhance current service levels and meet all obligations.

215. Inherent in the concept of operational accountability is a broad interpretation of the meaning of stewardship of public resources. Stewardship comprises not only the safekeeping of all resources, capital as well as financial, and compliance with all requirements for their use (fiscal accountability), but also the efficient and effective use of resources to meet authorized service objectives and all obligations undertaken by the government on an ongoing basis (operational accountability).

216. Financial statements for business-type activities and certain fiduciary activities (trusts) traditionally have focused on providing operational accountability information, similar to their private-sector counterparts. Except for the absence of a profit motive, the operating objective of business-type activities is similar to that of for-profit entities: to provide services financed fully or predominantly by fees or charges paid by service recipients (exchange revenues).[73] Business-type activities set their charges in much the same way as for-profit entities do. User charges are based in large measure on the economic cost of the service, including all capital and financial resources used in providing the service during the period, and on the need to recover that cost to preserve the activity's resource base and support future operations.

[73]The objective of business-type activities is not always fully achieved. Because some of the services they provide are considered socially necessary or desirable, even if they are not self-supporting, some business-type activities receive supplementary financial support from taxes and other nonexchange revenues. The transactions of such activities are, nevertheless, primarily exchange transactions, and a direct, if not equal, relationship exists between the cost of providing the service and the user fee charged, and between the user charge and the value placed on the service by the recipient.

217. Because of these similarities, the financial statements for business-type activities traditionally have been similar in focus, content, measurement, and display to those of for-profit entities. For both kinds of entities, an important measure of the efficiency of operations is provided by comparing the revenues earned by the service with the expenses incurred in providing the service, and reporting the difference (net income or net loss). Information useful for assessing the ability to continue to provide services and meet all obligations is provided by a balance sheet that includes all assets that support the activity, all liabilities, and the net assets held to support the provision of future services.

218. The financial statements for certain fiduciary activities of governments—nonexpendable trusts, endowments, and pension trusts—also have focused on providing operational accountability information. Their operating objective is to maximize earnings on trust principal, within an agreed level of risk, so that the earnings can be used to provide authorized services or benefits. Again, reported net income or loss (or change in net assets) provides a measure of efficiency, and year-end balances provide information about the ability to maintain principal and continue to finance services and benefits.

Why Should Operational Accountability Information Be Provided for Governmental Activities?

219. The fiscal accountability focus of financial statements for governmental activities meets some of the obligations of stewardship of public resources. The information provided about planned and actual expenditures for the current year, how expenditures were financed, whether inflows and outflows of current financial resources complied with budgetary and other legal requirements, whether inflows were sufficient to meet outflows, and amounts available for appropriation is important for resource-allocation decisions and the financial management of governmental activities *in the short term*. However, the citizenry, legislative and oversight bodies, and investors and creditors also need information about the probable *medium- and long-term effects* of past decisions on the government's financial position and financial condition. Without that information, these groups cannot assess the probable effect of current-period activities on the future demand for resources, or whether the government can continue to meet its service objectives and financial obligations in the future.

220. Operational accountability information is useful for these purposes. It includes the periodic economic cost of the services provided (operating costs). It also informs users about whether the government is raising sufficient revenues each period to cover that cost (operating results), or whether the

government is deferring costs to the future or using up accumulated resources to provide current-period services (interperiod equity). Although more difficult to measure, other important information about operations includes whether services are being provided economically and efficiently and whether the benefits of services exceed the costs of providing them (effectiveness, or program results).

221. Providing these kinds of information is part of the objectives of financial reporting in Concepts Statement 1.[74] Those objectives apply to *all* activities of governments, governmental as well as business-type and fiduciary. The fact that governmental activities are financed primarily by taxes and other nonexchange revenues does not shield them from the basic economic reality that no organization can remain financially sound and continue to meet its operating objectives if it persistently fails to recover its operating costs. The fiscal stress that many governments have encountered in the past several decades—as the range of services demanded, their cost, and citizens' resistance to taxes and debt have all increased—illustrates that governments' ability to remain solvent by increasing taxes and borrowing is not limitless.

222. With operational accountability information, all participants in public decision making should be in a better position to assess the service levels that can be provided from existing revenue sources and how those resources should be allocated, as well as the effect of current-period operations on future service needs and resource requirements. Decision makers also could better evaluate whether a service can be provided most economically and effectively by the government itself, through a private subcontractor, by a private enterprise, or jointly with another government or governments.

223. The key information element that was not provided by the current fiscal accountability model for governmental activities is *operating costs*. The benefits of government programs and other services frequently were not measurable, at least in financial terms. Moreover, assessments of what constitutes a "benefit" are necessarily subjective. They will vary depending on the needs and values of the individuals or groups participating in the decisions, and those needs and

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[74]The Board acknowledges that operational accountability cannot be fully achieved in financial statements or with financial data. When the Board established the financial reporting objectives in Concepts Statement 1, it anticipated that additional means of reporting would be needed to convey some of the operational accountability information needed by users, including service efforts and accomplishments (SEA) information and financial condition indicators. Nevertheless, financial statements that focus on operational accountability can report some of the information required to meet those needs and can provide a foundation for other kinds of reporting.

values change over time. However, operating costs *are* objectively measurable and reportable in financial statements. With information about costs, decision makers have a basis for evaluating the cost–benefit of programs and other services; cost is a benchmark against which decision makers can compare their own evaluation of benefits. Cost also provides a consistent basis for evaluating a government's operating results—whether revenues were sufficient to cover costs—both over time and compared with the operating results of similar governments. Operating results, in turn, are a critical factor in assessments of a government's financial position and financial condition.

Why Is the Economic Resources/Accrual MFBA Necessary for Operational Accountability Information?

224. Operational accountability information focuses on reporting *economic activity.* The provision of objective, consistent, and comparable information about operating costs requires a measurement focus on economic (capital as well as financial) resource flows. It also requires use of the accrual basis of accounting, which recognizes economic transactions and other events when they occur, rather than only when the related inflows and outflows of cash or other financial resources occur. A charge is made to operations in the period when goods and services are *used or consumed,* rather than, as is the case with the current financial resources and modified accrual MFBA (and the total financial resources and accrual MFBA), when goods and services are *acquired,* because the consumption of resources is an economic event that affects the government's operating results and financial position. Acquired but unused goods and services are reported as assets until they are used, thus giving important information about resources already acquired that can be used to provide future services.

225. The consumption (expense) basis provides more complete, objective, and comparable information about a government's costs than the acquisition (expenditure) basis, both for a single period and over time. On the expenditure basis previously used for reporting governmental activities, some costs that had been incurred and benefited only the current period were not charged to operations of that period, because they did not require the use of current financial resources until future periods. Examples include employee fringe benefits that have been earned but have not been funded in the current period; accretions of deep-discount debt; and claims, judgments, and other items with extended payment periods. The failure to recognize a charge to operations for

these items understates a government's economic cost of operations for the period when the costs were incurred, and overstates costs for the periods when the related cash or other current financial resource outflows occur.

226. At the same time, some expenditures overstate costs in the acquisition period and understate future costs. For example, on the expenditure basis (whether current or total financial resources are measured), the entire cost of a building, such as a fire station, is recognized as an expenditure in the acquisition period, even though the building is expected to last for many years.

227. From an economic perspective, the fire station contributes to the provision of public safety programs throughout its useful life, and a charge for the use (allocation of depreciable acquisition cost) of the fire station should be included in the government's total costs for each year of that life. To do otherwise makes it difficult to compare both the periodic cost of public safety programs of the same government over time and the costs of similar governments for similar services. Consistency and comparability also would be affected by using debt service as a surrogate for depreciation, as some have suggested. Capital assets are not always financed with debt, and the debt repayment term may not coincide with the asset's useful life. That approach, therefore, results in inconsistent treatment of capital asset costs within a government and a reduction in the comparability of the operating costs of similar governments.

Why Not Report Operational Accountability Information for Governmental Activities in Governmental Funds?

228. The characteristics of operational accountability information discussed in the previous paragraphs, including the economic resources and accrual MFBA, are incompatible with the fiscal accountability focus of the financial statements for governmental funds. That focus includes the existing fund structure and the reporting of expenditures of current financial resources, rather than expenses for resources consumed. Operational accountability information encompasses *all* resources raised, held, and used to provide services—capital as well as financial resources. It requires a focus on all governmental activities combined (or all activities of the government as a whole), including all resources provided to support them. It also requires the recognition of all measurable economic transactions and other events of the period that change net resources. Each governmental fund, however, reports only a portion of governmental activities based on the authorized sources and uses of current financial resources for a particular purpose or purposes. Governmental funds are not, nor are they intended to be, economic entities or cost centers; they cannot individually report

operating results and financial position from an economic perspective. Rather, they are management, control, and financing vehicles that are useful for demonstrating that current financial resources were raised and used for specific authorized purposes.

229. The Board has concluded, therefore, that operational accountability information for governmental activities should be reported in government-wide financial statements, together with similar information for business-type activities and component units. This approach enables the financial statements for governmental funds to continue to focus on providing fiscal accountability information that is essential for many users.

Basic Financial Statements and the Objectives of Financial Reporting

230. The Board acknowledged in Concepts Statement 1 that its broad concept of accountability and the related objectives could not all be accomplished through financial statements. Rather, the objectives were written to pertain to *general purpose external financial reporting,* which includes information that accompanies the financial statements in a CAFR, popular reports, and other external reports of governments, as well as information reported in financial statements.

231. In developing the requirements of this Statement, the Board reexamined how and to what extent the objectives of Concepts Statement 1 should be addressed *in the basic financial statements.* As part of that reexamination and for the same purpose, the Board also considered the results of various user needs studies, including the views obtained through focus group sessions with members of all three primary user groups. The results of due process of several previous proposals for changing the reporting requirements for the financial statements also were carefully examined. As a result of these considerations, the standards in this Statement address the number, content, measurement, and display requirements for a government's financial statements, whether they are presented in the financial section of a CAFR or separately. Taken as a whole, the basic financial statements (including notes) required by this Statement are designed to meet (or partially meet) all of the objectives of financial reporting stated in Concepts Statement 1. However, some objectives are more appropriately addressed in some financial statements than in others. Objectives that are not met in the government-wide statements are met in the fund statements and vice-versa, to the extent possible within the constraints of financial statements.

Objectives That Should Be Addressed in the Government-wide Financial Statements

232. The focus of the government-wide statements is on reporting the operating results and financial position of the government *as an economic entity*. (As discussed in Part II of this appendix, the government-wide statements should distinguish between the governmental and business-type activities of a primary government and between the primary government and its discretely presented component units.) Because the focus is on the *government's* operating results and financial position, the government-wide financial statements should not include activities accounted for in the fiduciary funds (as redefined in this Statement) and component units that are fiduciary in nature. Fiduciary activities, such as employee benefit plans, whose resources are not available to support the government's programs and other services, should be reported only in fund financial statements.

233. Users should use the government-wide statements to obtain information about (a) operating results, including the economic cost and net cost of services, (b) how current-period activities were financed (use of previously accumulated resources, revenues, and borrowings), and (c) financial position, including capital and financial assets and long-term as well as short-term liabilities. The information provided also should contribute to users' assessments of (d) the economy, efficiency, and effectiveness of operations, (e) the effect of operations on financial position and financial condition (the ability to continue current service levels and meet all liabilities as they become due), and (f) the extent to which interperiod equity is being achieved.

234. By providing this information, or information that is useful for these purposes, the government-wide financial statements should contribute to meeting the *operational accountability* aspects of the overall objective in paragraph 77 of Concepts Statement 1: fulfilling government's duty to be publicly accountable and enabling users to assess that accountability. The government-wide statements also should meet (or help meet) the objectives in paragraphs 77a, 77c, and 78 (operating results; cost of services; economy, efficiency, and effectiveness; and interperiod equity); 78b (how activities were financed); 78c, 79, and 79a (financial position and financial condition); and 79b (capital assets). It should be emphasized that, although the government-wide financial statements can make a significant contribution to achieving these objectives, full achievement requires additional information that is beyond the scope of the basic financial statements. This is particularly true of information

needed for assessments of financial condition (paragraphs 79 and 79a), SEA (77c), and interperiod equity (77a).[75] The Board will consider additional standards that may be needed to meet these objectives in future phases of the Financial Reporting Model project.

Objectives That Should Be Addressed in Fund Financial Statements

235. Information about governmental funds' activities and balances is important to help users understand and interpret the government-wide statements as well as how the government manages and controls its short-term financial resources, in compliance with legal requirements. Both governmental and proprietary fund financial statements provide detail about restrictions and reservations that affect financial resources and about internal movements of resources that may be obscured by the high level of aggregation that is necessary in the government-wide statements. This additional information can be very important for assessing short-term financing needs as well as the effect of short-term resources and decisions on medium-to-long-term resource needs. The information provided about restrictions and legal compliance also can assist users in determining the government's ability to continue to raise resources, repay short- and long-term obligations, and provide needed services.

236. The following discussion of objectives that should be addressed in fund financial statements focuses on the governmental funds. This is because governments are required to apply an operational accountability reporting model for proprietary and fiduciary funds (as redefined in this Statement), similar to current requirements. Therefore, the uses and objectives of information reported for those funds are similar to the uses and objectives of information reported for all activities included in the government-wide statements.

237. Similar to previous requirements, the focus of the governmental fund statements is on reporting inflows, outflows, and balances of current financial resources; the amounts available for appropriation; and fiscal compliance. The information should be useful in assessing the following information, for the general fund, for each major governmental fund, and for all nonmajor govern-

[75]Information that is useful for assessing financial condition and possible ways to report that information are discussed in the GASB's Research Report on the relationships between financial reporting and the measurement of financial condition (Berne). The objectives, elements, and characteristics of SEA reporting are discussed in GASB Concepts Statement No. 2, *Service Efforts and Accomplishments Reporting*.

mental funds combined: (a) the sources, uses, and balances of current financial resources, (b) the extent of compliance with legally adopted budgets and other finance-related legal or contractual requirements, (c) actual current financial results compared with legally adopted budgets, and (d) the amounts available for appropriation. The additional information required by this Statement for major funds should assist users by providing information about the management of specific resources.

238. By providing the information required in the fund financial statements, the basic financial statements should contribute to meeting the overall objective in paragraph 77 of Concepts Statement 1: fulfilling government's duty to be publicly accountable and enabling users to assess that accountability. That is, the information should assist users in holding governments accountable for the sources and uses of current financial resources by demonstrating whether resources were obtained and used in accordance with the entity's legally adopted budget and demonstrating compliance with other finance-related legal or contractual requirements (paragraph 77b). The governmental fund financial statements also should meet (or help meet) some of the objectives in paragraphs 78 and 79 of Concepts Statement 1 by providing information about the sources and uses of financial resources (paragraph 78a), how the governmental entity met its cash requirements (paragraph 78b), and legal or contractual restrictions on resources and risks of potential loss of resources (paragraph 79c).

Alternatives Considered and Rejected

Respondents' Reactions to Dual-Perspective Reporting (ED)

239. Respondents to the ED who supported the Board's proposals for dual-perspective reporting generally agreed that two perspectives were necessary to meet the wide range of user needs that governmental general purpose external financial reporting should address. They also agreed that, at the fund perspective, the previous financial reporting model should continue, with some changes, because it met important information needs of users. Many of these respondents also concurred with the Board's view that information is needed about the long-term effects of governmental activities on a government's financial position and financial condition. Moreover, these respondents agreed that this information is needed in addition to, rather than instead of, fiscal accountability information and should be provided in an additional set of financial statements.

240. Respondents who disagreed with dual perspectives were not uniform in their preferred alternatives. Most said they would prefer a single perspective or suggested modifications to one or both proposed perspectives that effectively would achieve that result. Some suggested a "pyramid" model similar to that proposed in the 1994 ITC. Those who clearly stated a preference for a single perspective were divided about whether it should be the entity-wide perspective or the fund perspective. In fact, dual perspectives received more support from the respondents than either of the two perspectives alone.

241. Those who said they would prefer only one perspective did not all choose the same MFBA or even a single MFBA for all activities (governmental, business-type, and fiduciary). Some preferred economic resources and accrual for all activities; some preferred total financial resources and accrual (or Statement 11, which uses that MFBA) for all activities; and some preferred current financial resources and modified accrual for governmental activities and, generally, economic resources and accrual for all other activities. This indicates that respondents had different views about what should be the focus of a government's financial statements. It also confirms the Board's view that governments should provide more than one kind of information to meet a variety of different user needs. However, the Board recognizes that government-wide and fund-based information are not mutually exclusive. Changes made to the ED proposals that acknowledge this relationship are discussed in Part II.

Alternatives

242. The principal alternatives that respondents proposed in response to the ED had all been examined by the Board during the Financial Reporting Model project. Several of them had been exposed for comment and had received little support. The following paragraphs summarize these alternatives and the Board's reasons for rejecting them in favor of the requirements of this Statement.

Why Not Just Continue with the Previous Model?

243. Respondents who recommended continuing with the previous (NCGA Statement 1) model pointed out that it had been in use for many years and had, in their view, provided useful information to a majority of users. Many of these respondents agreed that some changes were needed. However, they did not believe that an entity-wide perspective was necessary. They did not believe that users were seeking the information that the entity-wide perspective was de-

signed to provide about the cost of services, operating results, and financial position of the government as a whole or of, respectively, all governmental activities and all business-type activities combined.

244. The Board agrees that the previous model provided *the information it was designed to provide* and that this kind of information continues to be important to many users. For that reason, the Board has retained many features of that model substantially unchanged in the fund financial statements. Most of the differences between that model and the fund financial statements required by this Statement are *evolutionary* changes; they should enhance the usefulness of fund-based reporting without changing its fundamental purpose.

245. However, the sophistication and complexity of governments' financial activities have steadily increased since the previous financial reporting model was designed. The Board believes that the information needs of users of governmental financial statements have expanded in a similar progression. Some of the information that today's users need surpasses the capabilities of the previous reporting model, particularly for governmental activities. That model was designed to meet specific needs primarily for fiscal accountability information and is inherently limited in its ability to satisfy the larger set of user needs that has evolved. The most frequently mentioned limitations and the requirements of this Statement that are designed to address them are summarized in paragraphs 246 through 249. Additional discussion of these changes is included in Part II of this appendix.

246. Transactions and other events that have occurred in the current period but will not require the use of current financial resources until future periods are not adequately reported. Governments undertake many commitments that will be financed with taxes and other nonexchange revenues but will not affect their statements of revenues, expenditures, and changes in fund balances for many years. Users need information about these transactions and other events to assess the full periodic cost of providing programs and services and whether revenues are sufficient to cover that cost. Without that information, users cannot adequately assess the likely demand for future taxes and other resources or the extent to which interperiod equity is being achieved. Full-cost information also is needed to help users assess whether governmental activities are being managed economically and efficiently. The Board has addressed this limitation by requiring information about all governmental activities combined to be reported in the government-wide statements, using the economic resources/accrual MFBA.

247. In the previous model, account group information—general fixed assets and unmatured general long-term liabilities—was reported in the combined balance sheet but separate from the funds, with offsetting amounts to achieve the required balance. The balancing account for unmatured general long-term liabilities—*amounts to be provided*—was reported in the balance sheet with assets, even though it was not an asset. Less-sophisticated users, in particular, tended to be confused by these amounts. More important, the reporting of capital assets and unmatured long-term liabilities outside the funds—and without affecting fund balances—may have implied to users that information in the account groups was less important than information in the funds. However, taxpayers provide significant resources to acquire capital assets (some of which—infrastructure assets—have not been reported in the balance sheet) and will be required to provide significant amounts of resources in the future to settle long-term liabilities, including expanded employee fringe benefits, claims and judgments, and other long-term obligations that today's governments undertake, as well as the traditionally recognized liabilities for bonded debt. The Board has addressed this limitation by requiring all general governmental capital assets (including infrastructure) and all general governmental long-term liabilities to be reported in the government-wide financial statements for all governmental activities combined. The Board believes that approach is more appropriate than continuing the previous reporting of account groups. By their nature, general governmental capital assets and long-term liabilities are assets and liabilities of the government as a whole that benefit or burden all governmental activities (and also business-type activities in some cases), not just the activities of a particular fund.

248. The fragmented nature of governmental fund reporting makes it difficult for most users of the financial statements to obtain a clear picture of total governmental activities. The "memorandum only" totals reported under the previous model were an inadequate surrogate because the effects of interfund activities were not eliminated. Users also found it difficult to obtain aggregated information about government services and the revenues raised to finance them because activities cross funds, and individual transactions can be divided and reported in more than one fund or fund type. In addition, governments have considerable flexibility both in the choice of funds for recognizing transactions and in moving resources from one fund to another. These features reduce users' ability to compare information reported for the same funds or fund types over time, as well as information reported for similar funds or fund types across similar governments. The government-wide financial statements are designed to address these issues. This Statement requires a column for all governmental activities combined (excluding significant inter–governmental

fund activity) to be included in those statements. It also requires a column for the total primary government that includes all governmental and business-type activities, again excluding significant movements of resources between the two kinds of activities. Because of these changes, the previous ability to present "memorandum only" totals as a surrogate for government-wide information has been eliminated.

249. The limitations just described in reporting governmental activities also affected the previous model as a whole, including the model for proprietary funds. For example, without information on the full cost of governmental activities and all assets (capital and financial) associated with these activities, users did not have information about the total cost of all government operations or the government's financial position. The Board believes that many taxpayers and other users are very interested in information about their government as an economic entity or information about, respectively, all governmental activities and all business-type activities. These users are less concerned about which funds or fund types are used to account for specific activities within each category. However, the nature of fund-based reporting, the fact that the effects of interfund activities are not eliminated from the financial statements, and the different MFBAs used for governmental versus business-type activities all reduced users' ability to obtain this information under the previous model. In addition, some believe that including in the combined balance sheet columns of "totals" that were not true totals, and reporting the assets of certain fiduciary funds—especially pension trust funds—as if they were assets of the government, were particularly confusing and potentially misleading features of the previous model for many users. As previously indicated, the requirements of this Statement for the government-wide financial statements address most of these limitations. In addition, fiduciary activities have been excluded from the government-wide financial statements because those activities benefit third parties, rather than the government itself.

Why Not Require the "Budgetary Basis" for Governmental Funds?

250. Several respondents suggested that the Board should require or accept the government's "budgetary basis" for the statement of revenues, expenditures, and changes in fund balances and the balance sheet, instead of the current financial resources and modified accrual MFBA. In this way, the MFBA for these financial statements would be the same as for the budgetary comparison statement, and only two MFBAs (budgetary basis at the fund perspective and economic resources and accrual at the entity-wide perspective) would be required for governmental activities, instead of three. In a more far-reaching

variation of this approach, some respondents suggested that fund-based financial statements should be reported only as RSI, using the budgetary basis. However, as discussed in previous sections of this appendix, the Board concluded that, to adequately meet users' need for audited financial information about fund activities and balances, the fund financial statements should be part of the basic financial statements.

251. The Board acknowledges that requiring the budgetary basis for governmental fund financial statements has conceptual appeal, given the current spending and budgetary and fiscal compliance focus of information reported in the governmental funds. Also, most governments budget on a cash or modified cash basis, or they use a modified accrual basis that is the same as or very similar to the current financial resources and modified accrual MFBA required for governmental fund financial reporting. Most of the financial reporting goals of fiscal accountability could be achieved, for individual governments, with any of these approaches. The Board concluded, however, that the disadvantages of accepting or requiring the budgetary basis outweigh the advantages.

252. The principal disadvantages are the variety of budgetary methods used in practice and the lack of nationwide standards for budgeting. Variations in practice include not only the measurement methods used but also what is included in the budget. Many governments do not include all governmental funds in their budgets; there is no "budgetary basis" for these funds. The absence of uniform standards for budgeting would result in a reduction in the comparability of governmental fund financial statements of similar governments, as well as a potential lack of year-to-year consistency for governmental fund financial statements of the same government owing to changes in budgetary methods.

253. The lack of consistency and comparability could be a particular problem for financial analysts and other members of the financial community. The Board believes that these and other users have developed decision models for individual governmental fund types that apply a common interpretation of the current financial resources and modified accrual MFBA, as described in NCGA Statement 1 and subsequent pronouncements. Users' ability to compare fund financial statements over time for the same government and among similar governments is essential for these decision models to be effective. Decision models can be adapted to accommodate changes in reported information. However, changes inevitably affect the identification and interpretation of trends, which often have a significant effect on financial decisions. Changes should not be required unless the alternatives are clearly expected to produce

superior results. The Board does not believe that allowing governments to use a variety of different budgetary approaches for financial reporting, many of which are cash-basis or modified cash-basis approaches, will provide more useful information than the application by all governments of the current financial resources and modified accrual MFBA.

If Changes Were Needed in the Previous Model, Why Not Make Them There Instead of Adding the Government-wide Financial Statements?

254. The Board has addressed a number of the limitations of current financial reporting within the framework of the previous model. The result is the requirements of this Statement for the fund financial statements. However, to address the major limitations described in this appendix requires either a change in the focus of the model for governmental activities, including the governmental fund structure, or the preparation of additional financial statements, with a different focus. It is not possible to produce a useful operating statement that reports both (a) expenses for economic resources *consumed* in providing services and (b) expenditures of current (or even total) financial resources to *acquire* resources. The focus of the operating statement needs to be clearly on comparing revenues with *either* expenses *or* expenditures. For that reason, this Statement requires an operating statement that reports expenses incurred for governmental activities (a government-wide statement) in addition to the governmental fund operating statements that report expenditures. To help users understand the different focuses of these statements, the Board has required a reconciliation of the differences between them for both revenues and expenses/expenditures.

Why Not Adopt the Economic Resources/Accrual MFBA for Governmental Funds?

255. Those who advocate using economic resources/accrual for governmental fund financial statements appear to want to preserve fund-based financial reporting, but they do not accept use of the current financial resources and modified accrual MFBA. However, as discussed earlier in this appendix, fund accounting and fund-based reporting were developed in order to help control current financial resources and demonstrate fiscal accountability, which requires a focus on short-term financing and compliance. Using the economic resources and accrual MFBA would require a change in the fundamental nature and purpose of governmental funds. It would require converting them from management, control, and current-period financing vehicles into artificial economic entities or cost centers.

256. From a purely mechanical standpoint, it would be possible to convert governmental funds into cost centers, as some have suggested, by allocating assets (including general capital assets) that benefit more than one governmental fund to all funds on some arbitrary basis, and allocating all general long-term liabilities based, for example, on which fund is selected to pay them. However, these allocations would not be objectively based on economic transactions of a particular fund, but rather on management's allocation policy. The allocations could be changed at any time, with the resulting lack of year-to-year consistency within a government and from one government to another in what are considered to be costs of a particular "cost center" (fund) and, therefore, in reported costs, operating results, and financial position.

257. Moreover, even if the basis used to allocate general capital assets and general long-term liabilities to the funds is consistently applied, it is not accurate to report to users that, for example, 50 percent of the carrying value of a building supports general fund activities, 10 percent of the building supports a particular capital projects fund's activities, 2 percent supports a debt service fund's activities, and so forth. It would be no more accurate to allocate the entire carrying value to the general fund. The acquisition price of a general capital asset can be allocated to more than one fund from a *funds flows* perspective; that is, it is appropriate to report that two or more funds had *expenditures* of resources for the same asset. However, similar allocations are not useful from an *economic* perspective.

258. When economic resources are measured, the purpose of reporting capital assets, including infrastructure, is to contribute to information about the consumption of all resources used in providing services in the current period and about the net economic resources remaining that can be used to provide services in the future. The economic reality is that general capital assets, including infrastructure, *in their entirety* support *all* governmental activities *as a whole* (and many of them support business-type activities as well), regardless of which fund or funds *could* be selected to report them. Similarly, general long-term liabilities, such as general obligation debt, are liabilities *of the government,* not of any individual fund or funds. If unrestricted resources of other funds were needed to settle the liabilities, the government would be required to use them.

259. The governmental funds, as currently constituted, are segregations of resources for accounting and financial reporting purposes. They are not independently constituted economic entities, nor are they designed to be cost centers. Governmental funds are not independent of the government that creates them,

even if their creation is required by law. They do not act in their own behalf. They cannot decide on their own whether to acquire an asset, nor can they independently incur or pay a liability. Rather, governmental funds are "fiscal and accounting entities" that help governments manage, control, and demonstrate accountability for current financial resources. Governmental fund financial statements communicate these activities to users by reporting the flows and balances of current financial resources duly authorized for specific purposes.

260. The Board questions what operating costs, operating results, and financial position would mean if they were reported for the general fund when major activities (such as debt service and capital projects) and major revenue sources (such as intergovernmental revenues and dedicated taxes) are excluded and reported separately. The meaning of operational accountability information would be even more questionable if it was reported for a special revenue fund or a debt service fund arbitrarily converted to a "cost center." It would be possible, of course, to report all governmental activities in the general fund; however, that would completely change the governmental fund structure and the purpose of fund-based reporting.

261. The Board acknowledges that some believe the current fund structure *should* be changed. Some of the ED respondents who prefer limiting reporting requirements to the government-wide financial statements would eliminate fund-based reporting or would make it optional. However, as previously discussed, the Board believes that fiscal accountability information about the sources and uses of current financial resources authorized for particular purposes is essential for many users. The current fund structure and fund-based reporting are important aids to providing that information, as well as to helping users understand and interpret information in the government-wide statements.

262. Operational accountability information for governmental activities also is important. However, it cannot be provided for individual governmental funds or fund types. It requires a more comprehensive frame of reference—all governmental activities combined, or the government as a whole. The government-wide financial statements achieve this result without sacrificing the current financial resources information that governmental funds are designed to provide.

Could the Government-wide Financial Statements Be Avoided by Requiring the Total Financial Resources and Accrual MFBA for Governmental Funds?

263. Most of the respondents to the ED who agreed that a longer-term view of governmental activities should be provided also agreed that the economic resources and accrual MFBA is appropriate for this purpose. However, some respondents indicated that a similar long-term view of a government's operations and financial position could be achieved by using a total financial resources and accrual MFBA, as previously adopted for governmental fund operating statements in Statement 11, for example.

264. Generally, these respondents believed that a total financial resources and accrual MFBA would be more appropriate for governmental activities than the economic resources and accrual MFBA because it would maintain the traditional focus on *financial* resource flows and balances, albeit including expenditures of noncurrent resources that traditionally have not been reported. That is, many of these respondents did not believe that reporting general capital assets (especially infrastructure assets) and depreciation would be useful in a governmental environment. However, they did believe that governmental funds should recognize current-period expenditures of financial resources for transactions and other events that have occurred, even though they may not require the use of current financial resources for many years.

265. Many of the respondents who preferred total financial resources and accrual advocated requiring its use at both perspectives. However, some did not agree with government-wide reporting of any kind. Others believed that, if an additional set of financial statements was provided, it should present aggregated (summary) totals for the activities reported in the funds, using the same total financial resources and accrual MFBA. Some of these respondents and others believed that fund-based financial statements could include totals for all governmental, proprietary, and fiduciary activities—thus, in their view, avoiding the need for an additional set of summary financial statements.

266. Most of the respondents who preferred total financial resources and accrual for governmental funds believed that general capital assets and general long-term liabilities should not be reported in individual funds, with the possible exception of long-term liabilities believed to benefit only the current period. The reasons generally were similar to those explained above with respect to the effects of attempting to apply the economic resources and accrual MFBA to

governmental funds. That is, the allocation of general government capital assets and general long-term liabilities to individual funds would be arbitrary and subjective, and such an allocation would alter the nature and purpose of the funds.

267. Some respondents said that Statement 11 should be implemented because it was adopted by unanimous vote of the Board after due process. However, Statement 11 addressed only governmental fund operating statements. Its implementation was indefinitely deferred in Statement 17 because neither the Board nor constituents could agree on requirements for balance sheets that would articulate with the Statement 11 requirements for operating statements and also would provide useful information. A majority of the respondents to the ED of Statement 17 supported deferring the effective date of Statement 11 until the balance sheet issues had been resolved satisfactorily. Many of those respondents also indicated that the Board should complete all major portions of the financial reporting model for simultaneous implementation, rather than implement different portions at different dates.

268. The Board acknowledges that the respondents to the 1985 DM, *Measurement Focus and Basis of Accounting—Governmental Funds,* clearly rejected the possibility of applying economic resources and accrual *in the funds* for many of the reasons discussed in the previous section of this appendix. Subsequent proposals, including the two EDs of Statement 11, the 1992 PV, and the 1994 ITC, did not include economic resources/accrual as a possible MFBA. However, none of those proposals contemplated requiring financial statements for the government as a whole, as an economic unit, as well as for the funds. Each proposal addressed either fund-based reporting only or fund-based reporting together with financial statements that would provide a summary of essentially the same information. In response to those proposals, respondents generally preferred total financial resources and accrual to current financial resources and modified accrual, when both possibilities were included.

269. In contrast to these proposals, the 1997 ED (and the 1995 PV) proposed using the economic resources/accrual MFBA for all activities reported in government-wide financial statements in order to provide *different* information, particularly about governmental activities, from the information provided in fund-based statements. Among the respondents to the ED who commented on MFBAs for governmental activities reported in the government-wide financial statements in relation to certain objectives of Concepts Statement 1 (those concerning operational accountability), the majority indicated that the economic resources/accrual MFBA would meet those objectives better than would other

MFBAs. Those who disagreed generally preferred a total financial resources/accrual MFBA, primarily because they did not believe that general capital assets, especially infrastructure assets, should be capitalized and depreciated.

270. Following the deferral of Statement 11 implementation, the Board concluded that the primary consideration in the Financial Reporting Model project should be the achievement of a *complete* financial reporting model that would meet a variety of user needs, consistent with the reporting objectives of Concepts Statement 1. In the Board's view, and as explained in previous sections of this appendix, the model required by this Statement is more complete and will result in more useful information for a wider range of users than any of the Board's previous proposals or Statement 11. The Board also believes that the financial statements required by this Statement, taken as a whole, will meet more of the Concepts Statement 1 objectives than the previous proposals or Statement 11 would have met, and will provide a sounder foundation for future financial reporting standards. The responses to the ED in favor of applying economic resources and accrual in the government-wide financial statements tend to support the Board's view that economic resources and accrual provides more useful information about the long-term effects of short-term decisions on governmental activities than would the total financial resources and accrual MFBA.

271. The Board has rejected a total financial resources and accrual MFBA for several reasons. Total financial resources and accrual combines some of the characteristics of both economic resources and accrual and current financial resources and modified accrual that are important to users, but it omits other, crucial features of those MFBAs. The result is a hybrid MFBA that does not meet either of the two major needs of users. It does not provide information from either an operational accountability perspective or a fiscal accountability perspective.

272. Similar to economic resources and accrual, total financial resources and accrual recognizes the operating statement effects of certain transactions and other events that do not require the use of current financial resources. It thus operates farther toward the accrual end of the spectrum of possible MFBAs from cash-basis to accrual-basis accounting and provides a longer-term view of operating activity than does the current financial resources and modified accrual MFBA. Because of the long-term accruals, users cannot obtain adequate information about current-period inflows and outflows of current financial resources, or whether current-period revenues were sufficient to meet expenditures duly authorized through the budgetary process. Although the balance

sheet could be classified, as some respondents have pointed out, there is no useful way to separate in an operating statement expenditures and revenues that have an effect on current financial resources from those that do not.

273. In addition, when total financial resources and accrual is applied, users cannot identify the amount available for appropriation without adjustments to offset the effects of transactions recognized elsewhere in the same financial statements that do not affect current financial resources. The Board believes that these adjustments would be confusing for users and should not be necessary. The amount available for appropriation is a key item of information for many users, especially legislators and members of the financial community. It should be reported in the simplest manner possible and be supported by consistently measured amounts in the same financial statements.

274. Although total financial resources and accrual recognizes the long-term effects of certain transactions, it does not provide full-cost information—a critical component of operational accountability information—because it fails to measure the cost of consuming capital assets used in providing services. Instead, it treats capital outlay as a "sunk cost" by recognizing the total acquisition price of capital assets as an expenditure in the period when the assets were acquired, as if they provided no benefit to future periods.

275. As previously discussed, recognizing expenditures for the acquisition price of capital assets when purchased distorts the measurement of the periodic cost of operations. It overstates costs for the period when a capital asset is acquired and understates costs for the periods when the capital asset is used. Obviously, this limitation also affects the measurement of operating results and financial position. Moreover, the timing of capital asset acquisitions, which generally is at management's discretion, affects users' ability to assess trends in the costs, operating results, and financial position reported for the same government over time as well as the ability to compare similar governments.

276. Total financial resources and accrual presents an ultraconservative view of a government's activities by recognizing all measurable liabilities but failing to recognize all measurable assets (capital assets, in particular). The result is a strong likelihood that governments will continually report deficits, not because they are in financial difficulty but because they have failed to recognize the future benefits embodied in capital assets. The Board believes that the concept of interperiod equity requires a balanced presentation that informs users about both expired and unexpired costs of the current period. Moreover, reporting continual deficits that are attributable only to the accounting MFBA used, and

not to underlying economic events, is not useful and can be misleading. That approach makes it difficult for users to assess a government's financial position and encourages them to accord little importance to reported deficits, whatever their cause.

277. The Board does not perceive any advantage to a total financial resources and accrual MFBA that is not surpassed by providing information for governmental activities based on *both* economic resources and accrual *and* current financial resources and modified accrual. The government-wide and fund statements required by this Statement will provide both kinds of information that users need in a single set of basic financial statements that include reconciliations of the differences that provide insight and greater understanding of the relationship between the two kinds of information. Explanations also will be provided in MD&A. The Board believes that this approach will meet the Concepts Statement 1 objectives—and therefore users' needs—more completely than would be the case if the total financial resources and accrual MFBA were applied.

PART II

278. Part I of this appendix addresses the *concepts* that underlie the new financial reporting model. The remainder of this appendix (Part II) discusses the Board's conclusions concerning specific standards and certain implementation issues, including the reasons for the changes that have been made to some of the standards proposed in the 1997 ED.

Relationship of the Basic Financial Statements and the CAFR

279. This Statement establishes certain requirements for the *basic financial statements* and *RSI* to be issued by state and local governments. It includes requirements as to the basic financial statements to be presented, the measurement focuses and bases of accounting to be used, the statement formats, and, to some extent, the statement contents. The basic financial statements replace the general purpose financial statements, previously required by NCGA Statement 1.

280. For the most part, this Statement modifies NCGA Statement 1 only as necessary to implement basic financial statements. Its scope does not include the CAFR as a whole, or the "full financial section" of a CAFR. The Board has on its

technical agenda other projects to consider the remaining components of the CAFR. In the interim, practitioners should continue to look to NCGA Statement 1, as modified, for guidance about the remaining components of the CAFR.

281. The requirements of this Statement do not alter the provision in paragraphs 128 and 138 of NCGA Statement 1 that states that governments should prepare and publish a CAFR. The requirement to report major fund information in the basic statements does, however, reduce the scope of combining statements to include only nonmajor funds.

The "Dual-Perspective" Approach Eliminated

282. Many respondents objected to the "dual-perspective" structure of the reporting model proposed in the ED. They did not agree that the basic statements should comprise two separate sets of financial statements that conveyed significantly different information and were, in large part, unassociated with one another. In response to those concerns, the Board investigated several alternatives to the dual-perspective approach before finding the solution for the basic framework of the new financial reporting model. In developing this model, the Board retained many of the features in the ED model that were found to benefit users while addressing some of the more significant concerns raised by financial statement preparers and auditors.

283. The key point of departure from the dual-perspective approach is the presentation of fund-based information. The notion of a *separate* fund "perspective," as set forth in the ED, has been eliminated. This Statement, however, does include a requirement for reporting fund financial statements that address the same financial reporting objectives met by the ED's fund perspective, but the nature of the information and the environment in which they are presented have been modified.

284. After the ED was issued, the Board had extended discussions and considered a wide variety of views expressed by users, preparers, attestors, and others about the importance of fund information. Alternatives considered included presenting fund information (a) as basic financial statements (the ED proposal), (b) in the notes to the basic financial statements, (c) as required supplementary information, or (d) in various combinations (for example, governmental funds in the basic statements and proprietary funds in the notes). On the basis of these discussions, the Board concluded that information about a

government's *major funds* should be provided, and that this information is important to financial statement users in two ways—it is important in its own right and as it relates to the government-wide financial statements.

285. The Board concluded that information about funds is important in its own right because:

a. Funds are created for management and accountability of financial resources and the activities they finance. Users need to understand these activities and assess the government's accountability for resources raised and spent.
b. For many governments, most activities are managed and accounted for in a limited number of funds. The Board believes it is essential for the users of a government's financial statements to be able to assess the sources and uses of financial resources and the balances remaining (and the availability of those balances for future use) in the government's major funds individually and in the nonmajor funds as a group.
c. Major fund information, together with other information about funds in the notes, assists the users in understanding how amounts reported in the government-wide statements are determined and informs them of instances of noncompliance.

286. Fund financial statements report the government's operations in more detail by providing information about its major funds. For this reason, the Board believes that information about funds is also important in relation to government-wide financial statements. The Board notes that:

a. Understanding the relative financial "health" of major funds contributes to users' understanding of the government-wide statements. Government-wide statements provide valuable information about the government as an economic unit. But governments are not operated on a day-to-day basis purely as economic units, but rather as collections of short-term financing mechanisms. Thus, the financial position of the government as a whole can be better understood if users also understand the relative health of the major funds of the government.
b. Information about major funds can provide more or less confidence in the conclusions reached about government-wide results and balances. Through cross-validation of results, users' conclusions about the government are either reinforced or questioned, prompting further inquiry into reasons for differences.

c. Fund-based information allows users to be more perceptive about what the government-wide statements do and do not report. This allows them to interpret the government-wide information more accurately. Users need to understand the long-term effect of short-term decisions.
d. Users need information about the movement of significant resources (internal activity) that may be obscured by aggregation in the government-wide statements. Providing fund-based information promotes inquiry about the reasons that governments shift resources among funds and whether interfund transactions were in compliance with restrictions on the use of resources. Other information, such as information about restrictions, also may be obscured by aggregation. The purpose of funds is to show how resources restricted for certain purposes are used. In addition, users need information about the availability of resources (reserves and fund balances) to meet the ongoing needs of the funds.

Required Reconciliations

287. Some ED respondents who opposed the dual-perspective reporting model objected to the disassociation of the two perspectives. They predicted that users would be confused by separate sets of statements whose relationship to one another is not clear. As set forth in the preceding paragraph, users need information about major funds to help them understand the government-wide financial statements. As part of developing that understanding, they should be able to see how funds relate to the government as a whole. One way to demonstrate that relationship, in a concise manner, is to provide a "crosswalk" explanation on the face of the fund financial statements. The ED proposed that an explanation be provided in MD&A. The Board has concluded, however, that the explanation is better suited on the face of the statements, or in an accompanying schedule, so that users can make the connection without having to consult different parts of the financial report. Relocating the explanation from MD&A to the statements also allows preparers to provide more detailed explanations, especially if the separate schedule approach is used.

288. The information presented on the face of the financial statements is required to be highly aggregated, much in the same way it was illustrated in MD&A in the ED. The Board recognizes the difficulty in providing an explanation that is highly aggregated, yet descriptive enough to meet the objective of the requirement. The Board also realizes that "readability," or "plain English," would be an unenforceable standard, but believes that preparers should strive to provide brief, yet effective, explanations on the face of the statements (or in an accompanying schedule). The minimum requirement for additional explanation in the notes, "if the aggregating information in the summarized reconciliation

obscures the nature of the individual elements of that reconciling item," acknowledges that, in some instances, the unavoidable complexity of an explanation takes precedence over the need to keep the explanation highly aggregated. Preparers will need to exercise judgment in balancing the characteristics of *highly aggregated* and *sufficiently descriptive*.

MD&A

289. Generally, the requirement to include MD&A in external financial statements was supported by respondents to the ED. A high percentage of *users* who responded to the ED were strongly supportive of the requirement. Respondents who raised concerns about MD&A, generally from the *preparer* and *attestor* communities, most often cited the status as RSI and what they believed was the potential lack of objectivity for several requirements as their reasons for not supporting the ED's proposal. The Board discussed those concerns and others, and made changes to the ED requirements that they believed were responsive to the concerns, while at the same time remaining focused on the objectives of MD&A. Nevertheless, because of the importance placed on broadening the communication base of GAAP reports, the Board reaffirmed much of the ED requirements, subject to the modifications discussed below.

Classification of MD&A as Required Supplementary Information

290. This Statement classifies MD&A as RSI. The Board's intent is to ensure, first, that the information will be presented and, second, that auditors will be associated with it. Some respondents to the ED were concerned about audit implications, and the Board carefully considered their concerns. Subsequent to issuing the ED, the Board resumed its dialogue with representatives of the audit community regarding the extent to which auditors would be associated with information in MD&A as RSI.

291. These discussions were beneficial in clarifying the Board's intentions, and as a result, the Board did not alter its conclusion in the ED that the classification of MD&A as RSI achieves appropriate auditor association at a reasonable cost. As discussed in AICPA Statement on Auditing Standards (SAS) No. 52, *Omnibus Statement on Auditing Standards—1987,* the auditor would apply certain

limited procedures to the RSI and would report deficiencies in, or omission of, such information. Briefly, based on SAS 52, the auditor would:

a. Inquire of management about the methods of preparing the information (whether it meets the standards, whether there have been any changes in measurement methods from the prior period, and so forth)
b. Compare the information with the audited financial statements and other knowledge obtained during the examination
c. Consider whether RSI should be covered in management's letter of representation
d. Apply additional procedures prescribed for specific types of RSI
e. Make additional inquiries if the foregoing procedures dictate.

292. If MD&A, required by this Statement as RSI, was not presented, the auditor's report would include an explanatory paragraph stating that certain supplementary information, although not a required part of the basic financial statements, had been omitted. Similarly, if the information was presented but departed materially from the prescribed guidelines, an explanatory paragraph would be required.

Relationship to the Letter of Transmittal

293. Some ED respondents also were concerned about the potential for duplication between a letter of transmittal, if presented, and MD&A. The Board will take all steps necessary to prevent redundancy between the two documents. This includes (a) working with organizations that administer certification programs and (b) developing GASB implementation guidance highlighting potential areas where duplication may occur. The Board continues to believe that combining MD&A with the letter of transmittal would not be appropriate, despite the practical appeal of doing so. If a letter of transmittal is presented, it should not duplicate, but may elaborate on, information required to be provided in MD&A.

294. The Board believes that MD&A and the letter of transmittal should be kept separate because they serve different purposes and because no authoritative standards have been set for the letter of transmittal. The Board is concerned, therefore, that information in the letter of transmittal may not be limited to objective information and analysis consistent with GASB standards of financial reporting. On the other hand, the Board acknowledges that government offi-

cials also need a means, such as the letter of transmittal, of expressing more subjective information than would be acceptable for MD&A. That information may include prospective information and other data that are currently beyond the scope of GAAP.

Minimum Requirements for MD&A Content

295. Some of the changes made to the ED model, including the departure from the "dual-perspective" approach, affected the required subject matter for discussion in MD&A, as proposed in the ED. In addition, several comments made by respondents implied that the purpose of some of the requirements may not have been sufficiently clear in the ED. The following subparagraphs explain how the Board has modified the minimum requirements (shown in *italics* at the beginning of each section) originally proposed in the ED.

a. *An explanation of the objectives of the two perspectives.* The decision to move away from the "dual-perspective" approach eliminated the need for this explanation. Nevertheless, despite the absence of different "perspectives," the Board believes that the new model offers enough variety in both new and familiar information that an explanation of the contents will continue to be useful. For this reason, the Board concluded that MD&A should include a brief *discussion* of the required financial statements (government-wide statements and fund statements) including a discussion of the different information provided in those statements. The usefulness of the discussion of the "different information" is enhanced if it explains how information about major funds either corroborates conclusions drawn from the government-wide financial statements or provides additional information for analysis. For example, the explanation should help users understand why a positive change in net assets of governmental activities occurred when at the same time the general fund experienced a significantly different effect in its fund balance. Or, if results are similar, that the positive change in net assets is reinforced by a similar change in fund balance. This discussion replaces the summarized explanation of differences between the two perspectives (reconciliation) that previously would have been presented in MD&A. (See item f, below.)
b. *Condensed entity-wide financial statements, comparing the current year with the prior year and including an analysis of the causes of significant changes in financial statement amounts.* The Board did not modify the proposal that MD&A should include an analysis of significant changes from the prior year for the statements of net assets and activities. However, in response to concerns that the statement of activities would not provide

certain key information that current model users deemed to be useful, the Board agreed that the financial summary information in MD&A should derive from the government-wide financial statements and should be presented in a format that compares *total* revenues and expenses and the key components of those amounts. The Board does not intend that this analysis devolve into a "boilerplate" recitation of amounts and percentages of change; rather, the analysis should include discussion of reasons for significant changes and important economic factors. The Board believes that this requirement will:

- Anchor MD&A in financial information reported in the basic financial statements.
- Ensure that comparative information will be available to financial statement users, in a condensed form for which the minimum elements are specified.
- Provide structure and guidance for analytical comments.

c. *An analysis of significant variations between the original and final budget amounts and between final and actual budget for the general fund.* The Board agreed that, even when the budgetary comparison schedule is presented as RSI, rather than as a basic financial statement, the usefulness of the MD&A discussion of original and final budgets has not been diminished and still should be required.

d. *A description of capital asset and long-term debt activity during the year.* The Board retained this requirement essentially as proposed in the ED, with an emphasis on minimizing any duplication of note disclosure requirements. For governments that elect to use the modified approach for reporting infrastructure assets, the Board added a requirement to discuss certain aspects of that approach. This requirement, along with note disclosure requirements and RSI, will allow users to assess the effects of using that approach.

e. *A discussion of whether the government's financial position has improved or deteriorated as a result of the year's activities.* This proposal was modified to focus on providing information that users need to help them assess whether the government's financial position has improved or deteriorated as a result of the current year's activities rather than requiring the government's management to make that determination. In addition, the proposal in the ED to "include comments about significant changes in the financial position (fund balance or fund equity) of individual funds" was expanded as a separate requirement to explain limitations on the availability of fund resources.

f. *A summarized explanation of the differences between balances and results reported at the two perspectives.* As stated in item a, above, the notion of separate "perspectives" has been eliminated in this Statement. In addition, the explanation contemplated by this requirement now appears on the face of the fund statements (or in an accompanying schedule) to emphasize and clarify the relationship of fund statements to the government-wide statements.
g. *A description of currently known facts, decisions, or conditions that have had or are expected to have a material effect on financial position or results of operations.* The meaning of *currently known* has been clarified to stress that it includes information that management is aware of on or before the audit report date. Also, the meaning of financial position is limited to reported or reportable net assets. Similarly, the meaning of *having an effect on results of operations* is clarified to encompass only revenues and expenses and changes in net assets. Finally, all references to "prospective" information have been eliminated. To the extent that it requires any consideration of future effects, this requirement is limited to a discussion of events that have already occurred (for example, enacted, as opposed to anticipated, tax rate or budget changes) and that are expected to have a significant effect on financial position or results of operations after the reporting date. The Board intends that governments will limit their discussion to objective statements based on those facts, decisions, or conditions.

Government-wide Reporting

Scope

296. The Board concluded that a government's basic financial statements should provide operational accountability information for the government as an economic unit, including information about the *cost of services, operating results,* and *financial position*. In addition, those financial statements should contribute to users' assessments of *financial condition*—that is, the government's ability to maintain service levels and continue to meet its obligations as they become due. The statement of net assets and the statement of activities are designed to help meet these objectives. The statement of activities should report the extent to which each of the principal functions, programs, or other services provided by the government or its component units either contributes to or draws from the general revenues of the government. The statement of net assets should report the composition and balances of net economic resources at the reporting date that can be used by the government to provide future services.

297. Operational accountability information focuses on an organization's primary objectives, which, for governments generally, are to provide services to their constituents. To provide information relevant to operational accountability, the Board concluded that the scope of the statement of net assets and the statement of activities should encompass all *governmental activities* and all *business-type activities* of the primary government and its component units. Generally, governments engage in both of these types of activities, as defined in this Statement, to provide services to their constituents as a whole or to broad groups of constituents.

Reporting Fiduciary Activities

298. In contrast, *fiduciary activities,* as redefined in this Statement,[76] should be excluded from government-wide measures of operational accountability, because fiduciary resources cannot be used to support the government's programs or other services. Rather, fiduciary activities involve holding and managing net assets for and on behalf of specific individuals or external organizations, in accordance with trust agreements or other custodial arrangements. Examples include the net assets of external participants in government-sponsored investment pools and the net assets of pension plans and other employee benefit plans, which are accumulated and managed in trust for the government's employees.

299. A majority of respondents to the ED who commented on the issue agree that fiduciary activities should not be included in the statements of net assets and activities, generally for the reasons explained in the previous paragraph. Some respondents suggested that fiduciary activities also should be excluded from the basic financial statements altogether or should be reported only through note disclosure. The Board points out, however, that a government is *accountable* for all the resources that it holds and manages, not just those that can be used to provide public services, and that an important part of accountability, or stewardship, is to provide financial information that users may need about those resources. The fiduciary activities of governments are important for many users, particularly for the owners and beneficiaries of fiduciary resources. The Board has concluded, therefore, that the fund financial statements should include a statement of fiduciary net assets and a statement of changes in fiduciary net assets. Component units that are fiduciary in nature also should be included in those statements with the primary government's fiduciary funds.

[76]The reclassification of certain activities formerly reported in fiduciary funds is discussed in paragraphs 395 through 402.

Separate Reporting of Governmental and Business-type Activities

300. About 5 percent of the respondents commented on the ED proposal to present separate columns for governmental and business-type activities of the primary government. Roughly the same number agreed as disagreed. The Board agreed to carry forward the ED proposal to the final standard because it believes that reporting the financial position for the primary government in a single column will be too aggregated for most users. Many of the Board's constituents, including participants in user focus group sessions, also believe that a single-column presentation of information for the primary government would blur distinctions among the government's activities and their related net assets and would create an increased risk of incorrect inferences as to the amount of unrestricted assets available for governmental activities. For example, an increase in the net assets of a business-type activity could mask a decrease in the net assets of governmental activities. Furthermore, the Board believes that the requirement to report the primary government's governmental and business-type activities in separate columns is necessary to report the financial position of governmental activities—information not available anywhere else in the financial statements.

301. Many of those who disagree with the MFBA proposed to be used for governmental funds (as discussed in paragraphs 413 through 416) are concerned about reporting the long-term effects of current-period transactions on governmental funds—primarily the general fund. They argue that information about the "financial position" of the general fund is obscured. The Board believes, however, that simply reporting the general fund on the accrual basis—as some have suggested—will not accomplish the desired objective. Resources are easily shifted back and forth by creating new funds and by other means. For example, a government can selectively include or exclude certain activities from its general fund and therefore can control, to a large extent, the financial position reported for the "general" fund. The Board believes that total governmental activities in the government-wide statements represents the general fund in its broadest terms, and that information about the financial position of the general government should be more useful than information about the general fund.

302. Paragraph 15 of the Standards section describes governmental and business-type activities in terms of their sources of financing. Governmental activities are primarily financed by nonexchange revenues, including taxes and intergovernmental revenues; business-type activities charge fees to external users for goods or services. However, the Board also observes that govern-

mental activities usually will be the same as activities reported in governmental and internal service funds, and business-type activities usually will be the same as activities reported in enterprise funds. The Board has concluded that this relationship generally provides a reasonable basis for classification of activities in the statement of net assets and the statement of activities. A detailed analysis of the activities reported in each fund by source of financing should not be a prerequisite for classifying activities as governmental or business-type.

303. Consistent with requirements for the statement of net assets, the Board has concluded that the net (expense) revenue of programs related to governmental and business-type activities of the primary government also should be displayed in separate columns in the statement of activities. By using a single-column display for all programs of the primary government, users could infer that all resources may be equally available to finance any particular program of the government, which rarely would be the case. The Board concluded that separate display of information related to governmental and business-type activities, in conjunction with separate reporting of restricted net assets, provides useful information about potential restrictions on the use of resources.

Total Columns

304. A total column is required for the primary government. The Board remained consistent with the conclusion in Statement 14, paragraph 49, that a total column for the reporting entity (the primary government and component units) may be presented but is not required. That conclusion is consistent with the notion in paragraph 13 of that Statement that the primary government should be the focal point. The Board also concluded that designating total columns as "memorandum only" is not relevant in this context. The primary reporting issue addressed by that requirement—combined financial statements with different measurement focuses and bases of accounting for different columns—does not exist in the government-wide financial statements.

Measurement Focus and Basis of Accounting (MFBA)

305. Only slightly over 20 percent of the ED respondents specifically commented on the MFBA proposed to be used in the government-wide statements. Of those who commented, more expressed support for the proposal than opposed it. Much of the resistance to the MFBA was grounded in a general disagreement about capitalizing and depreciating infrastructure assets. (See the related discussion about infrastructure in paragraphs 335 through 342.) Aside from that concern, however, one of the most common remarks made

about using the flow of economic resources measurement focus is that governmental activities are different from business-type activities and should not be forced to use the same model. Some suggested that the "business model" is not suitable for governments.

306. The Board notes that, although many business-like measures have been incorporated for reporting transactions and balances, the governmental model required by this Statement emphasizes cost of services and changes in financial position, not net income. The Board continues to believe that to satisfy certain objectives of Concepts Statement 1, government-wide reporting using the flow of economic resources and accrual MFBA is unavoidable. The Board's reasoning for the government-wide MFBA requirement is explained in paragraphs 219 through 227 and 232 through 234 in Part I.

Applicability of FASB and Certain GASB Pronouncements to Governmental Activities

307. This Statement requires that governmental activities reported in the government-wide statements comply with the requirements of all GASB pronouncements and all FASB pronouncements issued before November 30, 1989, that do not conflict with or contradict GASB standards. Generally, pronouncements of the FASB and its predecessors have not been applicable to governmental funds. In addition, some GASB pronouncements address only proprietary funds, and others provide separate guidance for proprietary funds. The Board conducted a thorough review of GASB and FASB pronouncements that would be applied for the first time to governmental activities, and concluded that it would be impractical to require governments to apply every pronouncement retroactively to governmental activities. As a result, the Board agreed that certain pronouncements should be applied only prospectively to those activities. Paragraph 146 discusses the implementation of those pronouncements.

308. The Board has concluded that the option in paragraph 7 of Statement 20 should *not* apply to reporting governmental activities—even though they will be reported using the same measurement focus and basis of accounting as business-type activities. The purpose of the option is to permit the financial reporting of state and local governments' business-type activities to more nearly parallel that of their private-sector counterparts. The Board concluded that such a need does not exist for governmental activities.

309. The provisions of APB Opinion 20, as amended, currently apply to proprietary funds but would also apply to governmental activities in the government-wide statements. Although Opinion 20 requires that the cumulative effect of an accounting change be included in net income for the period, in practice proprietary funds currently report that effect as an adjustment of beginning fund equity on the face of the all-inclusive operating statement. Board members agreed that the provisions of Opinion 20 should apply to both proprietary funds and business-type activities and governmental activities but that all activities should report the cumulative effect of an accounting change as an adjustment of beginning net assets. The Board believes that the exception taken to the requirements of Opinion 20 is appropriate because it was intended to avoid the manipulation of "earnings per share" by commercial enterprises. In government, however, the concerns that led to the requirement have largely been nonexistent.

Eliminations

310. As a general notion, the Board has concluded that *internal* activity and balances—reported as *interfund* activity and balances in fund financial statements—should be eliminated in the preparation of the statements of net assets and activities, to avoid the inappropriate "grossing-up" effects that internal activity would otherwise have on aggregated amounts. The specific standards in this Statement regarding eliminations apply this general notion within the context of the minimum required level of reporting in the statement of net assets and the statement of activities, as discussed in the paragraphs below.

311. *In the statement of net assets,* this Statement requires that all amounts reported in fund balance sheets as interfund balances be eliminated within the governmental activities and business-type activities columns, respectively. However, the residual internal balances between the two types of activities should not be eliminated, because to do so would be inconsistent with the requirement to separately report governmental and business-type activities.

312. Although residual internal balances between governmental and business-type activities should not be eliminated in the columns for those activities, this Statement does, however, require that all internal balances be eliminated in the total primary government column. The Board has concluded that this provision does not require the reporting of an additional *column* to display the eliminations between activity types. Appendix C illustrates a display technique that reports internal receivables and payables on a single line as "internal balances"

(reported with either assets or liabilities) that offset each other in the aggregation process. Alternatively, the balances could be reported separately as assets and liabilities and adjusted out of the combined totals, accompanied by a notice of the elimination.

313. Paragraph 58 of this Statement requires that amounts reported in fund balance sheets as receivable from or payable to fiduciary funds should be reported in the statement of net assets as receivable from or payable to external parties. The definitions of fiduciary funds in paragraphs 69 through 73 provide that the balances reported in these funds should be limited to amounts held for *external parties*. The Board believes, therefore, that amounts due to or from fiduciary funds are, in substance, due to or from the *beneficiaries or other external parties,* rather than the *fiduciary funds themselves*.

314. *In the statement of activities,* this Statement requires the elimination of the "effect of internal service fund activity." In essence, eliminating the "effect" of internal service fund activity requires preparers to "look back" and adjust the internal service fund's internal charges to break even. Internal service fund net income would cause a pro rata *reduction* in the charges made to the participating funds/functions. Conversely, an internal service fund net loss would require a pro rata *increase* in the amounts charged to the participating funds/functions.

315. The Board also concluded that the "grossing-up" effect of allocating expenses, similar in nature to those generally reported in internal service funds, should be eliminated, even if internal service funds are not used. Although the same principle applies when that type of internal activity occurs *within a single function,* the result of the elimination would be an equal reduction in both direct expenses and program revenues—with no effect on the *net* (expense) revenue of the function. For example, assume that a city's public safety function reported $35,000 of direct expenses and $3,000 of program revenues (charges for services and grants and contributions) for a net expense of $32,000. However, its direct expenses and program revenues both include $1,000 of internal activity between public safety programs. The net expense of the public safety function is $32,000, whether or not the internal activity is eliminated. Thus, the Board notes that, as a practical matter, eliminations of this kind are not necessary unless the effect on direct expenses or program revenues is material.

316. On the other hand, the elimination of *interfund services provided and used* between functions is not appropriate—for example, sale of power from a utility (business-type activity) to a governmental function. Although such purchases and sales are *internal* to the primary government and might be eliminated on that basis, they should not be eliminated because the selling function is a business-type activity that provides services primarily to customers that are *external* to the government; the government is merely one of its customers. In other words, those purchases and sales are similar to arm's-length transactions between the primary government and other (external) parties. Thus, eliminating activity of this type would understate the direct expenses of the purchasing function and the program revenues of the selling function.

Intra-entity Activity and Balances

317. In the ED, the Board decided to carry forward the requirements set forth in Statement 14, paragraphs 57 and 58, with regard to the classification and elimination of transactions and balances between the primary government and its blended and discretely presented component units. An exception was made, however, for transactions between the primary government and a discretely presented component unit that are in substance "arm's-length" exchanges. The ED proposed that those transactions should *not* be reclassified; that is, they would be allowed to stand as revenues and expenses to avoid understating the purchaser's program expenses and the seller's charges for services. This Statement broadens the exception for discretely presented component units to encompass *all* resource flows, as explained in the next paragraph.

318. After the issuance of the ED in January 1997, the Board determined that the proposed governmental model and Statement 33 were inconsistent in their treatment of resource flows between primary governments and their discretely presented component units. The ED would have reported certain of these resource flows as *transfers*. The Board discussed alternative concepts for reporting these flows and chose an approach that clarifies that, consistent with Statement 14, the primary government is the focus of the government-wide financial statements. The Board favors this approach because it provides a more complete picture of the cost of services and net cost of services *of the primary government.* Reporting this information was the Board's primary motivating factor in developing the statement of activities, and the focus on the primary government is consistent with the philosophy of Statement 14. As the Board indicated in that Statement, information about discretely presented component units (legally separate from the primary government in both form and substance) should be an overview of relationships and is required because the

primary government is accountable for them. Using this focus, all resource flows (except loans, repayments, and similar "balance sheet" transactions) between a primary government and its discretely presented component units are required to be reported as external transactions—revenues and expenses—in both the primary government's financial statements and the component unit's separately issued financial statements. Resource flows between the primary government and *blended* component units (legally separate from the primary government in form, but not in substance) are reported as revenues and expenses in separately issued reports of those component units but should be reclassified as transfers (internal activity) when included in the reporting entity's financial statements.

Statement of Net Assets

319. The statement of net assets is designed to display the financial position of the primary government (governmental and business-type activities) and of its discretely presented component units. This financial statement presents different information from that found in the traditional combined and combining balance sheets. Major differences include the level of aggregation; the focus on governmental and business-type *activities,* rather than *fund* and *fund-type* reporting; the use of the economic resources measurement focus and accrual basis of accounting for all assets and liabilities; the reporting of general capital assets and general long-term liabilities, which previously were reported only in account groups; and the reporting of infrastructure assets, which previously was optional. Specific issues and decisions related to this statement are discussed below.

Net Assets Format Encouraged

320. The Board encourages, rather than requires, the use of the net assets format in the statement of net assets and permits the use of the balance sheet format as an alternative. The Board believes the net assets format *(assets less liabilities equal net assets)* focuses users' attention more clearly on the net assets remaining at year-end. However, because the same information is presented in either format, the Board concluded that the balance sheet format *(assets equal liabilities plus net assets)* should also be allowed.

Sequence of Presentation of Assets and Liabilities

321. This Statement encourages governments to present assets and liabilities in order of relative liquidity, although use of a classified statement of net assets, which distinguishes between current and long-term assets and liabilities, is also acceptable. Although some ED respondents would have preferred that the statement of net assets be *required* to distinguish between current and non-current assets and liabilities, the Board agreed that the option to present assets and liabilities *either* in the order of their relative liquidity *or* in a classified format should be retained. Nevertheless, the Board understands that, to users, the most important component of a classified approach is the requirement to identify the "current portion" of liabilities whose average maturities are greater than one year—that is, the amount due to be repaid within the next year. For this reason, the Board agreed to require this information to be presented in summary form on the face of the statement of net assets and in more detail in the required disclosures about changes in long-term liabilities.

Classification of Net Assets

322. The ED proposal to report three components of net assets—net assets invested in capital assets, net of related debt; restricted net assets; and unrestricted net assets—was not addressed by many respondents and is carried forward to this Statement. Some respondents did question how the term *related debt* should be defined for purposes of the first component. The Board believes that most governments can readily distinguish between debt that is "capital related" and debt that is not.

323. Paragraph 33 provides financial reporting guidance for "unspent" proceeds of "capital-related" debt. The Board concluded that if that portion of the debt was considered "capital related," the *invested in capital assets, net of related debt* component of net assets would be understated because there would be no capital assets to offset the debt. On the other hand, including the unspent proceeds with capital assets would not be appropriate. The Board agreed that a practical solution would be to allocate that portion of the "capital-related" debt to the component of net assets that includes the unspent proceeds, for example, *restricted for capital projects*. The Board does not believe that this implies that the debt is "*payable* from restricted assets" but, rather, is merely consistent with the "net" assets philosophy.

324. This Statement also requires governments to distinguish between expendable and nonexpendable restricted net assets. These subcategories had been proposed in the Board's ED on the college and university reporting model to provide comparable net asset categories with private colleges and universities. Because the expendable/nonexpendable distinction is applied in some special-purpose governments, such as libraries and museums, and even in some general purpose governments, the Board concluded that this classification also should be applied to those entities.

325. The Board also took into account the discussion of the expiration of donor restrictions in paragraph 17 of FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made*. That paragraph states, "If an expense is incurred for a purpose for which both unrestricted and temporarily restricted net assets are available, a donor-imposed restriction is fulfilled to the extent of the expense incurred unless the expense is for a purpose that is directly attributable to another specific external source of revenue." The Board believes that the decision whether to first apply restricted or unrestricted resources to specific expenses should be a management matter and therefore did not include a similar requirement in this Statement. Paragraph 115h requires disclosure of the government's policy in the summary of significant accounting policies.

326. The Board added the requirement for disclosures about donor-restricted funds in paragraph 121 based on the belief that information about net appreciation of those funds is necessary to assist users in understanding the government's ability to spend those resources because laws and spending policies can differ.

327. The requirement to report restricted net assets on the face of the statement of net assets was also generally well received by ED respondents. However, some had concerns about the Board's definition of the term *restricted*. Some were concerned that restricted net assets should not be reported when those restrictions arise from enabling legislation passed by the government's own legislative body. However, the Board continues to believe that certain restrictions established by enabling legislation should be reported in the statement of net assets. The Board agreed to elaborate on that decision in this Statement by noting that restrictions should be based on the substance of the enabling legislation. Paragraph 34 of this Statement provides further clarification regarding the *substance* of enabling legislation by requiring that the restriction be based on a *legally enforceable* requirement.

328. Some respondents representing business-type activities suggested that restricted net assets also result from decisions made by an entity's own governing board when that entity meets the criteria for following FASB Statement 71. Those criteria require that the governing board of a rate-regulated enterprise should be empowered by statute or contract to establish rates that bind customers. The Board agreed with that suggestion, noting that in these circumstances, governing board decisions have the same effect as enabling legislation.

329. Some ED respondents claimed that users would be confused because restricted net assets in the statement of net assets and reserved fund balances in governmental fund balance sheets are different. The Board understands the concerns expressed by those respondents, but although the terms *reserved* and *restricted* in everyday vocabulary appear to denote a similar status, their meanings in a governmental financial reporting context are significantly different. *Restricted* derives from external, legal constraints, whereas *reserved* is a function of the budgetary notion of "available for appropriation." The Board concluded that it is just as important to use the term *reserved* in the context of governmental funds as it is to display external restrictions in the statement of net assets.

Reporting Capital Assets and Long-term Liabilities

330. Because the statement of net assets is prepared using the economic resources measurement focus and the accrual basis of accounting, its scope encompasses all long-term and short-term *financial* assets and liabilities, as well as all *capital* assets. Capital assets, including infrastructure assets, and long-term liabilities reported in the statement of net assets are those associated with governmental and business-type activities of the primary government and discretely presented component units. They include both:

a. Capital assets and long-term liabilities of proprietary funds, which are also reported in those funds
b. *General capital assets* (previously, "general fixed assets") and *general long-term liabilities* (previously, "general long-term debt")—that is, capital assets and long-term liabilities other than those reported as fund assets and liabilities.[77]

[77]Long-term liabilities of fiduciary funds or component units that are fiduciary in nature should not be reported in the statement of net assets, but only in the statement of fiduciary net assets.

331. This Statement requires that general capital assets and general long-term liabilities be reported in the column for governmental activities in the statement of net assets. The Board believes that these assets and liabilities usually are more closely associated with the financing and support of governmental activities than with business-type activities.

332. General capital assets and general long-term liabilities traditionally have not been assigned to any particular fund or funds. The Board has concluded that this treatment continues to be appropriate, given the nature and objectives of governmental funds. Although general capital assets usually are acquired, and general long-term liabilities usually are repaid, by expending the current financial resources of governmental funds, the assets and liabilities generally apply to all activities of the government—not just those of the fund paying for them. Moreover, because general capital assets are not financial, and general long-term liabilities are not current, they do not meet the criteria for recognition as governmental fund assets and liabilities under the *current financial resources* measurement focus required for governmental funds.

Elimination of account groups

333. This Statement eliminates the requirement to report the general fixed assets and general long-term debt account groups. The Board has concluded that including account groups in governmental fund balance sheets would be inappropriate because account groups are not *funds* and capital assets and long-term debt do not meet the criteria for recognition in governmental funds. In the government-wide statement of net assets, all capital assets and long-term debt are reported in the appropriate column.

Capital assets of proprietary funds

334. No changes have been made to the measurement and reporting requirements for proprietary fund capital assets. However, the Board has decided to allow the modified approach to reporting infrastructure asset systems (discussed in paragraphs 340 through 342) to be used in proprietary fund reporting. This decision allows for similar reporting of infrastructure assets of the same class regardless of the activity in which they are reported. (For example, a highway may be reported as a governmental-type activity or, in the case of a toll road, as a business-type activity.)

Reporting general infrastructure assets

335. This Statement requires that general infrastructure assets be reported as a part of capital assets in the statement of net assets. Reporting infrastructure assets of business-type activities currently is required. The Board believes that reporting general infrastructure assets is an essential step in the evolution of financial reporting standards that will more effectively address some of the objectives of financial reporting set forth in Concepts Statement 1. Specifically, the Board believes that capitalization and a measure of the cost of using infrastructure assets is important to assist users in:

a. Determining whether current-year revenues were sufficient to cover the cost of current-year services (Concepts Statement 1, paragraph 77a)
b. Assessing the service efforts and costs of programs (paragraph 77c)
c. Determining whether the government's financial position improved or deteriorated as a result of the year's operations (paragraph 78c)
d. Assessing the government's financial position and condition (paragraph 79a)
e. Assessing the service potential of physical resources having useful lives that extend beyond the current period (paragraph 79b).

336. The required reporting of general infrastructure assets has been one of the aspects of the new reporting model of most concern to respondents throughout the project's due process. Respondents' views about whether general infrastructure assets should be reported corresponded more or less with their views about whether there should be a government-wide statement of net assets and, if so, whether the economic resources measurement focus should be used. Many of those who support the use of the economic resources measurement focus also believe that general infrastructure assets should be reported. Some respondents, however, do not believe that reporting infrastructure assets for governments is important, and some do not believe depreciation expenses are relevant to users of financial statements. Some ED respondents who oppose the infrastructure reporting requirements suggested as a compromise that it would be less burdensome to apply the requirements on a prospective basis only. Over 1,500 letters on the subject of infrastructure reporting were received from April through June 1999. Constituents, largely from local governments, stated in those letters that they did not believe that the benefits of complying with the requirement to report general infrastructure assets, especially retroactively, were sufficient to justify the cost that would have to be incurred. Therefore, they believed that the reporting of general infrastructure assets did not meet the test of practicality.

337. The Board deliberated the issues raised by the written responses to the ED, at public hearings, in the letters, and at task force meetings. It again concluded that reporting infrastructure assets is essential to provide information for assessing financial position and changes in financial position, and for reporting the cost of programs or functions. It decided, however, to extend the transition period to allow additional time to report infrastructure assets retroactively. The Board also decided to allow phase 3 governments[78] to report infrastructure assets prospectively only. For phase 1 and 2 governments, the Board decided not to allow prospective-only application because of the effect it could have on the completeness and usefulness of the information reported. Prospective-only reporting would generally understate (a) total assets, the capital asset portion of net assets, and total net assets in the statement of net assets and (b) the amount reported as depreciation of infrastructure assets in the statement of activities (because depreciation on infrastructure assets acquired prior to the effective date of this Statement would be omitted). The Board therefore concluded that, notwithstanding the allowance made for phase 3 governments, retroactive reporting of infrastructure assets is essential for meeting many of the financial reporting objectives in Concepts Statement 1, as discussed above.

Implementing infrastructure reporting

338. The Board recognizes the substantial implementation issues that reporting infrastructure assets presents. In developing the infrastructure reporting requirements, the Board consulted with preparers, attestors, engineers, and their professional associations. Field tests were conducted. Before it issued the ED, the Board asked thirty state and local governmental entities and ten audit firms that assist in the preparation of financial reports for state and local governments to estimate the staff hours and additional costs (excluding staff hours) that would be required to develop information retroactively for infrastructure assets using the methods being considered. The twenty-eight who responded varied in their estimates of time and cost. Although a few respondents estimated staff hours and other costs that could be considered prohibitive, most of the entities responded that it was possible to gather, prepare, and report this information without excessive effort.

[78]See paragraph 143 for an explanation of the implementation phases.

339. Based on this consultation, other research, and responses to the ED, the transition provisions of the Statement have been designed to minimize the costs of implementing the Statement while nevertheless requiring infrastructure assets to be reported. This Statement permits initial capitalization using deflated current replacement cost, which in the Board's judgment represents estimated historical cost. The Statement indicates that bond documents and capital budgets may be consulted as source documents for estimated historical cost. All governments are permitted deferred implementation. Required capitalization is limited to major assets as defined by the Statement. The required retroactive capitalization period need not extend beyond years ending after June 30, 1980. Composite depreciation rates based on groupings of similar assets or classes of dissimilar assets are permitted.

Modified approach

340. In this Statement, the Board concluded that, generally, a government's capital assets should be reported as assets when acquired (capitalized) and should be depreciated over their estimated useful lives. However, based on concerns raised in responses to the ED, at public hearings, and at task force meetings about the use of depreciation as a measure of the cost of use for infrastructure assets, the Board decided that an alternative approach to historical cost depreciation would be beneficial if a reliable method of applying such an approach could be developed and agreed upon. The Board reviewed a number of approaches generally based on methods of measuring whether infrastructure assets were being preserved. It heard from engineers and transportation finance officers and learned that although these approaches are of great value in managing infrastructure assets, they have not developed to the point at which consistent methods or measurement scales can be used to assess condition sufficient for recognition in financial statements. The Board concluded that additional research is needed to determine if a workable, comprehensive "preservation method" can be developed. The Board plans to add a project to its agenda to address this issue.

341. However, as a compromise the Board decided that it was important to allow governments to begin reporting using a method other than historical cost–based depreciation. The modified approach allows governments *to not report depreciation expense* for eligible infrastructure assets if (a) the government manages the eligible infrastructure assets using an asset management system that possesses certain characteristics and (b) it documents that the eligible infrastructure assets are being preserved at (or above) a condition level established by the government. Using this approach, governments would re-

port as expenses all infrastructure expenditures except those that result in additions or improvements, which would be capitalized. To help users assess the degree to which infrastructure assets are being maintained and preserved, governments would disclose in RSI the assessed condition of eligible infrastructure assets and a comparison of estimated and actual expenses to maintain and preserve the assets. Governments may use a variety of methods to measure the condition of their infrastructure assets. For example, several different approaches may be taken to measure the condition of paved roads. Some measure only road smoothness, others measure the distress on the pavement's surface, and others use a combination of these or other measures. For purposes of this Statement, any of these methods would be acceptable as long as they are capable of producing condition assessments that can be replicated.

342. Under the modified approach, there is no expense reported for a decline in an asset's condition. Therefore, if a government *can no longer document* that eligible infrastructure assets are being preserved approximately at (or above) a condition level established by the government, the government would stop reporting based on the modified approach and instead would report depreciation expense for those assets in subsequent years.

Works of art and historical treasures

343. The Board believes that works of art, historical treasures, and similar assets are capital assets whether they are held singly or in collections. However, the Board considered whether an exemption from capitalization and depreciation should be provided for certain collections for practical reasons. For example, many collections consist of numerous items acquired over long periods of time. For these collections, it may not be possible or cost-beneficial to establish or estimate the aggregate amount at which the collection should be capitalized. The ED proposed criteria for exemption similar to those established in FASB Statement 116 for the private sector. In redeliberation, the Board clarified that this exemption does not apply to collections already capitalized as of June 30, 1999. The Board also clarified that the revenue recognition requirements of Statement 33 should apply to donations and purchases of works of art, historical treasures, and similar assets even if they are added to noncapitalized collections. The Board also concluded that depreciation should not be required for those capitalized collections or individual items that are considered to be inexhaustible.

Statement of Activities

Net (Expense) Revenue Format and Underlying Reporting Objectives

344. The Board believes that the statement of activities should be presented in a net (expense) revenue format for several reasons:

a. The statement of activities provides additional information about the operations of governmental entities from fund-based financial statements. Use of the net (expense) revenue format provides information that is designed to meet the following financial reporting objectives, as stated in Concepts Statement 1: Financial reporting should provide information (1) to determine whether current-year revenues were sufficient to cover the cost of current-year services (paragraph 77a) and (2) about how the governmental entity financed its activities (paragraph 78b). The emphasis of these objectives is not on funds or fund types, but rather on services and activities.
b. Users are interested in the cost of programs and to what extent they either contribute to, or draw from, the general revenues of the government. The net (expense) revenue format distinguishes between service-providing programs of the government at the functional category level (if not lower), regardless of which funds are used to manage them. The statement of activities reports the net cost of each functional category to the government.
c. Establishing the financial burden on the reporting government's citizenry or taxpayers as a financial reporting focus has introduced a new dimension to governmental financial reporting. The Board believes that this clearly defined presentation of governmental operations provides an opportunity for analysis and insight previously not possible.
d. The net (expense) revenue format is also consistent with the budgetary orientation of governmental activities. It presents information in the same sequence as it is generally considered by government officials in the budgetary process—that is, "What will the program cost, and how will we pay for it?"
e. The Board believes that comparability among governments should be enhanced, because all governments will be required to report their operating results (1) using a single measurement focus and (2) without displaying the various combinations of funds each may use to manage its resources. Comparisons of governments offering similar programs will no longer be affected by differences in measurement focuses and bases of accounting based on which funds each government uses. The net (expense) revenue

format also improves comparability by requiring aggregated reporting of information that is otherwise disaggregated, to varying degrees, depending on how many funds each government uses to account for a given function or program.

ED Responses

345. The most common objection from respondents who oppose the "net cost" format is that it may compel users to make inappropriate value judgments about governmental functions that report net expense rather than net revenue. They suggest that the objective of the statement of activities appears to be that functions *should be* self-supporting, and those that are not should somehow be held in lesser esteem. Their argument is that the worth of governmental activities should not be determined by whether they "pay their own way." The Board agrees, and continues to maintain, that it never intended to convey such a message in the statement of activities. The objective of the "net cost" approach is *not* to identify which functions make money and which ones lose money, but rather to show the extent to which individual functions either contribute to or draw upon the general revenue-raising capacity of the government.

346. The Board believes that the net cost approach allows users to gain a better understanding of the cost of governmental functions than they would otherwise obtain if the "traditional" operating statement format was used. All programs or services have a "cost." Some provide specific services or privileges with directly identifiable benefits—therefore, some or all of the cost can be recovered through charges to the service or privilege recipients. Similarly, some programs or services help meet the objectives of *other* governments or organizations that, in turn, help pay for the costs of those programs or services with grants or contributions. Other programs provide a more generic "public benefit" and generally are financed in large part by the government's general revenues. Users want information about both the *cost* and *net cost* of functions in all of those different scenarios.

347. The Board also discussed the proposal in the ED that stated, "Information in the statement of activities should be presented in this format," and agreed that the final Statement should not be as prescriptive. Governments with only a few programs could present their functional categories in columns rather than rows to make the statements appear less complex. Also, large, complex governments that want to present more functions than would comfortably fit on a single page could use two pages—the first containing the net program cost

information and the second presenting the general revenues and changes in net assets information. Illustrations of these modifications of the standard statement of activities format are presented in Appendix C.

348. The Board believes that *communication* is the key to preventing users from misunderstanding the message of the statement of activities. MD&A is the medium that government officials will use to put the new information into the proper context. In addition to the “good program/bad program” concern discussed above, several ED respondents made a persuasive argument about an additional concern. They noted that citizens may be confused by the budgetary-style sequencing of information in the statement of activities because the actual inflows and outflows in the budgetary document are measured differently. The requirement in paragraph 11a, to discuss in MD&A “the relationships of the statements to each other, and the significant differences in the information they provide,” presents governments with the opportunity to discuss the “net cost” of programs and how those measurements differ from the fund and budgetary results.

Implementation cost

349. The cost of implementing the requirements of the statement of activities was also a concern to many ED respondents. The Board has consistently acknowledged that there may be additional costs involved—especially in the early years of implementation. Identifying direct and indirect costs and program and general revenues may require some system modifications (coding) or may entail some additional analysis at year-end. These are unavoidable consequences of change, however, and the Board believes that the broad-based support for the statement of activities justifies the additional costs of implementation. As is true with any new requirement, the costs and difficulties will diminish as the process becomes established.

350. Some of the concerns about the cost of implementation can be attributed to misunderstanding because they were based on respondents’ notion that revenues are required to be *allocated* to the various functions. Just the opposite is true, however. Revenues should *not* be allocated to programs—only directly related revenues should be reported as program revenues. Identifying program revenues should be somewhat of an intuitive process, and many governments may already account for them separately. It is unlikely that significant user fees or program-specific grants will be recorded in the same revenue account as taxes or other general revenues.

Comparability

351. Some respondents cited comparability among their concerns with the statement of activities. They asserted that noncomparability may result because governments are free to establish their own level of detail (provided that the minimum requirement is met). However, the Board continues to believe that comparability will be enhanced through the statement of activities, but acknowledges that governments are different and may not be comparable in some ways. The only solution would be for the Board to provide rigid, prescriptive requirements for classification of activities as programs or functions—a standard government-wide chart of accounts. The Board decided against doing so. It believes that the new model presents enough challenges for preparers without requiring them to reclassify their operating activities into preestablished categories. In the future there may be a different reaction to "standardizing" program categories, depending on how SEA reporting develops. It is also likely that a great deal of research would be needed before an acceptable standard set of categories could be established.

"Traditional" format option

352. Several respondents argued that a "traditional" format should be required (or at least allowed as an option) because certain useful information for the government as a whole (for example, total revenue—without having to add several numbers to calculate it), available in the current model, will not be presented in the statement of activities. The "lost" data also include details of revenues by source; for example, the federal and state composition of intergovernmental revenues will not be apparent from the program revenue column, as illustrated. The information will, nevertheless, still be presented in the fund statements on the modified accrual basis, as it has been. The Board recognizes that there is a need to provide this information, but does not believe it overrides the potential value of the new information that will be presented in the statement of activities. As discussed in paragraph 295b, the Board agreed that the comparative analysis of the government-wide financial summary information in MD&A should discuss total revenues, expenses, and the key components of those amounts.

353. As discussed later in paragraphs 461 through 465, certain special-purpose governments are provided alternatives to using the standard statement of activities approach.

Minimum level of detail

354. The Board has concluded that governments should be allowed flexibility in deciding the level of program detail, beyond the minimum requirements, to report in the statement of activities. A high degree of interest has developed in recent years for “cost of services” information. Legislators, citizens, and other users are keenly interested in financial reporting at this level. The Board believes that the statement of activities is the reporting medium in which to begin to deliver that information.

355. One of the most prevalent concerns raised during due process on the PV version of the statement of activities was the uncertainty about how detailed the “program” classifications should be. Many respondents to that document were concerned that they would be required to regroup and reclassify all their fund-based financial data for the statement of activities. In the ED, the Board defused the situation to a great extent by establishing that the statement of activities should present at least the same level of detail that was provided in the governmental fund financial statements or the enterprise fund segment disclosures. Because the level of detail would already be established in the fund statements and segment disclosures, transition to the new model should be easier. The Board would have preferred a more standardized requirement but agreed that to *require* data to be presented at the “services” level for all types of governments would overburden some governments and potentially overwhelm some users. This Statement *encourages* governments to expand the level of detail farther down into the programs and services tiers, if their users have the interest, and if they have the means to do so.

356. Some have suggested, however, that a potential drawback to linking the minimum requirement to the fund-based details is that this might discourage governments from providing more detail in the governmental fund statements. Nevertheless, as stated earlier, the Board concluded that the more highly detailed levels—like programs or services—could prove to be too much of a burden on the general government preparers, given the breadth of the other changes associated with implementing the new model.

Reporting direct and indirect expenses

357. The Board concluded that the *minimum requirement* for associating expenses with functions in the statement of activities should be to report the direct expenses of each function. *Direct expenses* are those that are specifically associated with a service, program, or department and, thus, can clearly be

associated with a particular functional category. This Statement permits indirect expenses (much of what is typically reported as "administration" or "general government") to be reported as a separate function. If, on the other hand, a government chooses to allocate indirect expenses to specific functions, the Board believes that direct and indirect expenses should be presented in separate columns, to provide a common frame of reference for governments that report "full cost" and those that report only direct expenses.

358. The main argument from the respondents who commented about the ED's proposal to report direct expenses for programs or functions was that "full cost" should be the standard. The concern was that without indirect costs assigned to the functions, the "true" cost of those functions would not be reported. Others noted that a full-cost allocation requirement would enhance comparability. On the other hand, one of the most compelling arguments against requiring indirect cost allocation was that the allocation method could be arbitrary or biased and could produce misleading results. Those who oppose an allocation requirement argue that without a complete set of indirect cost allocation standards, comparability could not be achieved.

359. The Board agrees with the sentiments of the opponents of required allocations. At this time, the Board believes that a good-faith application of the direct expense definition and the requirement for a separate column when indirect costs are allocated provide the most even-handed opportunity for comparability.

360. The Board also continues to believe that the approach taken in the ED—to define direct expenses and presume that any other expense is indirect—is a reasonable and workable approach. The *direct expense* definition used in the ED and in this Statement closely resembles the definition of *direct costs* in OMB Circular A-87, *Cost Principles for State, Local, and Indian Tribal Governments*. Preparers and auditors familiar with those cost principles should readily understand the statement of activities requirement.

Reporting depreciation expenses

361. The ED proposed only one *requirement* and one *prohibition* for depreciation. The *requirement* was that depreciation expense for capital assets that can specifically be identified with a functional category should be included in direct expenses of that function. The *prohibition* was that depreciation expense for infrastructure assets should not be allocated to the direct expenses of the various functions.

362. Despite the understandable concern of a few respondents that depreciation expense should not be "buried" in direct expenses, the Board concluded that both of these provisions should be retained for this Statement. To remove the capital element of program costs would significantly diminish the usefulness of the statement of activities and substantially weaken the reasoning for requiring the flow of economic resources measurement focus for the government-wide statements. Similarly, the Board believes that to "spread" the depreciation expense for infrastructure assets over the various programs would significantly overstate program costs.

363. ED respondents who commented on depreciation reporting generally wanted the expenses to be reported separately and argued that depreciation should not be allowed to "disappear" into the direct expenses of the various programs. They argued that users need to see the program revenue coverage without depreciation. They noted that the amount of depreciation expense charged to the various programs would not be reported anywhere in the financial statements. The proposed disclosures about the balances and changes in capital assets in the ED included the depreciation expense charged for the year, but this was broken down by type of asset, not by program or function. The Board was persuaded by the respondents' concerns and agreed that depreciation expense by function is useful information that should be included in the disclosures about balances and changes in capital assets. The Board also concluded that if a separate line is used to report the "nondirect" depreciation expense, governments should clearly indicate on the face of the financial statements that this amount excludes direct depreciation expenses of the various programs.

Reporting interest on general long-term debt

364. For the ED, the Board had concluded that *interest expense on general long-term debt* normally should not be included in direct expenses. Interest on general long-term debt results from financing decisions that involve government-wide considerations. Although interest is sometimes attributed to a particular function, the Board believes that the connection often is not sufficiently objective or verifiable to serve as the basis for financial reporting. Often, management has considerable discretion in deciding how to allocate financial resources from various sources, including general long-term debt, to functions, because financial resources are, to a great extent, fungible. For example, a city may buy two similar pieces of equipment for two separate programs—one purchased with accumulated resources and the other financed through the issuance of general long-term debt. In deciding which program should include

the interest expense, management may be influenced by consideration of which program can best “afford” to report it. In this case, arguably, the attribution of interest expense to a particular program may have less to do with an objective connection to that program than with an arbitrary allocation of expense.

365. Nevertheless, the Board concluded that there are circumstances in which borrowing is so essential to a particular program that excluding interest expense from direct expenses would be misleading. An example is a program that is highly leveraged during its start-up phase. Thus, the Board decided to require that interest on general long-term debt be included in direct expenses in those limited instances when borrowing is essential to the creation or continuing existence of a program, recognizing that professional judgment may be necessary when making that determination.

366. Some respondents and some focus group participants believe financial analysts need to know total interest costs—a compelling argument for separate reporting of interest expense in the statement of activities. In addition, the respondents did not dispute the logic of the ED’s portrayal of the assignment of interest as a potentially arbitrary and possibly biased exercise. Some respondents asked for clarification about whether interest should be a separate line item, be included within “general government,” or either. The Board believes that the advantage of not allocating interest is best realized if a separate line is used and agreed that this Statement should more clearly state that a separate line should be used (unless the amount is immaterial). Because users are interested in total interest expense, this Statement requires disclosure (or on the face of the statement) of the amount not included in the separate line item.

Revenues

367. The component of the statement of activities in the ED that drew the most response was the revenue reporting requirements. Many ED respondents stated their concerns about allocating revenues, generally, and the treatment of taxes, specifically. Confusion over the characteristics that distinguish program revenue from general revenue was also apparent in some of the comments.

368. The nature of the comments from ED respondents indicated that much of the concern, or confusion, about what is or is not a program revenue resulted from the absence of a clearly stated definition, or objective, in the ED. For example, the ED offered only that general revenues “should be reported as a means of financing the net expense (expenses less program revenues).” The

Basis for Conclusions implied that the essential characteristic of a program revenue is that it reduces the net cost of the program to be financed from general revenues. Based on respondent concerns, the Board has added expanded discussions of the objectives of the statement of activities and the process of distinguishing between general and program revenues.

Defining program revenues

369. The ED proposed that program revenues be reported in two categories—charges for services, and program-specific grants and contributions. Charges for services include revenues attributable to a specific program because they result from exchange or exchange-like transactions or other events, such as charges to customers. Charges for services reduce the net cost of the program to be financed from general revenues.

370. Program-specific grants and contributions include grants and other financial assistance directly attributable to specific programs. These categories differ from charges for services in two ways:

a. Program-specific grants and contributions are not "generated by" the program, in the same sense as charges for services.
b. The grantor generally is not the beneficiary of the goods, services, or privileges provided; that is, there is not a direct relationship between the resource provider and the benefit recipient, as in an exchange or exchange-like transaction. Generally, the grant recipient provides the program or service to help achieve some objective of the grantor, either directly or indirectly. The grantor helps pay the costs of the program and therefore reduces the net cost of a program that the government is required to finance from taxes and other general revenues.

371. The Board determined, however, that program-specific grants and contributions should be further subdivided into "operating" and "capital" categories. One reason for making the change was to achieve greater consistency with the separate reporting requirement for capital contributions in proprietary fund statements of revenues, expenses, and changes in fund net assets. In addition, some respondents commented that, in the economic resource flows environment of the statement of activities, significant capital grant revenues would not be "matched" with the related capital outlay and that users would benefit from seeing the extent to which revenues were restricted to capital purposes.

372. Some respondents expressed concern about grants that are awarded to cover more than one purpose. The question was whether such grants should be general revenue because they are not restricted to a specific program. The intent in the ED, although not explicitly stated, was to include multiprogram grants in program revenues, provided that they could be "unbundled" and identified with the different programs or functions on a rational basis. The Board believes that the designation of a multipurpose grant as program revenue can objectively be decided by relying on specific identification of purposes and relative amounts in formal grant documents. This Statement makes it clear that a grant is not necessarily limited to a single program to qualify as program revenue.

Tax revenues

373. The ED proposed that all taxes should be reported as general revenues. That proposal precipitated several comments from ED respondents. Some voiced their opinion that the financial statements should show how taxes (and other general revenues) were allocated to the specific programs. This approach would in substance produce an income statement for each program—made up largely of a pro rata allocation of general revenues to produce a "bottom line." The Board believes that such an approach would easily be subject to manipulation and arbitrary allocations, and questions the meaning of a contrived "net income" for a governmental program. The net cost of a program in the statement of activities tells users how much tax and general revenues were needed for (and, therefore, "allocated" to) each program.

374. Others were troubled by the ED proposal because they believe that taxes that are levied for a specific program and restricted for use in only that program should be included in program revenues. The Board understands the logic of that position and recalls that the PV contained a similar provision. The ED dropped the "dedicated" tax category from program revenues based on the belief that tax revenues that are raised by the government through its own powers and that are earmarked or restricted for use in a program (as distinct from charges to program customers or applicants for services) should not be regarded as reducing the net cost of the program to be financed from general revenue sources. Rather, it is more meaningful to regard such taxes as one of the sources of general revenues through which the government finances the net cost of the program. The Board continues to endorse that reasoning and believes it is consistent with the objective and focus of the statement of activities.

375. The Board also considered the argument that there may be certain revenues, currently regarded as "taxes," that should not be included in the blanket classification of "all taxes as general revenues." Some ED respondents suggested that certain taxes, such as motor fuel taxes, more closely resemble program-generated revenue than they do "taxes." Motor fuel taxes, they assert, are produced by the transportation function and therefore are more like revenues from "those who purchase, use, or directly benefit from the goods or services of the program" than they are like revenues from "all taxpayers, regardless of whether they benefit from a particular program." Nevertheless, the Board continues to believe that the generation of the tax revenues by the transportation function is too indirect to qualify as program revenues and concluded that the ED provisions about "all taxes" should not be modified. In addition, to regard motor fuel taxes as program revenues would be inconsistent with recently issued Statement 33, which specifically refers to motor fuel taxes as nonexchange transactions.

Investment earnings

376. Some respondents asked whether investment earnings that are restricted for use in specific programs or functions can be reported as program revenues. One specifically asked the question about permanent fund earnings. The Board believes that, generally, the nature of permanent funds and the investment earnings they generate makes that revenue similar to revenue provided by "parties outside the reporting government's citizenry." As such, the earnings on permanent fund investments should be reported as program revenues if they are restricted to a specific program or programs. Similarly, earnings on investments not held by permanent funds may also be legally restricted to certain specific functions or programs. The Board believes that if the earnings on the invested accumulated resources of a program are legally restricted to be used by that program, the net cost to be financed by the government's general revenues is reduced. Thus, it is appropriate to report the investment earnings in those specific situations as program revenues.

Reporting Term and Permanent Endowments

377. Because some entities—for example, libraries and hospitals—receive permanent and term endowments, the Board considered how these amounts affect net program cost. It concluded that, based on the unavailability of the principal portion of these revenues to finance programs, it would be inappropriate to report them as reductions of program costs. Although some argue that *term* endowments eventually become available to finance programs, the Board

decided that because of the uncertainty of the timing of release of most term restrictions (such as upon death of the provider), it would be more appropriate to report these endowments in the same manner as permanent endowments.

Special and Extraordinary Items

378. The definition of *extraordinary items* in this Statement—transactions or other events that are both unusual in nature and infrequent in occurrence—is consistent with that in APB Opinion 30. In addition, this Statement defines a second category, *special items,* as "transactions or other events within the control of management that are significant and either unusual in nature or infrequent in occurrence." Special items and extraordinary items should be reported separately. One of the reasons for these requirements is to highlight significant "one-shot" financing measures, such as certain sales of capital assets. Transactions or other events beyond the control of management (thus, not *special* items) that are *either* unusual in nature *or* infrequent in occurrence should be disclosed in the notes to the financial statements.

Government-wide Cash Flows Reporting

379. Some ED respondents suggested that a government-wide statement of cash flows should be added to the basic financial statements to "complete the set" of government-wide statements. The Board continues to believe, however, that a statement of cash flows should *not* be added to the required government-wide financial statements. The Board is aware that fund statements for major governmental funds provide *similar,* but not the *same,* information as a statement of cash flows would for those activities. Thus, after this Statement has been implemented for a representative period of time, if it becomes clear that there are unmet user needs that could be addressed in a government-wide statement of cash flows, the Board will consider reopening the discussions about government-wide cash flows reporting.

Reporting Fund-based Information

380. The Board's research indicates that financial statement users are primarily interested in information at *two* levels: highly aggregated information about the governmental unit as a whole and detailed information about individual funds. This Statement requires information about the government as a whole to be provided in the statement of net assets and the statement of activities. It also requires information about the government's major funds (and its nonmajor

funds in the aggregate) to be provided in the fund financial statements. The ED included a proposal to require *fund-type* information in the basic financial statements, augmented by major fund reporting in some fashion. However, because research indicates that users do not find combined information by fund type—as presented in the previous model's general purpose financial statements—to be useful, the Board changed the focus of fund-based reporting in basic financial statements from fund types to major funds.

Reporting Major Funds

381. The usefulness of *fund-type* information has been debated for years. In both the PV and the ED, the Board attempted to enhance fund-type reporting with information about major funds. As the new model began to evolve, users consistently endorsed the Board's efforts to retain the "details" of the previous model. However, as time passed, it became more apparent to the Board that users' interest in the "details" does not relate so much to fund types as it does to individual fund information. As a result, the Board decided to eliminate the ED's proposal to provide *fund-type* information in the basic financial statements in favor of information about *major funds*. That decision was based primarily on the needs of users for information about important individual funds that is obscured when it is embedded in the fund types. For example, the special revenue fund type could include individual funds used to account for activities financed by federal resources, some by state resources, and others by local revenues.

382. Using the criteria for determining a major fund, the Board has found that many governments report a relatively high percentage of their fund assets, liabilities, revenues, and expenses/expenditures in the general fund and major funds. For many governments, the aggregated amounts reported in the "other funds" column will not be significant.

383. This Statement requires nonmajor funds to be separately displayed in the aggregate. Combining statements for those funds are not required, but if they are presented, they would be included as *supplementary information* as was done in the previous model. At this time, the Board believes that the need for information about individual funds is met through the major fund reporting requirements, and that the additional costs of including nonmajor fund information in the basic statements, the notes, or RSI would exceed the benefits of doing so. The major fund criteria establish *minimum* requirements; thus, governments may classify other individual funds as major funds if the government's officials believe they are particularly important to financial statement users, as discussed in paragraph 76.

384. The 1997 ED exempted fiduciary funds from the major fund reporting requirements primarily because information about "major" funds was already required by other standards. Statements 25 and 26, as amended by this Statement, and Statement 31 provide reporting requirements for individual pension plans and investment pools. The major fund reporting exemption for fiduciary funds is carried forward to this Statement.

385. The Board also has concluded that internal service funds should be exempt from the major fund reporting requirements. The nature of internal service funds is such that the statement of revenues, expenses, and changes in fund net assets, in essence, "double-counts" amounts charged to other funds. This Statement eliminates the net effect of internal service fund transactions in the government-wide statements for precisely that reason. The Board does not believe that applying the major fund criteria to internal service funds' *revenues and expenses* is useful, because the other side of the transactions in the participating funds already has been considered when applying the criteria. Similarly, the application of major fund criteria to the *assets and liabilities* of internal service funds is also of questionable value. Generally, the assets and liabilities that would qualify an internal service fund as "major" are not *fund* assets and liabilities, but rather are *government-wide type assets and liabilities* (for example, motor pool or other general capital assets and risk financing liabilities) whose benefits and burdens are allocated to funds by management-devised formulas. The Board does not believe that any additional useful information is provided by casting these government-wide type assets and liabilities into a major fund setting.

Revised Criteria for Enterprise, Internal Service, and Fiduciary Funds

386. Although the requirements of this Statement for reporting fund-based information are built upon the traditional state and local government funds structure, the Board has concluded, based in part on responses to the 1988 DM, *Measurement Focus of Governmental Business-Type Activities or Entities,* and other research on business-type activities and fiduciary funds, that modifications to the traditional criteria are needed for enterprise, internal service, and fiduciary fund financial reporting.

Enterprise Fund Definition

387. The revised criteria for the use of *enterprise fund* reporting are intended to provide more consistency from year to year, and greater comparability among governments, by clarifying under what circumstances enterprise fund reporting

is required and when it is optional. The Board believes that the three criteria in this Statement are an improvement over the criteria established by NCGA Statement 1 in several respects. Perhaps most significantly, this Statement makes clear that enterprise fund reporting should be used for any activity that is financed with *debt secured solely by net revenue* from its fees and charges to external users. Enterprise fund reporting is also required for any activity that operates under *laws or regulations* requiring that its costs of providing services, including capital costs (depreciation or debt service), be recovered with fees and charges. The final criterion—requiring enterprise fund reporting for any activity for which management establishes fees and charges, pursuant to its *pricing policies,* designed to recover its costs of providing services, including capital costs—is similar to the existing criterion. However, it adds an element of objectivity by basing the standard on established policies rather than management's intent. Further, this Statement makes clear that all criteria for required use of enterprise fund reporting should be applied only in the context of an activity's principal revenue sources. For example, paragraph 67a requires an activity to be reported as an enterprise fund if the activity is financed by debt secured solely by a pledge of the net revenue from fees and charges of the activity. To apply the principal revenue source test in relation to this criterion, a government should compare an activity's pledged revenues to its total revenues.

ED responses

388. Twelve percent of ED respondents commented on the proposed definition and criteria for reporting enterprise funds. Of these, a majority generally agreed with the proposed definition, which would permit enterprise fund accounting for any activity that charges a fee for its services. Some respondents were concerned that this definition was too permissive. However, the Board noted that the previous definition did not even require that an activity charge a fee for its services. The Board agreed that any attempt to further limit the circumstances under which enterprise fund accounting is permitted has the potential to cause a substantial change in practice.

389. Others disagreed with the proposed definition because they believed the criteria would require the creation of enterprise funds where they do not exist today. These respondents focused on the use of the term *activity* and were concerned that it would require enterprise funds to be created for minor

activities that are required to have (or do have) a policy to cover all costs. However, the Board notes that footnote 33 to the definition makes it clear that separate reporting is not required when the activity represents a minor revenue source to the government.

Reporting by governmental hospitals

390. This Statement supersedes the AICPA's SOP 78-7, *Financial Accounting and Reporting by Hospitals Operated by a Governmental Unit,* for governmental hospitals. That SOP required all governmental hospitals to be reported using enterprise fund accounting and reporting. However, in practice, some hospitals and other governmental healthcare providers that finance their operations solely or principally through nonexchange revenues use governmental funds to report their operations. This practice was first formally acknowledged in the July 1990 AICPA Audit and Accounting Guide, *Audits of Providers of Health Care Services,* which the Board cleared for issuance. The elimination of the provisions of SOP 78-7 and the new definition of enterprise funds (paragraph 67) are not intended to change current accounting and reporting practice by governmental healthcare organizations (governmental fund versus enterprise fund accounting and reporting), unless one of the three criteria established by the new definition of enterprise funds in paragraph 67 is met.

Reporting unemployment compensation benefit plans

391. Based on the second criterion in the ED—required by law to recover its costs—the Board concluded that unemployment compensation benefit plans should be reported as enterprise funds similar to public entity risk pools. Several state preparers and auditors commented on that proposal in the ED and suggested a variety of alternatives. Some supported the ED position. Others focused on the trust relationship that they believe exists and would prefer that the plans be reported in trust funds. Still others favored special revenue funds. Board members discussed a number of factors in making their decision, including:

- Whether taxes assessed against employers should be considered to be exchange-like or insurance transactions
- The position taken in the ED
- Where unemployment compensation liabilities would be reported and the resources for its repayment
- How the plans would be presented in the government-wide statements.

Based on these considerations, especially the first consideration listed above, the Board concluded that the ED proposal should be retained.

Internal Service Funds Definition

392. This Statement amends the previous criteria for the use of *internal service funds* from NCGA Statement 1, as amended. The new criteria are consistent with those adopted by the Board in Statement 10 regarding appropriate limits on the use of internal service fund reporting for risk financing.

393. NCGA Statement 1, as amended, defines internal service funds as those used "to account for the financing of goods or services provided by one department or agency to other departments or agencies of the governmental unit, *or to other governmental units,* on a cost-reimbursement basis" (paragraph 26, emphasis added). However, Statement 10 establishes a narrower standard for the use of internal service funds in the area of risk financing. According to Statement 10, paragraph 76, an insurance or risk management pool should use internal service fund reporting "only as long as the [sponsoring governmental] entity is the predominant participant in the fund." If external participation reaches the point where the sponsoring entity is not the predominant participant, the pool should be reported as a public entity risk pool, using an enterprise fund. In the ED, the Board had concluded that this concept should be applied to all internal service funds. Respondents did not oppose the ED's proposal.

Fiduciary Funds Definition

394. In this Statement, the term *fiduciary funds* denotes funds that are used to report resources held by a governmental unit in a trustee or agent capacity for others. As discussed in paragraph 298, this Statement excludes fiduciary activities (including component units that are fiduciary in nature) from the scope of the government-wide financial statements, on the basis that the government cannot use the resources of fiduciary activities to support its programs. The Board concluded that a distinction between private-purpose and public-purpose trust and agency activities is important and should help to ensure that net assets that cannot be used to support the government's programs are excluded from the government-wide statements.

Reclassification of public-purpose funds

395. Consistent with the narrower definition of fiduciary funds in this Statement, the Board has concluded that public-purpose funds previously classified as expendable and nonexpendable trust funds generally should be reclassified as special revenue and permanent funds. (As explained in paragraph 391, however, unemployment compensation benefit plans are required to be reported as enterprise funds.) In addition, portions of agency fund assets held at the reporting date for other funds should be reported in those funds rather than in agency funds. The Board believes that these reclassifications are necessary to avoid understating the economic resources that can be used by the government to support its governmental and business-type activities and also to avoid overstating fiduciary funds.

396. In many cases, public-purpose funds are established in trust form or are referred to in common parlance as "trusts." The Board has concluded, nevertheless, that assets held by a government as a trustee or agent for other funds or component units of the government (in effect, for itself) should not be reported *in fiduciary funds* in general purpose external financial reports. The Board believes that such reporting, even if correct in form, would obscure essential facts: that the assets "belong" to the government in a sense that the assets of private-purpose trust and agency funds do not; and that the assets can be used, subject to applicable time and purpose restrictions, to support the government's activities.

397. In considering fund types to which public-purpose funds could be reclassified, the Board first considered existing governmental and proprietary fund types. The Board found the nature and purpose of public-purpose *expendable* trust funds to be sufficiently compatible with the definition of special revenue funds to reclassify those funds for external reporting purposes. In the case of public-purpose *nonexpendable* trust funds, because there is no compatible existing fund type, the Board decided to create a new fund type—permanent funds.

398. The ED included permanent funds within the proprietary fund category. Although not specifically stated in the ED, the reason that permanent funds were classified as proprietary funds was to preserve the MFBA used for nonexpendable trust funds. The measurement concept intended to be retained—the previous model's concept of "capital maintenance"—applied to all proprietary funds, ranging from a complex capital-intensive enterprise operation to the simple investment of trust fund assets.

399. Few ED respondents commented about *any* of the provisions regarding permanent funds. Some who addressed permanent funds expressed their support for the proposal. Generally, those respondents who opposed the provisions in the ED did so for one of two reasons. They believed either that (a) switching permanent funds from proprietary *funds* to governmental *activities* would confuse users or (b) the funds should be classified differently.

400. The Board's research indicates that the preponderance of nonexpendable trust/permanent funds are used to account for *financial* resources held and invested for *governmental* purposes (for example, cemeteries, libraries, museums, parks, public land maintenance, social services, and scholarships). Revenue recognition is generally consistent between the accrual and modified accrual bases. Statement 31 requires the same reporting whether the investments and earnings are in governmental or proprietary funds. Except for depreciation (and perhaps an occasional noncurrent liability), other incidental activity in permanent funds would likely not differ much, if at all, between the accrual and the modified accrual bases.

401. Therefore, the Board believes it would make little difference from an "earnings measurement" perspective whether permanent funds are categorized as governmental or proprietary. On the other hand, the Board's research indicates that, especially for state governments, the significance of the balances and transactions in permanent funds relative to enterprise funds would often have a distorting effect on major fund reporting and on business-type activities if reported as such in the government-wide statements. Consequently, the Board believed it could eliminate one potential source of confusion in the new model and simplify the reconciliation of governmental funds to governmental activities in the government-wide statements by classifying permanent funds as *governmental* rather than *proprietary*.

402. The Board acknowledges that the nature of the activity accounted for in a typical permanent fund seems to be ideal for capital maintenance measurement, thus suggesting that permanent funds might be categorized as *proprietary* funds. The Board does not dispute the logic of that conclusion, yet it believes that, as a practical matter, "capital maintenance" can be measured for permanent funds in the governmental funds setting because of the predominance of financial resources in those funds. Furthermore, as discussed in paragraphs 431 through 434, the Board has adopted the "change in net assets" approach rather than a "capital maintenance" approach for reporting under the flow of economic resources measurement focus and accrual basis of accounting. Thus, the significance of capital maintenance measurements in the new

model is diminished. As stated earlier, reporting permanent funds as *governmental* is a practical solution that provides a significant benefit by simplifying the model and reducing the differences between fund-based and government-wide information. The Board believes the advantages of the practical answer in this case outweigh the apparent conceptual/definitional inconsistency.

Higher Education Funds

403. The ED had included in the list of funds to be used for financial reporting purposes a category labeled *higher education funds*. These funds would have been used to report the funds of colleges and universities that are part of the primary government. This reporting was based on the April 1997 Exposure Draft, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities,* which proposed a separate financial reporting model for public colleges and universities. Since that time, however, the Board has concluded that public colleges and universities should not report using a separate model but should apply the provisions of this standard. A revised ED of the same title, discussing this decision, was issued by the Board at the same time as this Statement. The Basis for Conclusions of that ED provides the reasons for the Board's decision not to pursue a separate financial reporting model for colleges and universities, thus eliminating the need for a separate fund category in this model.

Governmental Funds Definitions

404. The ED proposed new definitions of *special revenue, capital projects,* and *debt service* funds. Few ED respondents commented on those definitions. However, because of Board concern that those definitions may unintentionally cause some governments to change their fund reporting practices, the Board agreed to drop the definitions proposed in the ED. Instead, this Statement refers to NCGA Statement 1, as amended, for definitions of governmental funds.

Revised Fund Structure

405. The revised fund structure for state and local government funds, after reclassification of public-purpose funds, is illustrated in Table B-1.

Table B-1
Fund Structure

Governmental Funds	Proprietary Funds	Fiduciary Funds
General fund	Enterprise funds	Pension (and other employee benefit) trust funds
Special revenue funds (including most funds previously classified as expendable trust funds)	Internal service funds	Investment trust funds
Capital projects funds		Private-purpose trust funds (trust arrangements under which principal or interest benefit specific individuals, private organizations, or other governments)
Debt service funds		Agency funds (limited to net assets held for specific other persons or entities)
Permanent funds (including public-purpose funds previously classified as nonexpendable trust funds)		

406. The classification of funds shown in the table does not extend to the methods a government may use in *accounting* for resources that it holds "in trust" for itself. The internal accounting methods that governments use to comply with legal requirements or for administrative reasons result from management policy decisions and are not affected by GASB standards.

Reporting Interfund Activity

407. This Statement establishes a new classification system, with new terms and definitions, for interfund activity, and modifies the requirements of NCGA Statement 1 for reporting transfers. It also provides guidance for classifying payments in lieu of taxes involving a primary government's funds and blended component units.

408. The term *interfund activity,* rather than *interfund transaction,* is used in this Statement when referring to financial interaction between funds, including blended component units. The Board believes that a distinction between *internal* events, including interfund activity, and *external* events, including transactions, is relevant and useful in financial reporting. Use of the term *transaction* is restricted to external events—that is, interactions with legally separate entities (discretely presented component units, other governments, other legally separate entities, and individuals).

409. In this Statement, different types of interfund activity have been identified by analogy to equivalent types of transactions. The Board believes that this approach is helpful in supporting a systematic approach to developing reporting standards for interfund activity. *Reciprocal interfund (internal) activity* (analogous to exchange and exchange-like transactions) includes (a) loans (also including activity previously termed "advances") and (b) interfund services provided and used (that is, interfund sales and purchases, previously described as "quasi-external transactions"). Notwithstanding changes in terminology, this Statement makes no essential change in the way these types of interfund activity should be reported.

a. Interfund loans should be reported as interfund receivables and payables on fund balance sheets.
b. Interfund sales and purchases should be reported as interfund services provided (revenues) and interfund services used (expenditures or expenses) on fund operating statements.

410. *Nonreciprocal interfund (internal) activity* (analogous to nonexchange transactions or other events) includes (a) transfers (redefined to include activities previously known as "operating transfers" and "residual equity transfers") and (b) reimbursements (no change in terminology).

a. The Board believes it is important to draw a clear distinction, in the financial statements, between (1) the resources that an activity or fund of the government derives from transactions or other events with external entities or from interfund sales and purchases (reciprocal) and (2) the resources it receives from transfers (nonreciprocal) from other activities or funds within the primary government itself. The former reflect the ability of the activity or fund to generate the resources it needs to operate or provide services. The latter reflect the extent to which it receives financial support from other activities or funds. In the statement of activities and in the statement of revenues, expenses, and changes in fund net assets (proprietary funds), the

Board believes that this distinction will be most clearly displayed by reporting transfers as a separate category after the general revenues, income before contributions, and special and extraordinary items lines, respectively (as the final item before change in net assets). In the statement of revenues, expenditures, and changes in fund balances (governmental funds), the Board believes that classification of transfers as other financing sources or uses is appropriate.

b. Consistent with NCGA Statement 1, paragraph 104, this Statement regards reimbursements as internal accounting adjustments used to reallocate the revenues and expenditures/expenses to the appropriate fund. Consequently, reimbursements should not be reported as interfund activity in the financial statements. Respondents did not oppose that provision in the ED.

411. Many governments move resources from one fund or blended component unit to another and refer to that internal activity as *payments in lieu of taxes*. The Board believes that if those payments are not for, and are not reasonably equivalent in value to, services provided, they are, in substance, *transfers,* rather than revenues and expenditures/expenses, and should be reported as such. On the other hand, if a government is able to demonstrate that payments in lieu of taxes are for identifiable services and that the amount of the payments is reasonably equivalent to the value of the services, they should be reported as revenues (or as interfund services provided) and as expenditures/expenses (or as interfund services used).

Separate Financial Statements for Each Fund Category

412. The Board believes, and respondents to the ED generally did not disagree, that each fund category is distinctive enough to warrant its own financial statements, prepared using the measurement focus and basis of accounting that best fits its nature, objectives, and method of financing. The required financial statements for governmental, proprietary, and fiduciary funds, summarized in Table B-2, essentially are a continuation of previous reporting standards set forth in NCGA Statement 1, as amended, and GASB Statement 25.

Table B-2
Basic Financial Statements by Fund Category

Fund Category	Measurement Focus and Basis of Accounting	Basic Financial Statements
Governmental	Current financial resources; modified accrual	Balance sheet Statement of revenues, expenditures, and changes in fund balances
Proprietary	Economic resources; accrual	Statement of net assets/balance sheet Statement of revenues, expenses, and changes in fund net assets/fund equity Statement of cash flows
Fiduciary	Economic resources; accrual	Statement of fiduciary net assets Statement of changes in fiduciary net assets* *(*Does not apply to agency funds.*)

Governmental Fund Reporting

MFBA

413. Although many respondents disagreed with the ED proposal to continue with the current MFBA, *users* who commented on this issue nearly unanimously supported it on the basis of its consistency with current information and its reporting of disaggregated information. Notwithstanding the endorsement by the user commentators, many other respondents still believe that other measures would be better for governmental funds—including economic or total financial resources. They raised essentially the same arguments that were offered in response to the PV in support of either of those MFBAs. Part I of this appendix addresses the Board's considerations of both the flow of economic resources and the flow of total financial resources measurement focuses.

414. Despite the Board's confirmation of the ED's basis for rejecting the economic and total financial resource flows MFBAs, Board members were sensitive to the concerns expressed by those respondents who remained troubled by the requirement to continue to use the previous MFBA for governmental funds. Thus, the Board considered several alternatives, including a budgetary-basis approach, and others that would have retained the previous MFBA but would have *permitted* governments to use another MFBA.

415. After extensive discussions of the alternatives during several Board meetings and with the members of the project task force, the Board became convinced that none of the multiple-MFBA alternatives would produce acceptable results. The overriding concern was that the proposals would further impair comparability between governments and make governmental financial statements more difficult to understand. Users would have to develop a working knowledge of multiple bases of accounting, rather than a single basis for each fund category. User representatives on the task force expressed a strong preference for a model that required a standard MFBA to be applied by all governments. It became clear to the Board that, regardless of the positive aspects of each of the alternatives, none of the multiple-MFBA approaches would be more acceptable to a larger portion of the constituency than the proposal in the ED. As a result, the Board agreed to investigate ways to modify the previous MFBA to address inconsistencies in the standards, clarify certain

imprecisely defined terms, and address concerns of preparers and attestors about the integrity and usefulness of the modified accrual basis of accounting. The Board is considering those issues in a separate project.[79]

416. In response to concerns about the continued use of the modified accrual basis by those who would prefer more accruals in governmental funds, the Board agreed to make two additional changes in governmental fund reporting. First, this Statement requires governments to present a summary reconciliation on the face of the governmental fund statements (or in an accompanying schedule) that provides information about the effect of long-term accruals not reported in the funds. Second, the Board agreed to require disclosures about how certain general long-term liabilities have been liquidated in the past from governmental fund resources.

Balance Sheet

417. This Statement continues the existing requirement[80] for separate display of the reserved and unreserved components of the fund balance of governmental funds. The Board believes that this distinction provides information that users have consistently deemed important and useful. It is different information from that provided by the three-component classification structure, based on restrictions, that is required for display in the government-wide financial statements. The components of governmental fund balances focus attention on the net unreserved current financial resources available for appropriation in future periods for the general purposes of the fund. Information about amounts "available for appropriation" has always been regarded as very useful by governmental financial statement users.

418. Most of the ED respondents who commented on the requirement to report reservations of governmental fund balances discussed the difference between reporting restricted net assets and reporting reservations of governmental fund balances, with opinions evenly divided. The Board discussed at length whether the meaning of the term *reservation* in NCGA Statement 1 is clear and whether reservations are being reported consistently and concluded that no change was needed at this time. The Board also considered what effect the elimination of fund-type reporting has on reporting reservations, where some reservations

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[79]An Exposure Draft of a proposed Interpretation, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements,* was issued on June 30, 1999.

[80]NCGA Statement 1, paragraphs 118–121.

are indicated by the fund type in which fund balances are reported. Because some Board members were concerned about the loss of this information *as it relates to fund balances,* the Board agreed that—for nonmajor funds—this Statement should require governments to report unreserved fund balances *by fund type.*

Statement of Revenues, Expenditures, and Changes in Fund Balances

419. As proposed in the ED, this Statement prescribes a single format for the statement of revenues, expenditures, and changes in fund balances for governmental funds. Except as discussed in the following paragraphs, this format is similar to the first of three acceptable formats described in NCGA Statement 1, paragraph 150, as amended. The Board's preference for the format selected is based largely on the notion that users are interested in the excess (deficiency) of revenues over expenditures, as well as the more comprehensive net change in fund balance. In addition, that format is the one most commonly used, and for that reason, users are most familiar with it. Respondents to the ED offered no significant opposition to this provision.

420. As noted earlier, this Statement requires all *transfers* to be reported as other financing sources and uses. The traditional distinction between operating transfers and residual equity transfers has been discontinued. The Board notes that the distinction between operating and residual equity transfers is not always clear, and practice therefore has varied. The Board believes not only that reporting both types of transfers in the same way is conceptually purer and consistent with the "change in net assets" reporting approach that pervades this model, but that it will improve comparability, as well as simplify the fund balance section of the statement.

421. As discussed in paragraph 378, it is the Board's intent that special and extraordinary items, as defined by this Statement, be reported separately from normal, recurring operations in both government-wide and fund financial statements. In governmental fund statements, special items and extraordinary items should be reported separately after other financing sources and uses, before arriving at the net change in fund balance for the year. This location is intended to draw maximum attention to these items so that users may more easily assess their nature, current effect, and ongoing implications. Respondents to the ED generally did not oppose this provision.

Proprietary Fund Reporting

Applicability of FASB Pronouncements

422. This Statement incorporates the option provided in Statement 20, paragraph 7, so that enterprise funds (and business-type activities) may apply all FASB Statements and Interpretations issued after November 30, 1989, except for those that conflict with or contradict GASB pronouncements.

423. The Board established Statement 20 as an interim standard, pending "further GASB research . . . expected to lead to the issuance of one or more pronouncements on the accounting and financial reporting model for proprietary activities" (paragraph 4). In the PV, the Board had proposed to rescind Statement 20, paragraph 7, thus prohibiting proprietary activities from applying FASB pronouncements issued after November 30, 1989, unless specifically made applicable by GASB pronouncements. After a review of responses to the PV, additional research, and consideration of the need for some level of comparability between (a) activities reported as enterprise funds and business-type activities and (b) their private-sector counterparts, the Board concluded that the provisions of paragraph 7 should be extended indefinitely for *enterprise funds* to provide guidance on issues that are not likely to be included on the GASB's agenda in the near future. The Board acknowledges that there may be situations in which an enterprise fund applies an FASB standard under paragraph 7 of Statement 20 and subsequently is required to change to a new GASB standard on similar issues. The Board has concluded that the option should *not* apply to internal service funds. The option is available so that state and local governments' business-type activities can be reported in a manner that more nearly parallels that of their private-sector counterparts. The Board believes that such a need does not exist for internal service funds.

424. ED respondents were evenly split between those who support the ED's position to continue the option and those who believe the option should be eliminated. Comparability continues to be the central issue. Some believe it is more important for business-type activities to be comparable—to the extent possible—with their private-sector counterparts. Others believe it is more important for those activities to be comparable with other business-type activities and with governmental activities. The Board is sensitive to the views of those who advocate comparability within "government," but is still committed to the position set forth in the ED.

425. One important aspect of Statement 20 is the continuation of FASB Statement 71 for governmental utilities that are rate regulated. However, the Board agreed that, although many general governments may argue that they are similar to rate-regulated entities, the provisions of Statement 71 should be limited to activities reported in enterprise funds and that meet the three criteria of Statement 71, paragraph 5. As noted in paragraph 62 of that Statement, normal Medicare and Medicaid arrangements with healthcare entities do not establish rates that bind customers for purposes of applying paragraph 5.

Internal Service Funds

426. Few ED respondents made comments—either supporting or opposing—the internal service fund provisions. Some respondents voiced their concern with the ED's proposal that internal service funds be reported as *proprietary funds* and as *governmental activities* in the government-wide financial statements. This requirement to "reclassify" internal service funds as *governmental* activities in the statement of net assets was the main area of respondent objection, with respondents citing either internal inconsistency or potential reader confusion as reasons for objecting.

427. The Board continues to believe that internal service fund activities should generally be included with governmental activities in the government-wide financial statements. Only a few respondents suggested that internal service fund balances should be included with business-type activities, and those who did argued only for consistency and comparability between "perspectives." The Board's perception of internal service funds as *governmental* was based on the nature of the activities, not the basis of accounting used in the funds.

428. To address respondent concerns, the Board agreed to simplify the overall model by reducing the perceived complexity. In the revised approach, a separate column is required to be used for internal service funds (that could be presented under a "governmental activities" subheading) to clarify the relationships of both the enterprise funds (similarly, under a "business-type activities" subheading) and the internal service funds to the government-wide financial statements. In this manner, the total enterprise funds column provides the details to the business-type activities balances and transactions in the government-wide statements, and the nonmajor fund data (for enterprise funds) will not be obscured by internal service fund information. In addition, the separate display of the internal service fund data as "governmental activities" provides the details of the reconciling item on the governmental fund financial

statements, avoiding the need to disclose those details in a note to the financial statements. If internal service funds were combined with nonmajor enterprise funds, the details would not be apparent.

Statement of Net Assets

429. This Statement requires proprietary funds to use a classified format in which current and noncurrent assets and liabilities and restricted assets should be distinguished based on the guidance in ARB 43. Research on user needs indicates a strong user interest in information about the classified assets and liabilities of business-type activities. Respondents to the ED generally agreed with the financial statement display requirements for proprietary funds, including the requirement for using a classified format.

430. The categories of net assets required for proprietary funds are the same as those proposed in the ED. Some respondents suggested that entities should be permitted to continue to distinguish between contributed capital and capital that is generated internally (retained earnings). However, the Board continues to believe that the focus of reporting in government should not be on a historical record of equity transactions, but on reporting net assets available to finance future services. Governments that wish to continue to provide information about the extent to which a particular enterprise fund has received capital subsidies may do so in the notes to the financial statements.

Statement of Revenues, Expenses, and Changes in Fund Net Assets

Change in net assets versus capital maintenance

431. As explained in paragraphs 282 through 286, the Board agreed to depart from the "dual-perspective" approach in the ED. As part of that conversion, the Board reexamined other provisions in the ED to identify those that may have been appropriate in a dual-perspective context but would produce inconsistencies within the new model. Of primary concern was the issue of applying a consistent approach throughout the model to financial reporting using the flow of economic resources measurement focus and accrual basis of accounting. The ED contained elements of two different approaches—a "change in net assets" approach and a "capital maintenance" approach. The *change in net assets* concept was most prevalent in the ED, especially in the statement of

activities, but proprietary fund operating statement requirements were based in part on a *capital maintenance* notion. The Board discussed both approaches in the interest of selecting a *single* approach to use in both government-wide and proprietary fund statements.

432. Under a capital maintenance approach, which traditionally has been used for enterprise and trust activity, certain resource flows—primarily contributions of capital (fixed) assets and permanently restricted contributions of financial assets—are excluded from the operating or income statement "bottom line" and are reported instead as direct changes in equity or net assets. That is, they are not revenues or expenses; they are "balance sheet–only" transactions. (In an "all-inclusive" operating or income statement, they are reported *after* beginning equity.)

433. Under the change in net assets approach, *all* changes in net assets are included somewhere in the principal "change" or "flow" statements *and are included* in the "bottom line" total—change in net assets for the year. These statements are commonly referred to as statements of changes in net assets or statements of activities, rather than income or operating statements. There are no "direct-to-equity" transactions and no mandatory reporting distinction between "capital transactions" and "operating transactions." No *additional* change in net assets is reported between beginning and ending net assets, as would be the case with a capital maintenance approach. In a change in net assets approach, the *net change for the year* and *net income* are not necessarily the same amount.

434. The Board concluded that the change in net assets approach, which is already required in the government-wide statement of activities, is also appropriate for proprietary funds. Among the factors influencing the decision were the lack of "owners" in government, thus negating the usefulness of making a capital/operating distinction, which is fundamental to the capital maintenance approach. The Board also believes the change in net assets approach is more straightforward and would enhance consistency not only within a set of basic financial statements, but also from one government to another. In addition, the Board was favorably motivated by the fact that the change in net assets approach would not prevent governments from displaying certain items differently (operating and nonoperating items, for example) or presenting different subtotals (operating income, for example) before the comprehensive performance measure "change in net assets."

Format requirements

435. This Statement prescribes a specific all-inclusive format and sequence for the statement of revenues, expenses, and changes in fund net assets of proprietary funds. The format is generally as described in NCGA Statement 1, except that capital contributions, additions to permanent and term endowments, special and extraordinary items, and transfers should each be reported separately after nonoperating revenues and expenses.

436. This Statement requires proprietary funds to distinguish between operating and nonoperating revenues and expenses, but does not establish definitions or a detailed list of criteria for making that distinction. Given the diversity of proprietary fund operations among state and local governments, the Board has chosen (a) to provide general guidelines and (b) to require each government to establish a definition of operating revenues and expenses appropriate to the activity being reported on, disclose its definition, and apply it consistently from period to period. The two guidelines set forth in this Statement tie the elements of operating income to the fund's principal purpose and to the categorization of related cash flows for preparing a statement of cash flows using Statement 9. That is, normally, transactions or other events for which the cash flows are not reported in operating activities—including most imposed nonexchange transactions or other events (such as tax revenues) and some exchange-like fees and charges (such as passenger facilities charges)—would not be reported as components of operating income. The Board believes that the guidelines will provide a general framework for definitions of operating income, while allowing governments the necessary flexibility to apply the guidelines appropriately in a variety of different situations.

437. This Statement requires that capital contributions be reported in the operating statement as a separate item after nonoperating revenues and expenses, rather than direct additions to a contributed capital equity account, as under previous standards. Generally, the Board views all contributions to proprietary funds as sources of net assets that will be used in producing services, whether currently or over a number of years. Accordingly, *all* contributions, including those that would have been classified as capital contributions under NCGA Statement 2, should be reported as a separate component of the change in net assets for the period. In reaching its conclusions on reporting capital contributions, the Board considered responses to its 1993 DM on reporting contributions, subsidies, tap fees, and similar inflows. The issues from that DM that are addressed by the Board's decision include inconsistencies in the types of transactions classified as capital contributions and artificial deficits caused by

reporting capital contributions as direct additions to equity but depreciating the capital assets obtained. The majority of respondents to the 1993 DM, the PV, and the ED agreed with the proposition that capital contributions should not be reported as direct additions to net assets.

Reporting endowments as revenues

438. The ED proposed that additions to permanent endowments should be reported as direct additions to net assets. However, as discussed in paragraphs 431 through 434, the "change in net assets" approach adopted for this Statement eliminates that requirement. This change is consistent with the requirement discussed in the preceding paragraph for proprietary funds to report *all* revenues, expenses, gains, and losses (including capital contributions) as components of changes in net assets.

Reporting net program cost information

439. As stated in paragraph 123, the Board encourages governments to provide net program cost information about their multipurpose enterprise funds by including a statement of activities as supplementary information. The Board believes that for certain multipurpose entities—for example, some governmental hospitals—meaningful information can be provided by using formats that convey information about "cost of services," such as the net program cost format discussed in paragraphs 38 through 40.

Statement of Cash Flows

440. The ED proposed that the direct method of reporting cash flows from operating activities should be used. Statement 9 had permitted use of *either* the direct *or* the indirect method. The Board found that the arguments presented in ED comment letters on the proposal for proprietary funds to present a statement of cash flows using the direct method were consistent with those made on the same requirement proposed in the PV. Research has shown that respondents from four groups—finance directors, citizens and legislators, creditors, and auditors—"clearly found the direct method to provide more and better information than the indirect method."[81] Note, however, that these groups were identified in the study as "users" even though some would not be considered users

[81] G. Robert Smith, Jr., "The Use of the Statement of Cash Flows in Governmental Reporting" (Ph.D. diss., Texas Tech University, May 1995), p. 322.

in Concepts Statement 1. In addition, many governments (with multiple business-type activities) have experienced implementation problems when some of their proprietary funds or component units use the direct method and others use the indirect method.[82]

Fiduciary Fund Reporting

441. The ED proposals for reporting fiduciary funds and similar component units were generally well supported by respondents. The Board considered comments from some respondents who wanted to disclose, rather than display, fiduciary fund information, but reaffirmed the position in the ED that the government's stewardship and accountability for fiduciary resources are more appropriately reported in the financial statements rather than the notes.

442. The financial statements required for fiduciary funds (and similar component units)—a statement of fiduciary net assets and a statement of changes in fiduciary net assets—are derived from the statements required for defined benefit pension plans in Statement 25. The Board believes that this format also works well when applied to other types of trust funds—pension trust funds used to report defined contribution pension plans, and trust funds established to report other postemployment benefits, external investment pools, and other private-purpose trusts.

443. This Statement continues the existing standards for reporting agency funds, with one exception. When an agency fund is used as a clearing account, any assets that are held in the agency fund at the reporting date pending distribution to other funds should not be reported in the agency fund, but rather in the funds for which they are held. The Board's decision on this point is related to the redefinition of fiduciary funds as funds that the government uses to hold assets as a trustee or agent for individuals, private organizations, or other governments. Accordingly, assets held for the government should no longer be reported in fiduciary funds, but rather in governmental or proprietary funds, as appropriate.

444. This Statement amends the requirements in paragraph 15 of Statement 25 and paragraph 7 of Statement 26 to include a combining statement of each individual plan in the basic financial statements. The Board determined

[82]FASB Statement No. 95, *Statement of Cash Flows,* in paragraphs 115 through 118 of the Basis for Conclusions, provides guidance on "indirectly determining amounts of operating cash receipts and payments."

that requiring combining statements of individual fiduciary funds in the basic statements of governments, other than public employee retirement systems (paragraph 465), was inconsistent with the reasoning for excluding fiduciary funds from the major fund reporting requirements. Consequently, the information for those individual plans, if not available in separate reports, is required to be disclosed in the notes, rather than in the basic statements.

Notes to the Financial Statements

445. This Statement addresses the subject of the notes to the financial statements only to the extent necessary to implement the requirements of this Statement. It refers to existing authoritative guidance, in NCGA Interpretation 6, as amended, regarding applicable note disclosures and prescribes additional disclosures. The Board has on its agenda a separate note disclosures project.

Segment Information

446. The previous standard on segment information, based on NCGA Interpretation 2, considers funds as segments. For example, a single fund that reports water, sewer, and solid waste operations would be defined as a segment. Some business-type activities have resolved this issue in practice by reporting separate columns or separate operating statements for what they consider to be separate segments. This Statement makes two significant changes to the previous standard. First, the information required has been made consistent with that required for major funds and major component units. Second, the Board redefined the term *segment,* so that it is no longer tied solely to the use of fund accounting systems. The Board decided that a segment should be redefined in relation to the needs of users for additional financial information about separately identifiable activities reported as or *within* enterprise funds or other stand-alone entities, for which revenue bonds or other revenue-backed debt instruments are outstanding and for which related expenses, gains, losses, assets, and liabilities can be identified.

Reporting Budgetary Information

447. The ED would have required a budgetary comparison statement as a basic financial statement. Some respondents suggested that this statement should be replaced with note disclosures about *noncompliance.* However, the Board believes that compliance reporting is not the only purpose of budgetary reporting. As noted in Concepts Statement 1, the objectives intended to be met also include

demonstrating whether resources were obtained and used in accordance with the entity's legally adopted budget. The Board believes that the best and most concise way to provide this information is to present a budgetary comparison. Other respondents suggested that budgetary comparison information should be presented as RSI, rather than in the basic financial statements.

448. The Board continues to support a requirement to provide a budgetary comparison, but has altered its position that it should be a *basic* financial statement. Rather, the Board believes this information is more appropriately presented as RSI. As noted above, the purpose of budgetary comparison reporting is to show whether resources were obtained and used in accordance with the entity's legally adopted budget. The Board acknowledges the importance of meeting that objective, but does not believe it is *essential* to the users' understanding of the financial position and results of operations of a government. Another important consideration in arriving at the decision to report budgetary comparison information as RSI is that the Board does not set standards for budgetary measures, but does have that responsibility for all other basic financial statements.

449. The Board acknowledges that some governments (for example, some whose budgetary and GAAP fund structures are essentially the same) believe that budgetary comparison information is essential and, accordingly, would prefer to include the information in the basic statements, rather than RSI. In recognition of that, the Board made an allowance, similar to the provision in footnote 18 to paragraph 33 of Statement 25. Thus, governments that wish to include budgetary comparison information in the basic statements (as *statements,* rather than *schedules*) are not prohibited from doing so. The Board believes, however, that a note disclosure option like the one allowed in Statement 25 is not appropriate for budgetary comparison reporting and therefore has not included it in this Statement.

450. The Board's decision to limit the required comparisons to the general and (major) special revenue funds was motivated, in part, by a desire to "uncomplicate" the financial report as much as possible. Generally, the legally adopted budgets for capital projects and debt service funds are tied to structured multiyear capital improvement plans or bond indenture requirements, and permanent fund spending is often subject to contractual or other third party–imposed conditions.

451. Despite opposition by some preparer and attestor respondents, the Board remains persuaded by the opinions of users who have steadfastly supported a requirement to include the original budget information in the budgetary comparison. The Board continues to believe that the original budget adds a new analytical dimension and increases the usefulness of the budgetary comparison. The requirement in paragraph 11e to discuss significant variations between the original and final budgets in MD&A is not meant to imply that the Board believes that budgetary changes are, by nature, undesirable. Rather, the information should be provided in the interest of accountability to those who are aware of, and perhaps made decisions based on, the original budget.

452. The Board believes that the primary purpose of the budgetary comparison is to provide information to users who are interested in budgetary compliance about the relationship between (a) actual flows of financial resources on the government's budgetary basis and (b) the legally enacted budget. Consistent with this view, the Board has concluded that governments should be allowed to use the same terminology and classifications in the budgetary comparison as in the budget document. This approach is provided as an alternative to the current requirement to present budgetary information in an operating statement format. The Board believes that one approach may be appropriate for some governments and their users, whereas the other method may be more responsive to the needs of other governments and their users. Accordingly, the Board does not prefer one method over the other.

Reporting Component Units

453. The method of reporting component unit information was not an issue raised by many ED respondents, and the few who did comment did not introduce new arguments that would persuade the Board to modify the proposal. The Board continues to believe that the method for reporting component units in this Statement is the most appropriate and effective approach to implementing the requirements of Statement 14.

454. Similarly, no compelling arguments were made that would cause the Board to reconsider the proposals in the ED regarding component units that are fiduciary in nature. The Board believes that the provision is consistent with the logic of paragraph 19 in Statement 14, and that this standard will result in improved reporting for these component units.

Reporting Major Component Units

455. Statement 14 provides three methods for reporting major discretely presented component units. The (combining) separate set of financial statements approach is one of those methods. In the ED, however, that particular method would have been eliminated because it did not fit with the "perspectives" approach of the ED model. But in this Statement, the perspectives reporting impediment is gone; therefore, the Board modified the ED provisions for reporting major component units to permit all three methods to simplify and minimize the amendments to Statement 14 and not cause governments to change their existing method of reporting major component units. The Board is aware that governments use all three methods. Those with one or two major components sometimes choose the separate-columns approach. Others with more component units have included the combining statement in the basic financial statements, or have presented the condensed statements in the notes. Each of the methods has a constituency, and the Board believes that all three methods should continue to be allowable alternatives.

Cash Flows of Discretely Presented Component Units

456. This Statement requires the financial statement data of discretely presented component units to be included in the government-wide financial statements of the reporting entity, rather than with the funds of the primary government. Because there is no requirement for a government-wide statement of cash flows, discretely presented component units are not required to present this statement, either. Similarly, paragraph 126 requires governments to present information about each major component unit, taken from the component unit's government-wide statements (except special-purpose governments engaged only in business-type activities). Again, cash flow information for major component units is not required. Users interested in cash flow information about a specific component unit should refer to the component unit's separately issued financial statements.

Reporting by Special-purpose and Single-program Governments

457. The Board believes that the basic financial statements to be presented by a special-purpose government should be appropriate to the nature and mix of the activities it performs, as discussed below.

Applicability of the AICPA Not-for-Profit Model

458. Some governmental entities have applied not-for-profit accounting and financial reporting principles by following SOP 78-10, *Accounting Principles and Reporting Practices for Certain Nonprofit Organizations,* or the AICPA Industry Audit Guide, *Audits of Voluntary Health and Welfare Organizations.* Statement 29 provided *interim guidance* on the application of not-for-profit principles to state and local governments, pending one or more GASB pronouncements on the governmental financial reporting model. This Statement supersedes portions of Statement 29.

459. Under the ED, entities following the AICPA Not-for-Profit model based on Statement 29 would have been required to apply the criteria for using enterprise funds to determine their appropriate accounting under the new model. However, most would not meet the criteria for using enterprise funds and would be required to *create* governmental fund and modified accrual information in order to provide the required fund-based statements. For this reason, the Board agreed that these governmental not-for-profits should be "grandfathered" by stating in this standard (see paragraph 147) that they may be reported like business-type activities. Not-for-profits that currently use the governmental model or that are created after the date of this Statement would be required to apply this Statement "as is."

Special-purpose Governments Engaged in Governmental Activities

460. In considering what financial statements should be presented in the separately issued annual financial reports of special-purpose governments, the Board applied the notion that both government-wide and fund-based financial statements should be required for special-purpose governments when it would provide additional useful information—that is, when differences between fund-based and government-wide reporting would not be limited to format and level of detail. Although general purpose governments almost always include governmental activities and funds, this may not be the case with special-purpose governments. The Board therefore concluded that because different MFBAs are required for governmental *activities* and governmental *funds,* any special-purpose government engaged in governmental activities or a combination of governmental and business-type activities should present both government-wide and fund financial statements in its separately issued statements.

Single Governmental Program Entities

461. Some special-purpose governments currently use only governmental funds to report their operations *and* are engaged in a single governmental program. Many report only a general fund or would report no other major funds under the new standard. The Board was concerned that presenting separate fund and government-wide statements in this situation may seem redundant or may confuse users. For this reason, the Board agreed that these entities should be given an option to combine their fund financial statements and their government-wide financial statements by providing a columnar (line-by-line) reconciliation on the face of the financial statements.

Special-purpose Governments Engaged Only in Business-type Activities

462. For special-purpose governments engaged only in business-type activities, the Board considered three issues related to the need to provide government-wide and fund-based financial statements:

a. Do the statements of net assets and activities provide “additional” information compared with the fund statements in the previous model? The same MFBA is used for both business-type activities and enterprise funds. The Board concluded that the different formats of the government-wide and fund financial statements would not provide enough incremental information to justify requiring both government-wide and fund financial statements.
b. What are the relative merits of requiring only the statements of net assets and activities or only the fund financial statements? Particularly, what are the relative merits of requiring a statement of activities in a net cost format or a statement of revenues, expenses, and changes in fund net assets in a traditional format? The primary criterion was relevance to user needs. The Board concluded that special-purpose governments engaged only in business-type activities should present only the financial statements required for enterprise funds—including a statement of revenues, expenses, and changes in net assets. The Board believes that these financial statements, along with the segment reporting requirement, will provide better information and promote greater comparability between the financial reporting of these business-type activities and similar activities in the private sector. However, the Board did agree that a statement of activities format may provide additional useful information for certain special-purpose governments engaged only in business-type activities (but with multiple programs), such as hospitals. For this reason, paragraph 123 of this Statement encourages those entities to present a statement of activities as other supplementary information.

c. Should major fund information, segment information, or both be required? Because special-purpose governments may not use multiple funds, even if they have multiple segments, the Board concluded that segment information, as required by this Statement for general purpose governments, should also be required for special-purpose governments engaged only in business-type activities.

Special-purpose Governments Engaged Only in Fiduciary Activities

463. The Board concluded that special-purpose governments engaged only in fiduciary activities should present only the financial statements required for fiduciary funds: a statement of fiduciary net assets and a statement of changes in fiduciary net assets. "Government-wide" financial statements should not be presented by these governments. The Board's decision was based on the fact that users of fiduciary fund financial statements focus on the various benefit plans and trust funds administered—each of which is administered for a specific set of owners and beneficiaries. The Board does not believe that a government-wide notion is relevant for such entities.

464. This Statement also addresses the application of the financial reporting requirements of Statements 25 and 26, regarding defined benefit pension plans and postemployment healthcare plans administered by them, to financial reporting by a PERS. In this Statement, the Board has classified a PERS as a special-purpose government that administers one or more defined benefit pension plans and sometimes other types of employee benefit plans. This classification is consistent with the definition of *PERS* in Statement 25.

465. Statement 25 requires a PERS that administers more than one defined benefit pension plan to present in its financial report combining financial statements and required supplementary schedules for all defined benefit pension plans it administers. Statement 26 requires separate reporting of a postemployment healthcare plan administered by a defined benefit pension plan. This Statement requires that a PERS apply those requirements in one of two ways:

a. By presenting a separate column for each defined benefit pension plan and each related postemployment healthcare plan it administers on the basic financial statements (an option that should be feasible for many PERS)
b. By presenting combining statements for those plans.

Small Governments

466. Some respondents to the ED believe that the Board should permit small governments to present less than the complete set of basic financial statements. Some think that the statements of net assets and activities would be sufficient, whereas others believe that only the fund-based statements should be presented. Respondents in both groups generally cite additional cost as a particular concern of small governments. The Board is sensitive to cost–benefit considerations for *all* governments, large and small, but is also guided by the notion that the purpose of financial statements is to provide useful information for users. The Board is not aware of any evidence that users of the financial statements of small governments—including the citizenry, legislative and oversight bodies, and investors and creditors—have substantially different information needs than do users of larger governments' financial statements. For that reason, the objectives of financial reporting established in Concepts Statement 1 apply to *all* governments, regardless of size.

467. The Board also points out that, because users' needs do not appear to be directly correlated with the size of governments, those needs cannot be used to help define what should be considered *small,* or whether assessments of size for financial reporting purposes should be based on population, expenditures, revenues, or some other measure. Indeed, the Board's research indicates that, in those states that have established reporting or audit exemptions for small governments, what is considered small varies considerably from one state to another. For all these reasons, the Board has concluded that the requirements of this Statement should apply regardless of a government's size.

468. However, as explained earlier, the Board has provided an alternative approach for certain single-program governments (many of which are "small") that allows them to "combine" their fund financial statements and their government-wide statements. In addition, as discussed in the following section, the Board has devised a three-year phase-in plan for implementing the new model. That extended implementation period should benefit smaller governments that may have fewer human and financial resources to implement this Statement. Furthermore, as explained in paragraph 337, the Board has modified the general infrastructure reporting requirements to exempt the implementation phase 3 governments from the retroactive reporting provisions.

Effective Date and Transition

469. When the ED was issued, the Board anticipated that the final Statement would be released by June 30, 1998, and established the effective date as "periods beginning after June 15, 2000." Hence, there was a two-year period between the issuance of the final Statement and its required implementation. One of the key reasons that a two-year implementation period was provided in the ED was a "promise" made by the Board in Statement 17, paragraph 5, that deferred the effective date of Statement 11 to "periods beginning approximately two years after an implementation standard is issued." Thus, even though the reporting model standard supersedes Statement 11, the Board believes it is nevertheless obligated to provide at least the two years that Statement 17 stated would be allowed. The Board's deliberations on the responses to the ED extended a year beyond the original target date for issuance of the final Statement. The Board believes an equal amount of time—one year—should be added to the effective date in the final standard. Thus, the earliest required effective date (maintaining the same link to the issuance date) for implementation of the reporting model is "periods beginning after June 15, 2001."

470. Since the ED was issued, the Board agreed to a three-year phase-in approach to implementation. Under the phase-in plan, governments with total revenues of $100 million or more in the first fiscal year ending after June 15, 1999, would be required to implement the model for years beginning after June 15, 2001; governments with total revenues of $10 million or more, but less than $100 million, would be granted one additional year; and governments with total revenues of less than $10 million would be given two additional years to implement the new model. The Board's reasoning was that many governments may not have sufficient resources to make the transition by the initial effective date. The Board decided that total revenues should include only the revenues of the *governmental* and *enterprise* funds. Other financing sources (including transfers-in) are not revenues and therefore are not included in the calculation. Extraordinary items are excluded to adjust for large amounts that could push a government into earlier implementation. Internal service funds are excluded to avoid "double-reporting" revenues. Fiduciary funds are excluded for the same reasons they are not included in the government-wide financial statements. And, finally, revenues of discretely presented component units are not indicative of resources available to the primary government for implementation. Because special-purpose governments engaged only in fiduciary activities report *additions,* rather than *revenues,* in the statement of changes in fiduciary net assets, the Board included a special provision applicable only to those governments.

471. The Board also agreed to limit the minimum initial capitalization of infrastructure to major general infrastructure assets acquired in fiscal years ending after June 30, 1980. This provides approximately a twenty-five-year period between this date and when phase 1 and 2 governments will be required to report assets acquired during this period. When considering the cost of developing this information compared to the benefits derived from more accurate cost-of-services information, the Board concluded that going back to this time period would achieve an appropriate balance for two reasons. First, during the initial deliberations, the proposed effective date for retroactive reporting was approximately twenty-five years after the effective date of NCGA Statement 1. That Statement requires governments to maintain an inventory of all of their capital assets beginning with fiscal years ending after June 30, 1980. Nevertheless, the Board recognizes that many governments did not implement this provision because general infrastructure *reporting* was *optional* at that time. Second, the Board's research indicates that capitalizing an estimate of costs incurred more than twenty-five years ago is not likely to significantly change the cost of services, operating results, and financial position of most governments after transition.

472. The Board decided to grant an extension of time to implement the new model for phase 2 and 3 governments based on differences in the resources (human or financial) potentially available for implementation. This approach will more directly benefit the governments themselves more than the users of their financial statements, but it also could benefit users. That is, a delay for entities with fewer resources would enable them to benefit from the report preparation and audit experiences of entities that will have implemented earlier. Capitalizing on a "learning curve" in this way could save resources for phase 2 and 3 governments and could provide for a smoother transition—which ultimately should benefit users as well. The Board concluded that a three-year phase-in plan would provide for a smoother transition than would a two-phased plan. For example, phase 3 local governments may find the experiences of phase 2 local governments of a similar type more relevant than the experiences of the state government or phase 1 counties or cities in the state. Also, as the number and variety of governments that have implemented increases, so too should the usefulness of workshops, journal articles, and other sources of assistance; but it will take time for updates to these sources of information to occur.

473. Governments that are blended or discretely presented component units will be required to implement the standard no later than the same year as their primary government. The Board believes that users may be confused if primary governments are able to partially implement the standard, and hopes that primary governments will be able to assist their component units with resources needed to implement the standard.

Prospective Application of Certain Pronouncements for Governmental Activities

474. Governmental activities are required to apply FASB pronouncements (and those of its predecessors) issued on or before November 30, 1989, that do not conflict with GASB pronouncements. Although many of the transactions considered in the FASB's and its predecessors' pronouncements may not take place or take place rarely within governmental activities (such as product financing arrangements), the Board agreed to adopt the pronouncements based on the belief that it will be better to embrace these standards now than to have to create a new GASB standard should the accounting for these transactions become an issue later. Certain of those pronouncements (and GASB Statement 23) would require governments, in the first year of applying this Statement, to calculate a beginning balance for certain prior-period transactions of governmental activities. For practical reasons, primarily to ease the implementation burden as much as possible, the Board determined that those particular pronouncements may be applied prospectively. (See paragraphs 307 through 309.)

Early Implementation

475. This Statement addresses two early-implementation issues—coordination with Statement 33 and consistent application between primary governments and their nonbusiness-type component units. The Board added the early-implementation provisions to alert governments that want to adopt the standard before its effective date that there are additional factors that need to be considered.

Retroactive Application

476. Adjustments resulting from a change to comply with this Statement—as with previous GASB Statements—should be treated as adjustments of prior periods and should be reported as restatements of beginning fund balance, fund equity, or net assets, as appropriate, for the earliest period restated. Financial statements of all prior periods presented are not required to be restated (although

restatement is permissible). As a practical matter, most general purpose governments do not issue comparative financial statements because of space limitations. The Board concluded, moreover, that the requirement to present condensed comparative information and analysis in MD&A should be deferred for the first year in which this Statement is applied, so that governments would not be required to restate prior periods solely for that purpose.

Appendix C

ILLUSTRATIONS

CONTENTS

Appendix C

ILLUSTRATIONS

477. This appendix illustrates the display and disclosure requirements of this Statement. It is presented for illustrative purposes only and is nonauthoritative. These sample financial statements and management's discussion and analysis (MD&A) are presented to assist the reader of this Statement in understanding its requirements and alternatives. In some instances, amounts that may be considered immaterial are used to illustrate specific requirements or alternatives. No inferences about determining materiality should be drawn from these illustrations.

This appendix does not represent a "complete set" of financial statements. It presents alternatives, where appropriate, organized by type of statement. For example, Exhibits B-1 through B-7 illustrate several ways that the statement of activities could be presented. Governments would use the format that is most appropriate and useful, based on the requirements set forth in this Statement and the needs of their financial statement users. A "typical" set of basic financial statements and RSI other than MD&A (listed below, including the illustrative notes to financial statements) is used as the basis for the illustrative MD&A. Some alternative approaches (for example, A-2, B-2, and D-2 rather than A-1, B-1, and D-1) could have been used.

A-1 .... Statement of Net Assets
B-1 .... Statement of Activities
C-1, C-2, C-3 .... Governmental Fund Statements
D-1, D-3, D-4 .... Proprietary Fund Statements
E-1 and E-2 .... Fiduciary Fund Statements
G-1, G-2, G-3 .... Budgetary Comparison Schedules

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)

The basic financial statements should be preceded by MD&A, which is required supplementary information (RSI). MD&A should provide an objective and easily readable analysis of the government's financial activities based on currently known facts, decisions, or conditions. MD&A should discuss the current-year results in comparison with the prior year, with emphasis on the current year. This fact-based analysis should discuss the positive and negative aspects of the comparison with the prior year. Governments are encouraged to use charts, graphs, and tables to enhance the understandability of the information presented. At a minimum, MD&A should include the components discussed in paragraph 11 of this Statement.

This illustration is based on the selected financial data listed in paragraph 477. Sample City, illustrated in those exhibits, does not use the modified approach for reporting infrastructure assets, discussed in paragraphs 23 through 25. *If it did,* the City would also be required to present information about its infrastructure assets in MD&A, as discussed in paragraph 11g. An illustration of the requirements of that subparagraph are presented below:

> The City manages its streets using the XYZ pavement management system. The City's policy is to maintain 85 percent of its streets at a pavement condition index of at least 70 (on a 100 point scale) and no more than 10 percent of its streets at a pavement condition index below 50. The most recent assessment found that the City's streets were within the prescribed parameters with 87 percent having a pavement condition index of 70 or better and only 2 percent of the streets having a pavement condition index below 50.

This sample MD&A illustrates how one could meet the minimum requirements set forth in paragraph 11. Different writing styles could just as effectively meet those requirements in a variety of ways. This illustration is not intended to serve as a template or blueprint for MD&A but rather to provide a frame of reference for preparers to use while giving consideration to their own particular circumstances.

This illustration meets the minimum requirements for MD&A, and in many instances, exceeds them to demonstrate how a basic MD&A might be embellished to improve readability or to provide useful information that goes beyond the minimum requirements. For example:

> The **Financial Highlights** section beginning on page 183 is not required, but providing one may stimulate some users' interest in reading the remainder of the discussion.

The discussions on pages 184 through 186 about *Reporting the City as a Whole, Reporting the City's Most Significant Funds,* and *The City as Trustee,* also are not required, but they may help some readers to understand what is included in the financial statements and how the information is presented. Discussions like these may be very useful in the first few years that this Statement is applied but may be shortened in the future as readers become familiar with the new financial statements.

Table 3 on page 190 and the accompanying analysis of its contents also exceed the minimum requirements. Additional information such as this, whether displayed in tables, graphs, or charts, can be used to help explain results or circumstances not readily apparent if the discussion were limited to only meeting the minimum requirements.

In other areas in this sample MD&A, a particular discussion may satisfy the requirements but also provide further narrative and analysis to put the explanation in the proper context. Preparers should be guided by their professional judgment and experience to determine how far beyond the minimum requirements they should go to best meet the needs of their financial statement users.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Our discussion and analysis of Sample City's financial performance provides an overview of the City's financial activities for the fiscal year ended December 31, 2002. Please read it in conjunction with the transmittal letter on page ___* and the City's financial statements, which begin on page 201.

FINANCIAL HIGHLIGHTS

- The City's net assets remained virtually unchanged as a result of this year's operations. While net assets of our business-type activities increased by $3.2 million, or nearly 4 percent, net assets of our governmental activities *decreased* by $3.1 million, or nearly 2.5 percent.
- During the year, the City had expenses that were $6.3 million more than the $99.5 million generated in tax and other revenues for governmental programs (before special items). This compares to last year, however, when expenses exceeded revenues by $8.9 million.
- In the City's business-type activities, revenues increased to $15 million (or 5.6 percent) while expenses decreased by 1.7 percent.
- Total cost of all of the City's programs was virtually unchanged (increasing by $800,000, or less than 1 percent) with no new programs added this year.
- The General Fund reported a deficit this year of $1.3 million despite the one-time proceeds of $3.5 million from the sale of some of our park land.
- The resources available for appropriation were $1.1 million less than budgeted for the General Fund. However, we kept expenditures within spending limits primarily through a mid-year hiring and overtime freeze and our continuing staff restructuring efforts.

USING THIS ANNUAL REPORT

This annual report consists of a series of financial statements. The Statement of Net Assets and the Statement of Activities (on pages 201 and 208–209) provide information about the activities of the City as a whole and present a longer-term view of the City's finances. Fund financial statements start on page 220. For governmental activities, these statements tell how these services were financed in the short term as well as what remains for future spending. Fund financial statements also report the City's operations in more

*[*Note: The preparer would cite the page numbers of the transmittal letter if one is provided.*]

detail than the government-wide statements by providing information about the City's most significant funds. The remaining statements provide financial information about activities for which the City acts solely as a trustee or agent for the benefit of those outside of the government.

Reporting the City as a Whole

The Statement of Net Assets and the Statement of Activities

Our analysis of the City as a whole begins on page 186. One of the most important questions asked about the City's finances is, "Is the City as a whole better off or worse off as a result of the year's activities?" The Statement of Net Assets and the Statement of Activities report information about the City as a whole and about its activities in a way that helps answer this question. These statements include *all* assets and liabilities using the *accrual basis of accounting,* which is similar to the accounting used by most private-sector companies. All of the current year's revenues and expenses are taken into account regardless of when cash is received or paid.

These two statements report the City's *net assets* and changes in them. You can think of the City's net assets—the difference between assets and liabilities—as one way to measure the City's financial health, or *financial position*. Over time, *increases or decreases* in the City's net assets are one indicator of whether its *financial health* is improving or deteriorating. You will need to consider other nonfinancial factors, however, such as changes in the City's property tax base and the condition of the City's roads, to assess the *overall health* of the City.

In the Statement of Net Assets and the Statement of Activities, we divide the City into three kinds of activities:

- Governmental activities—Most of the City's basic services are reported here, including the police, fire, public works, and parks departments, and general administration. Property taxes, franchise fees, and state and federal grants finance most of these activities.
- Business-type activities—The City charges a fee to customers to help it cover all or most of the cost of certain services it provides. The City's water and sewer system and parking facilities are reported here.
- Component units—The City includes two separate legal entities in its report—the City School District and the City Landfill Authority. Although legally separate, these "component units" are important because the City is financially accountable for them.

Reporting the City's Most Significant Funds

Fund Financial Statements

Our analysis of the City's major funds begins on page 191. The fund financial statements begin on page 220 and provide detailed information about the most significant funds—not the City as a whole. Some funds are required to be established by State law and by bond covenants. However, the City Council establishes many other funds to help it control and manage money for particular purposes (like the Route 7 reconstruction project) or to show that it is meeting legal responsibilities for using certain taxes, grants, and other money (like grants received from the U.S. Department of Housing and Urban Development). The City's two kinds of funds—*governmental* and *proprietary*—use different accounting approaches.

- *Governmental funds*—Most of the City's basic services are reported in governmental funds, which focus on how money flows into and out of those funds and the balances left at year-end that are available for spending. These funds are reported using an accounting method called *modified accrual* accounting, which measures cash and all other *financial* assets that can readily be converted to cash. The governmental fund statements provide a detailed *short-term view* of the City's general government operations and the basic services it provides. Governmental fund information helps you determine whether there are more or fewer financial resources that can be spent in the near future to finance the City's programs. We describe the relationship (or differences) between governmental *activities* (reported in the Statement of Net Assets and the Statement of Activities) and governmental *funds* in a reconciliation at the bottom of the fund financial statements.
- *Proprietary funds*—When the City charges customers for the services it provides—whether to outside customers or to other units of the City—these services are generally reported in proprietary funds. Proprietary funds are reported in the same way that all activities are reported in the Statement of Net Assets and the Statement of Activities. In fact, the City's enterprise funds (a component of proprietary funds) are the same as the business-type activities we report in the government-wide statements but provide more detail and additional information, such as cash flows, for proprietary funds. We use internal service funds (the other component of proprietary funds) to report activities that provide supplies and services for the City's other programs and activities—such as the City's Telecommunications Fund.

The City as Trustee

Reporting the City's Fiduciary Responsibilities

The City is the trustee, or *fiduciary,* for its employees' pension plans. It is also responsible for other assets that—because of a trust arrangement—can be used only for the trust beneficiaries. All of the City's fiduciary activities are reported in separate Statements of Fiduciary Net Assets and Changes in Fiduciary Net Assets on pages 235 and 236. We exclude these activities from the City's other financial statements because the City cannot use these assets to finance its operations. The City is responsible for ensuring that the assets reported in these funds are used for their intended purposes.

THE CITY AS A WHOLE

The City's *combined* net assets were virtually unchanged from a year ago—*increasing* from \$209.0 million to \$209.1 million. In contrast, last year net assets *decreased* by \$6.2 million. Looking at the net assets and net expenses of governmental and business-type activities separately, however, two very different stories emerge. Our analysis below focuses on the net assets (Table 1) and changes in net assets (Table 2) of the City's governmental and business-type activities.

Table 1
Net Assets
(in Millions)

	Governmental Activities		Business-type Activities		Total Primary Government	
	2002	2001	2002	2001	2002	2001
Current and other assets	\$ 54.3	\$ 49.0	\$ 13.8	\$ 15.7	\$ 68.1	\$ 64.7
Capital assets	170.0	162.1	151.4	147.6	321.4	309.7
Total assets	224.3	211.1	165.2	163.3	389.5	374.4
Long-term debt outstanding	(79.3)	(61.8)	(78.3)	(77.3)	(157.6)	(139.1)
Other liabilities	(21.4)	(22.6)	(1.4)	(3.7)	(22.8)	(26.3)
Total liabilities	(100.7)	(84.4)	(79.7)	(81.0)	(180.4)	(165.4)
Net assets:						
Invested in capital assets, net of debt	103.7	100.3	73.1	71.6	176.8	171.9
Restricted	22.8	27.1	1.4	2.8	24.2	29.9
Unrestricted (deficit)	(2.9)	(0.7)	11.0	7.9	8.1	7.2
Total net assets	\$ 123.6	\$126.7	\$ 85.5	\$ 82.3	\$ 209.1	\$ 209.0

Net assets of the City's governmental activities decreased by 2.5 percent ($123.6 million compared to $126.7 million). *Unrestricted* net assets—the part of net assets that can be used to finance day-to-day operations without constraints established by debt covenants, enabling legislation, or other legal requirements—changed from a $700,000 deficit at December 31, 2001 to a $2.9 million deficit at the end of this year.

This deficit in unrestricted governmental net assets arose primarily because of three factors. First, the City did not include in past annual budgets the amounts needed to fully finance liabilities arising from property and casualty claims. The City does not purchase commercial insurance to cover these claims. The City also did not include in past budgets amounts needed to pay for unused employee vacation and sick days. The City will need to include these amounts in future years' budgets as they come due. Second, during the past two years, tax revenues and State grants have fallen short of amounts originally anticipated. Finally, the City Council decided to draw down accumulated cash balances to delay the need to approve new tax increases. These factors are discussed in greater detail below.

The net assets of our business-type activities increased by 3.9 percent ($85.5 million compared to $82.3 million) in 2002. This increase, however, cannot be used to make up for the *decrease* reported in governmental activities. The City generally can only use these net assets to finance the continuing operations of the water and sewer and parking operations.

Table 2
Changes in Net Assets
(in Millions)

	Governmental Activities		Business-type Activities		Total Primary Government	
	2002	2001	2002	2001	2002	2001
Revenues						
Program revenues:						
Charges for services	$ 15.8	$ 14.6	$12.7	$11.9	$ 28.5	$ 26.5
Federal grants	2.5	2.4	1.6	1.5	4.1	3.9
State grants and entitlements	7.5	8.3	—	—	7.5	8.3
General revenues:						
Property taxes	56.1	53.6	—	—	56.1	53.6
Other taxes	13.3	13.0	—	—	13.3	13.0
Federal entitlements	1.5	1.4	—	—	1.5	1.4
Other general revenues	2.8	2.6	0.7	0.8	3.5	3.4
Total revenues	99.5	95.9	15.0	14.2	114.5	110.1
Program expenses						
General government	9.6	9.3	—	—	9.6	9.3
Public safety	34.9	33.8	—	—	34.9	33.8
Public works	10.1	10.5	—	—	10.1	10.5
Engineering services	1.3	1.4	—	—	1.3	1.4
Health and sanitation	6.7	6.5	—	—	6.7	6.5
Cemetery	0.7	0.5	—	—	0.7	0.5
Culture and recreation	11.5	11.9	—	—	11.5	11.9
Community development	3.0	3.3	—	—	3.0	3.3
Education	21.9	21.3	—	—	21.9	21.3
Interest on long-term debt	6.1	6.3	—	—	6.1	6.3
Water	—	—	3.6	3.7	3.6	3.7
Sewer	—	—	4.9	4.8	4.9	4.8
Parking facilities	—	—	2.8	3.0	2.8	3.0
Total expenses	105.8	104.8	11.3	11.5	117.1	116.3
Excess (deficiency) before special items and transfers	(6.3)	(8.9)	3.7	2.7	(2.6)	(6.2)
Special items—park land sale	2.7	—	—	—	2.7	—
Transfers	0.5	(0.4)	(0.5)	0.4	—	—
Increase (decrease) in net assets	**$ (3.1)**	**$ (9.3)**	**$ 3.2**	**$ 3.1**	**$ 0.1**	**$ (6.2)**

The City's total revenues (excluding special items) increased by 4 percent ($4.4 million). The total cost of all programs and services was virtually unchanged (increasing by $800,000, or less than 1 percent) with no new programs added this year. Even with this low growth in expenses and the sale of 1,170 acres of park land on the City's south side for a gain of $2.7 million, the City still did not cover this year's costs. The factors that led to the accumulated deficit also were the primary reasons for this year's shortfall. Our analysis below separately considers the operations of governmental and business-type activities.

Governmental Activities

Revenues (excluding the sale of park land) for the City's governmental activities increased by 3.8 percent ($3.6 million), while total expenses increased just under 1 percent ($1 million). With the gain on the sale of the park land, the decrease in net assets for governmental activities was narrowed to $3.1 million in 2002. This compares to a $9.3 million decrease in net assets in 2001.

The City's management took three major actions this year to avoid the level of deficit reported last year. Two of these actions increased revenues and the third reduced expenses:

- The City increased property tax rates by an average of 5 percent. This increase, the first in four years, raised the City's tax revenues by $2.5 million in 2002. Based on increases in the total assessed valuation, property tax revenues are budgeted to increase by an additional $2.8 million next year.
- The City sold three parcels of park land for $3.5 million, giving the City a gain (net of the $823,000 originally paid for the land) of $2.7 million. This was a one-time special item. Although this property has been added back to the tax rolls, the tax revenues it may generate are not expected to increase resources in any single year to the same level we recognized from selling the land.
- The City imposed a hiring and overtime freeze in midyear (excluding the City's police, fire, and sanitation departments) that resulted in approximately a $2.2 million savings in wages and related benefits expenses reported in 2002 compared to 2001. This freeze, plus cost savings of $500,000 from our continuing staff restructuring efforts, held down the increase in expenses.

Despite the rate increase, property tax revenues lagged by $680,000 compared to the final budget estimates because delays in several major commercial and residential developments precluded adding them to this year's tax rolls. More than half of the City's other revenue sources also fell short of the final budget estimates. These shortfalls include franchise fee revenues, which vary based on sales generated by businesses operated within the City. The fire at the State Street Mall affected many retail businesses in the City, as discussed on page 191. In addition, grant revenues were lower than expected because of overall state cutbacks.

The cost of all *governmental* activities this year was $105.8 million compared to $104.8 million last year. However, as shown in the Statement of Activities on pages 208–209, the amount that our taxpayers ultimately financed for these activities through City taxes was only $80 million because some of the cost was paid by those who directly benefited from the programs ($15.8 million) or by other governments and organizations that subsidized certain programs with grants and contributions ($10.0 million). Overall, the City's governmental program revenues, including intergovernmental aid and fees for services, increased in 2002 from $25.3 million to $25.8 million, principally based on increases in fees charged for services. The City paid for the remaining "public benefit" portion of governmental activities with $69.4 million in taxes (some of which could only be used for certain programs) and with other revenues, such as interest and general entitlements.

Table 3 presents the cost of each of the City's five largest programs—police, fire, public works, education, and parks and recreation—as well as each program's *net* cost (total cost less revenues generated by the activities). The net cost shows the financial burden that was placed on the City's taxpayers by each of these functions.

Table 3
Governmental Activities
(in Millions)

	Total Cost of Services		Net Cost of Services	
	2002	**2001**	**2002**	**2001**
Police department	$ 20.3	$ 19.7	$19.5	$19.1
Fire department	9.4	9.2	8.7	8.4
Public works	10.1	10.5	7.0	7.3
Education	21.9	21.3	21.9	21.3
Parks and recreation	9.9	9.7	4.4	4.6
All others	34.2	34.4	18.5	18.3
Totals	**$105.8**	**$104.8**	**$80.0**	**$79.0**

Business-type Activities

Revenues of the City's business-type activities (see Table 2) increased by 5.6 percent ($15 million in 2002 compared to $14.2 million in 2001) and expenses *decreased* by 1.7 percent. The factors driving these results include:

- The City water and sewer system, benefiting from growth in hook-ups by residential customers who are converting from septic systems, saw its operating revenues climb 10 percent to $11.3 million, but operating expenses rose only 4 percent, to $6.9 million. High maintenance costs—caused by the harsh winter months in 2001—did not occur this year.
- The City parking facilities, however, continued to operate at a deficit (by $1.4 million this year versus $1.3 million in 2001). In both years, this decrease is attributable primarily to the largest of the three City-owned garages, located on State Street. This year, the garage had to be closed for two extended periods due to ruptured gas lines beneath nearby streets, which now have been repaired, and the State Street Mall fire. These closings stopped revenues from being generated by the garage for two months, while only slightly reducing expenses.

THE CITY'S FUNDS

As the City completed the year, its governmental funds (as presented in the balance sheet on pages 220–221) reported a *combined* fund balance of $34.9 million, which is slightly below last year's total of $35.0 million. Included in this year's total change in fund balance, however, is a deficit of $1.3 million in the City's General Fund. Furthermore, without the cash from the sale of park land, fund balances would be $3.5 million lower. The primary reasons for the General Fund's deficit mirror the governmental activities analysis highlighted on pages 189 and 190. In addition, these other changes in fund balances should be noted:

- The City spent $11.3 million this year on the Route 7 reconstruction project, reducing the beginning fund balance in that capital projects fund by the same amount. This reduction was expected because capital fund balances at the beginning of this year included the proceeds of general obligation bonds issued last year to finance that project. Although these and other capital expenditures reduce available fund balances, they create new assets for the City as reported in the Statement of Net Assets and as discussed in Note 1 to the financial statements.

- In the same way, the fund balance of the Community Redevelopment Fund increased by $17.5 million this year when community redevelopment housing bonds were issued. By year-end, only $2.2 million of the debt proceeds had been used for construction of new housing units and $2.3 million was transferred to the Debt Service Fund. Overall, fund balance in the Community Redevelopment Fund increased by $13.1 million.
- Each year, the State provides the City with a portion of the gasoline tax revenues it collects. This money can only be used to replace, maintain, or improve the City's roads. This year, $3 million of these resources, including $1.7 million accumulated in previous years, was used primarily on ten major repaving projects.

General Fund Budgetary Highlights

Over the course of the year, the City Council revised the City budget several times. These budget amendments fall into three categories. The first category includes amendments and supplemental appropriations that were approved shortly after the beginning of the year and reflect the actual beginning balances (versus the amounts we estimated in October 2001). The second category includes changes that the Council made during the third quarter to take into account the mid-year hiring and overtime freeze and some of the City's staff restructuring efforts. The principal amendment in this case was to eliminate the original budget contingency appropriation used in the past to cover employee overtime and charges associated with staff turnover. In addition, the Council revised its estimated resources to reflect its decision to sell an additional parcel of park land. Finally, the Council approved several increases in appropriations to prevent budget overruns.

Even with these adjustments, the actual charges to appropriations (expenditures) were $1.3 million below the final budget amounts. The most significant positive variance ($534,646) occurred in the City's general government account, where the staff restructuring and hiring freeze resulted in a 10 percent reduction of the general administration workforce.

On the other hand, resources available for appropriation were $1.1 million below the final budgeted amount. As we noted earlier, property and franchise tax collections were less than expected. Reductions in State funding also affected grant resources available for appropriation. These shortfalls were partially offset by an increase in public service taxes. This increase resulted from a 15 percent increase in utility and cable television taxes, which was approved by the City Council in the third quarter.

The City's General Fund balance of $1.7 million reported on pages 220–221 differs from the General Fund's *budgetary* fund balance of $1.4 million reported in the budgetary comparison schedule on page 269. This is principally because *budgetary* fund balance excludes $182,821 of supplies inventories that are reported as expenditures for budgetary purposes when they are purchased and $40,292 of encumbrances reported as expenditures for budgetary purposes.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At the end of 2002, the City had $321 million invested in a broad range of capital assets, including police and fire equipment, buildings, park facilities, roads, bridges, and water and sewer lines. (See Table 4 below.) This amount represents a net increase (including additions and deductions) of just under $12 million, or 3.8 percent, over last year.

Table 4
Capital Assets at Year-end
(Net of Depreciation, in Millions)

	Governmental Activities		Business-type Activities		Totals	
	2002	**2001**	**2002**	**2001**	**2002**	**2001**
Land	$ 27.1	$ 29.4	$ 3.8	$ 3.7	$ 30.9	$ 33.1
Buildings and improvements	30.2	30.5	115.5	113.6	145.7	144.1
Equipment	21.2	22.9	1.2	1.0	22.4	23.9
Infrastructure	91.5	79.3	30.9	29.3	122.4	108.6
Totals	**$170.0**	**$162.1**	**$151.4**	**$147.6**	**$321.4**	**$309.7**

This year's major additions included (in millions):

Route 7 reconstruction project, paid for with proceeds of general obligation bonds issued last year	$11.3
Replacement of older segments of the wastewater collection system and treatment facilities, paid for with proceeds from a revenue note issued last year	3.2
Redevelopment housing construction, paid for with revenue bonds issued this year	2.2
Land acquired through the City's power of eminent domain, paid for with General Fund resources	2.0
Water distribution mains, hydrants, and meters, paid for with water and sewer revenue bonds issued this year	1.6
	$20.3

The City's fiscal-year 2003 capital budget calls for it to spend another $16 million for capital projects, principally for the completion of its Route 7 reconstruction project and to create housing units in the City's new community redevelopment housing program. The City has no plans to issue additional debt to finance these projects. Rather, we will use bond proceeds from the community redevelopment bonds issued this year and resources on hand in the City's Gas Tax Fund. More detailed information about the City's capital assets is presented in Note 1 to the financial statements.

Debt

At year-end, the City had $158 million in bonds and notes outstanding versus $141 million last year—an increase of 12 percent—as shown in Table 5.

Table 5
Outstanding Debt, at Year-end
(in Millions)

	Governmental Activities		Business-type Activities		Totals	
	2002	**2001**	**2002**	**2001**	**2002**	**2001**
General obligation bonds (backed by the City)	$32.6	$32.7	$ —	$ —	$ 32.6	$ 32.7
Revenue bonds and notes (backed by specific tax and fee revenues)	46.7	30.7	78.3	77.3	125.0	108.0
Totals	**$79.3**	**$63.4**	**$78.3**	**$77.3**	**$157.6**	**$140.7**

New debt resulted mainly from issuing revenue bonds for two new projects—$18 million of community redevelopment housing bonds and $3.6 million of water system improvement bonds. In addition, to improve cash flow and to take advantage of lower interest rates, the City management decided to refinance nearly $43 million of two general obligation debt issues and one revenue bond issue by issuing refunding bonds. By refinancing the debt, the City will save $2.3 million in principal and interest over the next 15 years.

The City's general obligation bond rating continues to carry the fourth highest rating possible, a rating that has been assigned by national rating agencies to the City's debt since 1995. All of the City's other debt—principally, revenue bonds and notes—carries the fifth highest rating. The State limits the amount of general obligation debt that cities can issue to 3 percent of the assessed value of all taxable property within the City's corporate limits. The City's outstanding general obligation debt is significantly below this $134 million state-imposed limit.

As noted earlier, the City did not previously purchase commercial insurance for property and casualty claims and has claims and judgments of $7.9 million outstanding at year-end compared with $8.1 million last year. Other obligations include accrued vacation pay and sick leave. More detailed information about the City's long-term liabilities is presented in Note 2 to the financial statements.

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

The City's elected and appointed officials considered many factors when setting the fiscal-year 2003 budget, tax rates, and fees that will be charged for the business-type activities. One of those factors is the economy. The City's non-agricultural employment growth has mirrored its population growth during 1998–2002, averaging annual gains of 4.2 percent. Unemployment in the City now stands at 3.9 percent versus 4.1 percent a year ago. This compares with the State's unemployment rate of 4.4 percent and the national rate of 4.9 percent.

Inflation in the metropolitan area continues to be somewhat higher than the national Consumer Price Index (CPI) increase. The City's CPI increase was 3.2 percent for fiscal year 2002 compared with the average U.S. city rate of 3 percent and the national rate of 2.8 percent. Inflation has been higher here due in part to residential housing market and energy price increases in 2001–2002.

These indicators were taken into account when adopting the General Fund budget for 2003. Amounts available for appropriation in the General Fund budget are $96.4 million, an increase of 4 percent over the final 2002 budget of $92.7 million. Property taxes (benefiting from the 2002 rate increases and increases in assessed valuations), public service taxes (with rate increases discussed on page 192), and grant revenue (boosted by increased State funding in several of our current programs) are expected to lead this increase. The City will use these increases in revenues to finance programs we currently offer and the effect that we expect inflation to have on program costs. Budgeted expenditures are expected to rise nearly 4 percent, to $95.9 million from $92.2 million in 2002. Increased wage and cost-of-living adjustments, based on agreements reached with the police, fire, and sanitation department unions in 2002 of roughly $800,000, are the largest increments. The City has added no major new programs or initiatives to the 2003 budget.

If these estimates are realized, the City's budgetary General Fund balance is expected to increase modestly by the close of 2003. More importantly, however, this will have been accomplished without selling capital assets or restructuring long-term debt to alleviate cash flow pressures, both actions needed in the current year. In addition, the City recently purchased commercial insurance for all property and casualty claims incurred after December 31, 2002.

As for the City's business-type activities, we expect that the 2003 results will also improve based on these recent rate decisions:

- The Public Service Commission approved a 2 percent rate increase for all water customers effective January 1. Sewer charges will not change.
- The City Council authorized a 15 percent increase in parking fees, both at the City-owned garages and for on-street meters.

CONTACTING THE CITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide our citizens, taxpayers, customers, and investors and creditors with a general overview of the City's finances and to show the City's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the City Controller's Office, at City, 1501 Coolidge Avenue, City, State.

STATEMENT OF NET ASSETS

The statement of net assets should report all financial and capital resources. Governments are encouraged to present the statement in a format that displays *assets less liabilities equal net assets,* although the traditional balance sheet format (assets equal liabilities plus net assets) may be used. Regardless of the format used, however, the statement of net assets should report the difference between assets and liabilities as *net assets,* not fund balances or fund equity. Governments are encouraged to present assets and liabilities in order of their relative liquidity. Liabilities with average maturities greater than one year should be reported in two components—the amount due within one year and the amount due in more than one year. Use of a classified format, which distinguishes between all current and long-term assets and liabilities, is also acceptable.

Separate columns should be used to distinguish between the governmental and business-type activities of the primary government and between the primary government and its discretely presented component units. A total column for the primary government should be presented. A total column for the reporting entity and comparative data from the prior year may be presented but are not required.

The difference between a government's assets and liabilities is its net assets. Net assets should be displayed in three components—*invested in capital assets, net of related debt; restricted* (distinguishing between major categories of restrictions); and *unrestricted.*

Requirements for the statement of net assets are discussed in paragraphs 30–37.

Illustrations

A-1: "Net assets" format with assets and liabilities presented in order of relative liquidity. Alternatively, assets and liabilities may be "classified" (see Exhibit A-2) within the net assets format.

A-2: Classified balance sheet format. Alternatively, assets and liabilities may be presented in order of relative liquidity (see Exhibit A-1) within the balance sheet format. In this illustration, the government has elected to use the modified approach for its general infrastructure assets, and accordingly, reports two capital asset categories—those that are being depreciated and those that are not (see paragraph 20).

A-3: Statement of net assets for a single-program government that engages in only governmental activities and has no component units.

A-4: Statement of net assets presented in combination with the governmental funds balance sheet for the single-program government in Exhibit A-3. This approach may be used in lieu of separate statements (see paragraph 136).

Alternatively, the internal balances could be reported on separate lines as assets and liabilities. A notation would need to be added to inform the reader that the "Total" column is adjusted for those amounts (see I-1).

Sample City
Statement of Net Assets
December 31, 2002

A-1

	Primary Government			
	Governmental Activities	**Business-type Activities**	**Total**	**Component Units**
ASSETS				
Cash and cash equivalents	$ 13,597,899	$ 10,279,143	$ 23,877,042	$ 303,935
Investments	27,365,221	—	27,365,221	7,428,952
Receivables (net)	12,833,132	3,609,615	16,442,747	4,042,290
Internal balances	175,000	(175,000)	—	—
Inventories	322,149	126,674	448,823	83,697
Capital assets, net (Note 1)	170,022,760	151,388,751	321,411,511	37,744,786
Total assets	224,316,161	165,229,183	389,545,344	49,603,660
LIABILITIES				
Accounts payable	6,783,310	751,430	7,534,740	1,803,332
Deferred revenue	1,435,599	—	1,435,599	38,911
Noncurrent liabilities (Note 2):				
Due within one year	9,236,000	4,426,286	13,662,286	1,426,639
Due in more than one year	83,302,378	74,482,273	157,784,651	27,106,151
Total liabilities	100,757,287	79,659,989	180,417,276	30,375,033
NET ASSETS				
Invested in capital assets, net of related debt	103,711,386	73,088,574	176,799,960	15,906,392
Restricted for:				
Capital projects	11,705,864	—	11,705,864	492,445
Debt service	3,020,708	1,451,996	4,472,704	—
Community development projects	4,811,043	—	4,811,043	—
Other purposes	3,214,302	—	3,214,302	—
Unrestricted (deficit)	(2,904,429)	11,028,624	8,124,195	2,829,790
Total net assets	$123,558,874	$ 85,569,194	$209,128,068	$19,228,627

Net assets restricted for capital projects includes approximately $13 million of capital debt for which the proceeds have not yet been used to construct capital assets (see paragraph 33).

Sample City
Statement of Net Assets
December 31, 2002

Alternatively, the internal balances could be reported on separate lines as assets and liabilities. A notation would need to be added to inform the reader that the “Total” column is adjusted for those amounts (see I-1).

	Primary Government			
	Governmental Activities	**Business-type Activities**	**Total**	**Component Units**
ASSETS				
Current assets:				
Cash and cash equivalents	$ 13,597,899	$ 8,785,821	$ 22,383,720	$ 303,935
Investments	27,365,221	—	27,365,221	7,428,952
Receivables (net)	12,833,132	3,609,615	16,442,747	4,042,290
Internal balances	175,000	(175,000)	—	—
Inventories	322,149	126,674	448,823	83,697
Total current assets	54,293,401	12,347,110	66,640,511	11,858,874
Noncurrent assets:				
Restricted cash and cash equivalents	—	1,493,322	1,493,322	—
Capital assets (Note 1):				
Land and infrastructure (see G-5)	118,620,361	34,788,333	153,408,694	751,239
Depreciable buildings, property, and equipment, net	51,402,399	116,600,418	168,002,817	36,993,547
Total noncurrent assets	170,022,760	152,882,073	322,904,833	37,744,786
Total assets	$224,316,161	$165,229,183	$389,545,344	$49,603,660
LIABILITIES				
Current liabilities:				
Accounts payable	$ 6,783,310	$ 751,430	$ 7,534,740	$ 1,803,332
Deferred revenue	1,435,599	—	1,435,599	38,911
Current portion of long-term obligations (Note 2)	9,236,000	4,426,286	13,662,286	1,426,639
Total current liabilities	17,454,909	5,177,716	22,632,625	3,268,882
Noncurrent liabilities:				
Noncurrent portion of long-term obligations (Note 2)	83,302,378	74,482,273	157,784,651	27,106,151
Total liabilities	100,757,287	79,659,989	180,417,276	30,375,033
NET ASSETS				
Invested in capital assets, net of related debt	103,711,386	73,088,574	176,799,960	15,906,392
Restricted for:				
Capital projects	11,705,864	—	11,705,864	492,445
Debt service	3,020,708	1,451,996	4,472,704	—
Community development projects	4,811,043	—	4,811,043	—
Other purposes	3,214,302	—	3,214,302	—
Unrestricted (deficit)	(2,904,429)	11,028,624	8,124,195	2,829,790
Total net assets	123,558,874	85,569,194	209,128,068	19,228,627
Total liabilities and net assets	$224,316,161	$165,229,183	$389,545,344	$49,603,660

Net assets restricted for capital projects includes approximately $13 million of capital debt for which the proceeds have not yet been used to construct capital assets (see paragraph 33).

Sample County Fire Protection District
Statement of Net Assets
June 30, 2002

ASSETS	
Cash and investments	$ 7,716,749
Taxes receivable	1,480,536
Other receivables	574,481
Prepaid expenses	7,763
Inventories	197,308
Capital assets, net of accumulated depreciation, where applicable:	
Land	301,576
Buildings and improvements	3,398,394
Fire apparatus—automotive	907,482
Furniture, fixtures, and equipment	911,754
Total capital assets, net (Note A)	5,519,206
Total assets	15,496,043
LIABILITIES	
Accounts payable	106,999
Salaries and benefits payable	273,367
Accrued interest payable	1,511
Deferred revenues	273,746
Compensated absences (Note B):	
Payable within one year	401,202
Payable after one year	200,601
Bonds and notes payable (Note B):	
Portion due within one year	235,453
Portion due after one year	3,195,905
Total liabilities	4,688,784
NET ASSETS	
Invested in capital assets, net of related debt	2,087,848
Restricted for debt service	468,167
Unrestricted	8,251,244
Total net assets	$10,807,259

Details about capital assets and long-term liabilities are not required to be presented on the face of the statement. They can be displayed, as shown here, or disclosed in the notes (see Notes 1 and 2).

For long-term liabilities, only the *total* amounts due within one year and those due beyond one year are required to be displayed.

Sample County Fire Protection District — A-4
Governmental Funds Balance Sheet/Statement of Net Assets
June 30, 2002

	General Fund	Other Funds	Total	Adjustments (Note C)*	Statement of Net Assets
ASSETS					
Cash and investments	$6,505,557	$1,211,192	$7,716,749	$ —	$ 7,716,749
Taxes receivable	1,427,885	52,651	1,480,536	—	1,480,536
Other receivables	567,607	6,874	574,481	—	574,481
Internal receivables	—	12,293	12,293	(12,293)	—
Prepayments	7,763	—	7,763	—	7,763
Inventories	197,308	—	197,308	—	197,308
Capital assets, net of accumulated depreciation (Note A)	—	—	—	5,519,206	5,519,206
Total assets	$8,706,120	$1,283,010	$9,989,130	5,506,913	15,496,043
LIABILITIES					
Accounts payable	$ 73,828	$ 33,171	$ 106,999	—	106,999
Salaries and benefits payable	273,367	—	273,367	—	273,367
Accrued interest payable	—	1,294	1,294	217	1,511
Internal payables	12,293	—	12,293	(12,293)	—
Deferred revenues	1,534,321	42,791	1,577,112	(1,303,366)	273,746
Long-term liabilities (Note B):					
Due within one year	—	—	—	636,655	636,655
Due after one year	—	—	—	3,396,506	3,396,506
Total liabilities	1,893,809	77,256	1,971,065	2,717,719	4,688,784
FUND BALANCES/NET ASSETS					
Fund balances:					
Reserved for inventories	197,308	—	197,308	(197,308)	—
Unreserved, reported in:					
General fund	6,615,003	—	6,615,003	(6,615,003)	—
Debt service funds	—	468,167	468,167	(468,167)	—
Capital projects funds	—	737,587	737,587	(737,587)	—
Total fund balances	6,812,311	1,205,754	8,018,065	(8,018,065)	—
Total liabilities and fund balances	$8,706,120	$1,283,010	$9,989,130		
Net assets:					
Invested in capital assets, net of related debt				2,087,848	2,087,848
Restricted for debt service				468,167	468,167
Unrestricted				8,251,244	8,251,244
Total net assets				$10,807,259	$10,807,259

*Rather than presenting a statement of net assets and a balance sheet for the governmental funds, a single-program government may combine the two statements linked together by the reconciliation. If the explanations for the reconciliation items are not provided on the face of the statement, they are required to be disclosed in the notes. Even if the explanations are provided on the face of the statement, it still may be necessary to provide additional disclosure of certain items as required by paragraph 77. In this example, Note C would provide the details for the main components of the adjustments.

STATEMENT OF ACTIVITIES

The operations of the reporting government should be presented in a format that reports the *net (expense) revenues* of its individual functions. General revenues, contributions to term and permanent endowments, contributions to permanent fund principal, special and extraordinary items, and transfers should be reported separately after the total net expenses of the government's functions, ultimately arriving at the "change in net assets" for the period.

Separate rows and columns should be used to distinguish between the governmental and business-type activities of the primary government and between the primary government and its discretely presented component units. A total column for the primary government should be presented. A total column for the reporting entity and comparative data from the prior year may be presented but are not required.

For most governments, the format illustrated in Exhibit B-1 provides the most appropriate method for displaying the information required to be reported in the statement of activities. However, some governments can modify the statement's format to be more responsive to their particular financial reporting needs or circumstances.

Requirements for the statement of activities are discussed in paragraphs 38–62.

Illustrations

B-1: Standard statement of activities format.

B-2: Statement of activities for a government that allocates indirect expenses to its functions.

B-3: Statement of activities with functions presented in columns, rather than rows. Governments with few functions might consider this approach more appropriate.

B-4: Statement of activities presented on two pages. Governments that choose to report their activities in greater detail may find this approach useful because of the additional space provided.

B-5: Statement of activities for the single-program government in Exhibits A-3 and A-4 engaged in only governmental activities with no component units (see paragraph 136).

B-6 and B-7: Statement of activities presented in combination with the statement of revenues, expenditures, and changes in fund balances for the single-program government in Exhibit B-5.

Using a combination approach requires the reporting government to reformat either the statement of revenues, expenditures, and changes in fund balances or the statement of activities. In Exhibit B-6, the governmental fund statement is modified to align with the statement of activities. Exhibit B-7 realigns the statement of activities to be compatible with the fund financial statement format. Neither format is preferred over the other, but financial statement preparers who choose to use a combination method should consider the significance of program revenues in determining which format best suits their particular situation. (When program revenues are negligible, as they are in this example, the format on B-7 might be the better choice. On the other hand, significant program revenues may support using the net cost format illustrated on B-6.)

Preparers should also consider that there is a difference in the message communicated to the users depending on the format used. In B-6, the message might be interpreted as "this is how we paid for the cost of the program"; the message from the approach in B-7 could be "this is what we did with the revenues we raised."

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Sample City
Statement of Activities
For the Year Ended December 31, 2002

The detail presented for governmental activities represents the *minimum* requirement. Governments are encouraged to provide more details—for example, police, fire, EMS, and inspections—rather than simply "public safety."

Functions/Programs	Expenses	Program Revenues: Charges for Services	Program Revenues: Operating Grants and Contributions	Program Revenues: Capital Grants and Contributions
Primary government:				
Governmental activities:				
General government	$ 9,571,410	$ 3,146,915	$ 843,617	$ —
Public safety	34,844,749	1,198,855	1,307,693	62,300
Public works	10,128,538	850,000	—	2,252,615
Engineering services	1,299,645	704,793	—	—
Health and sanitation	6,738,672	5,612,267	575,000	—
Cemetery	735,866	212,496	—	—
Culture and recreation	11,532,350	3,995,199	2,450,000	—
Community development	2,994,389	—	—	2,580,000
Education (payment to school district)	21,893,273	—	—	—
Interest on long-term debt	6,068,121	—	—	—
Total governmental activities	105,807,013	15,720,525	5,176,310	4,894,915
Business-type activities:				
Water	3,595,733	4,159,350	—	1,159,909
Sewer	4,912,853	7,170,533	—	486,010
Parking facilities	2,796,283	1,344,087	—	—
Total business-type activities	11,304,869	12,673,970	—	1,645,919
Total primary government	$ 117,111,882	$28,394,495	$5,176,310	$6,540,834
Component units:				
Landfill	$ 3,382,157	$ 3,857,858	$ —	$ 11,397
Public school system	31,186,498	705,765	3,937,083	—
Total component units	$ 34,568,655	$ 4,563,623	$3,937,083	$ 11,397

General revenues:
Taxes:
Property taxes, levied for general purposes
Property taxes, levied for debt service
Franchise taxes
Public service taxes
Payment from Sample City
Grants and contributions not restricted to specific programs
Investment earnings
Miscellaneous
Special item—Gain on sale of park land
Transfers
Total general revenues, special items, and transfers
Change in net assets
Net assets—beginning
Net assets—ending

Net (Expense) Revenue and Changes in Net Assets			
Primary Government			
Governmental Activities	Business-type Activities	Total	Component Units
$ (5,580,878)	$ —	$ (5,580,878)	$ —
(32,275,901)	—	(32,275,901)	—
(7,025,923)	—	(7,025,923)	—
(594,852)	—	(594,852)	—
(551,405)	—	(551,405)	—
(523,370)	—	(523,370)	—
(5,087,151)	—	(5,087,151)	—
(414,389)	—	(414,389)	—
(21,893,273)	—	(21,893,273)	—
(6,068,121)	—	(6,068,121)	—
(80,015,263)	—	(80,015,263)	—
—	1,723,526	1,723,526	—
—	2,743,690	2,743,690	—
—	(1,452,196)	(1,452,196)	—
—	3,015,020	3,015,020	—
(80,015,263)	3,015,020	(77,000,243)	—
—	—	—	487,098
—	—	—	(26,543,650)
—	—	—	(26,056,552)
51,693,573	—	51,693,573	—
4,726,244	—	4,726,244	—
4,055,505	—	4,055,505	—
8,969,887	—	8,969,887	—
—	—	—	21,893,273
1,457,820	—	1,457,820	6,461,708
1,958,144	601,349	2,559,493	881,763
884,907	104,925	989,832	22,464
2,653,488	—	2,653,488	—
501,409	(501,409)	—	—
76,900,977	204,865	77,105,842	29,259,208
(3,114,286)	3,219,885	105,599	3,202,656
126,673,160	82,349,309	209,022,469	16,025,971
$123,558,874	$85,569,194	$209,128,068	$ 19,228,627

Sample City
Statement of Activities
For the Year Ended December 31, 2002

Indirect expenses are presented in a separate column to enhance comparability (of direct expenses by function) between governments that allocate indirect expenses and those that do not.

			Program Revenues		
Functions/Programs	**Expenses**	**Indirect Expenses Allocation**	**Charges for Services**	**Operating Grants and Contributions**	**Capital Grants and Contributions**
Primary government:					
Governmental activities:					
General government	$ 9,571,410	$(5,580,878)	$ 3,146,915	$ 843,617	$ —
Public safety	34,844,749	4,059,873	1,198,855	1,307,693	62,300
Public works	10,128,538	3,264,380	850,000	—	2,252,615
Engineering services	1,299,645	111,618	704,793	—	—
Health and sanitation	6,738,672	558,088	5,612,267	575,000	—
Cemetery	735,866	55,809	212,496	—	—
Culture and recreation	11,532,350	1,858,966	3,995,199	2,450,000	—
Community development	2,994,389	1,740,265	—	—	2,580,000
Education (payment to school district)	21,893,273	—	—	—	—
Interest on long-term debt	6,068,121	(6,068,121)	—	—	—
Total governmental activities	105,807,013	$ 0	15,720,525	5,176,310	4,894,915
Business-type activities:					
Water	3,595,733		4,159,350	—	1,159,909
Sewer	4,912,853		7,170,533	—	486,010
Parking facilities	2,796,283		1,344,087	—	—
Total business-type activities	11,304,869		12,673,970	—	1,645,919
Total primary government	$ 117,111,882		$28,394,495	$5,176,310	$6,540,834
Component units:					
Landfill	$ 3,382,157		$ 3,857,858	$ —	$ 11,397
Public school system	31,186,498		705,765	3,937,083	—
Total component units	$ 34,568,655		$ 4,563,623	$3,937,083	$ 11,397

General revenues:
Taxes:
Property taxes, levied for general purposes
Property taxes, levied for debt service
Franchise taxes
Public service taxes
Payment from Sample City
Grants and contributions not restricted to specific programs
Investment earnings
Miscellaneous
Special item—Gain on sale of park land
Transfers
Total general revenues, special items, and transfers
Change in net assets
Net assets—beginning
Net assets—ending

Net (Expense) Revenue and Changes in Net Assets			
Primary Government			
Governmental Activities	Business-type Activities	Total	Component Units
$ —	$ —	$ —	$ —
(36,335,774)	—	(36,335,774)	—
(10,290,303)	—	(10,290,303)	—
(706,470)	—	(706,470)	—
(1,109,493)	—	(1,109,493)	—
(579,179)	—	(579,179)	—
(6,946,117)	—	(6,946,117)	—
(2,154,654)	—	(2,154,654)	—
(21,893,273)	—	(21,893,273)	—
—	—	—	—
(80,015,263)	—	(80,015,263)	—
—	1,723,526	1,723,526	—
—	2,743,690	2,743,690	—
—	(1,452,196)	(1,452,196)	—
—	3,015,020	3,015,020	—
(80,015,263)	3,015,020	(77,000,243)	—
—	—	—	487,098
—	—	—	(26,543,650)
—	—	—	(26,056,552)
51,693,573	—	51,693,573	—
4,726,244	—	4,726,244	—
4,055,505	—	4,055,505	—
8,969,887	—	8,969,887	—
—	—	—	21,893,273
1,457,820	—	1,457,820	6,461,708
1,958,144	601,349	2,559,493	881,763
884,907	104,925	989,832	22,464
2,653,488	—	2,653,488	—
501,409	(501,409)	—	—
76,900,977	204,865	77,105,842	29,259,208
(3,114,286)	3,219,885	105,599	3,202,656
126,673,160	82,349,309	209,022,469	16,025,971
$123,558,874	$85,569,194	$209,128,068	$ 19,228,627

The minimum requirement established in paragraph 41 is to report direct expenses for each function. The additional details shown here (natural classifications) are not required, but are presented to demonstrate how this modified format can accommodate more information.

As a practical matter, it is likely that only governments with few functions within a single category and no component units would find this approach to be a viable alternative. For example, if this government had two business-type activities, four more columns would be needed (two for the BTA programs, one for total BTAs, and one for the total primary government).

Sample Township **B-3**
Statement of Activities
For the Year Ended December 31, 2002

	Total	Administration	General Assistance	Roads and Bridges	Debt Service
Expenses:					
Salaries, wages, and benefits	$ 63,394,761	$8,366,769	$49,313,900	$ 5,714,092	$ —
Materials and supplies	15,856,788	54,321	12,345,678	3,456,789	—
Other program expenses	16,100,539	875,320	14,282,961	942,258	—
Depreciation	4,386,804	275,000	2,796,760	1,315,044	—
Interest on debt	6,068,121	—	—	—	6,068,121
Total expenses	105,807,013	9,571,410	78,739,299	11,428,183	6,068,121
Program revenues:					
Charges for services	15,720,525	3,146,915	11,018,817	1,554,793	—
Operating grants and contributions	5,238,610	843,617	4,394,993	—	—
Capital grants and contributions	4,832,615	—	2,580,000	2,252,615	—
Net program expense	80,015,263	5,580,878	60,745,489	7,620,775	6,068,121
General revenues:					
Taxes:					
Real estate	56,136,722				
Others	16,408,487				
Grants and contributions not restricted to specific programs	1,457,820				
Investment earnings	1,958,144				
Miscellaneous	939,804				
Total general revenues	76,900,977				
Change in net assets	(3,114,286)				
Net assets—beginning	126,673,160				
Net assets—ending	$123,558,874				

This example uses columns instead of rows to report the various functions. For a government with few functions, like this one, it may appear less complicated than the left-to-right, top-to-bottom approach of the standard statement of activities in B-1. In addition, the “Total” column is presented first, rather than all the way to the right. This allows all of the descriptions to follow consecutively in a single column.

Sample City
Statement of Activities
For the Year Ended December 31, 2002

B-4a

Functions/Programs	Expenses	Program Revenues: Charges for Services	Program Revenues: Operating Grants and Contributions	Program Revenues: Capital Grants and Contributions	Net (Expense) Revenue (B-4b)
Primary government:					
Governmental activities:					
General government	$ 9,571,410	$ 3,146,915	$ 843,617	$ —	$ (5,580,878)
Public safety	34,844,749	1,198,855	1,307,693	62,300	(32,275,901)
Public works	10,128,538	850,000	—	2,252,615	(7,025,923)
Engineering services	1,299,645	704,793	—	—	(594,852)
Health and sanitation	6,738,672	5,612,267	575,000	—	(551,405)
Cemetery	735,866	212,496	—	—	(523,370)
Culture and recreation	11,532,350	3,995,199	2,450,000	—	(5,087,151)
Community development	2,994,389	—	—	2,580,000	(414,389)
Education (payment to school district)	21,893,273	—	—	—	(21,893,273)
Interest on long-term debt	6,068,121	—	—	—	(6,068,121)
Total governmental activities	105,807,013	15,720,525	5,176,310	4,894,915	(80,015,263)
Business-type activities:					
Water	3,595,733	4,159,350	—	1,159,909	1,723,526
Sewer	4,912,853	7,170,533	—	486,010	2,743,690
Parking facilities	2,796,283	1,344,087	—	—	(1,452,196)
Total business-type activities	11,304,869	12,673,970	—	1,645,919	3,015,020
Total primary government	$ 117,111,882	$28,394,495	$5,176,310	$6,540,834	$(77,000,243)
Component units:					
Landfill	$ 3,382,157	$ 3,857,858	$ —	$ 11,397	$ 487,098
Public school system	31,186,498	705,765	3,937,083	—	(26,543,650)
Total component units	$ 34,568,655	$ 4,563,623	$3,937,083	$ 11,397	$(26,056,552)

This alternative uses a two-page approach. This first page presents only the program expense and revenue information. The second page (see B-4b) begins with the totals from this page and then presents the general revenues and changes in net assets information. This approach would allow the government to present a far greater number of functions, or to further break down the program expenses into natural classifications (see B-3). Complex governments that want to report a large number of functions or want to provide additional expense information might find this two-page approach to be a practical alternative to the standard format of the statement of activities (see B-1). The added space on the second page also allows governments to provide more details of general revenues.

Sample City
Statement of Activities (continued)
For the Year Ended December 31, 2002

B-4b

	Primary Government			
	Governmental Activities	Business-type Activities	Total	Component Units
Changes in net assets:				
Net (expense) revenue (from B-4a)	$ (80,015,263)	$ 3,015,020	$ (77,000,243)	$(26,056,552)
General revenues:				
Taxes:				
Property taxes, levied for general purposes	51,693,573	—	51,693,573	—
Property taxes, levied for debt service	4,726,244	—	4,726,244	—
Franchise taxes	4,055,505	—	4,055,505	—
Public service taxes	8,969,887	—	8,969,887	—
Payment from Sample City	—	—	—	21,893,273
Grants and contributions not restricted to specific programs	1,457,820	—	1,457,820	6,461,708
Investment earnings	1,958,144	601,349	2,559,493	881,763
Miscellaneous	884,907	104,925	989,832	22,464
Special item—gain on sale of park land	2,653,488	—	2,653,488	—
Transfers—internal activities	501,409	(501,409)	—	—
Total general revenues, special items, and transfers	76,900,977	204,865	77,105,842	29,259,208
Change in net assets	(3,114,286)	3,219,885	105,599	3,202,656
Net assets—beginning	126,673,160	82,349,309	209,022,469	16,025,971
Net assets—ending	$123,558,874	$85,569,194	$209,128,068	$ 19,228,627

Sample County Fire Protection District
Statement of Activities
For the Year Ended June 30, 2002

Expenses:	
Public safety—fire protection:	
Personal services	$ 9,440,023
Materials and services	1,250,788
Depreciation	306,623
Interest	205,779
Total program expenses	11,203,213
Program revenues:	
Charges for services	622,590
Net program expense	10,580,623
General revenues:	
Property taxes	11,412,154
Investment earnings	597,661
Miscellaneous	29,245
Total general revenues	12,039,060
Increase in net assets	1,458,437
Net assets—beginning of the year	9,348,822
Net assets—end of the year	$10,807,259

The natural classifications of expenses are not required. Paragraph 41 requires the total program expense—$11,203,213—to be presented. Nevertheless, for single-program governments, or those that have only a few programs (see B-3), the usefulness of the statement of activities is enhanced with the additional expense details. Similarly, more details of the general revenues also could be presented.

Sample County Fire Protection District
Statement of Govermental Fund Revenues, Expenditures, and Changes in Fund Balances/Statement of Activities
For the Year Ended June 30, 2002

B-6

	General Fund	Other Funds	Total	Adjustments (Note Y)*	Statement of Activities
Expenditures/expenses:					
Fire protection—operations	$10,684,793	$ —	$10,684,793	$ 518,420	$11,203,213
Capital outlay	76,090	219,175	295,265	(295,265)	—
Debt service:					
Principal	5,452	220,000	225,452	(225,452)	—
Interest	1,534	204,028	205,562	(205,562)	—
Total expenditures/expenses	10,767,869	643,203	11,411,072	(207,859)	11,203,213
Program revenues:					
Charges for services	622,590	—	622,590	—	622,590
Net program expense				—	10,580,623
General revenues:					
Property taxes	10,750,111	391,442	11,141,553	270,601	11,412,154
Investment earnings	526,079	71,582	597,661	—	597,661
Miscellaneous	29,245	—	29,245	—	29,245
Transfers—internal activities	(500,000)	500,000	—	—	—
Total general revenues and transfers	10,805,435	963,024	11,768,459	270,601	12,039,060
Excess of revenues and transfers in over expenditures and transfers out	660,156	319,821	979,977	(979,977)	—
Change in net assets				1,458,437	1,458,437
Fund balance/net assets:					
Beginning of the year	6,152,155	885,933	7,038,088	—	9,348,822
End of the year	$ 6,812,311	$1,205,754	$ 8,018,065	$ 0	$10,807,259

*In this example, Note Y would provide the details for the main components of the adjustments (see A-4).

Sample County Fire Protection District

Statement of Governmental Fund Revenues, Expenditures, and Changes in Fund Balances/Statement of Activities For the Year Ended June 30, 2002

	General Fund	Other Funds	Total	Adjustments (Note Y)*	Statement of Activities
Revenues:					
Property taxes	$10,750,111	$ 391,442	$11,141,553	$ 270,601	$11,412,154
Investment earnings	526,079	71,582	597,661	—	597,661
Charges for services	622,590	—	622,590	—	622,590
Miscellaneous	29,245	—	29,245	—	29,245
Total revenues	11,928,025	463,024	12,391,049	270,601	12,661,650
Expenditures/expenses:					
Current:					
Personal services	9,434,005	—	9,434,005	6,018	9,440,023
Materials and services	1,250,788	—	1,250,788	—	1,250,788
Depreciation	—	—	—	306,623	306,623
Capital outlay	76,090	219,175	295,265	(295,265)	—
Debt service:					
Principal	5,452	220,000	225,452	(225,452)	—
Interest	1,534	204,028	205,562	217	205,779
Total expenditures/ expenses	10,767,869	643,203	11,411,072	(207,859)	11,203,213
Excess (deficiency) of revenues over expenditures	1,160,156	(180,179)	979,977	478,460	—
Other financing sources/uses:					
Transfers—internal activities	(500,000)	500,000	—	—	—
Excess (deficiency) of revenues and transfers in over expenditures and transfers out	660,156	319,821	979,977	(979,977)	—
Change in net assets	—	—	—	1,458,437	1,458,437
Fund balances/net assets:					
Beginning of the year	6,152,155	885,933	7,038,088	—	9,348,822
End of the year	$ 6,812,311	$1,205,754	$ 8,018,065	$ 0	$10,807,259

*In this example, Note Y would provide the details for the main components of the adjustments (see A-4).

GOVERNMENTAL FUND FINANCIAL STATEMENTS

The balance sheet should report information about the current financial resources (assets, liabilities, and fund balances) of each major governmental fund and for nonmajor governmental funds in the aggregate. Assets, liabilities, and fund balances of governmental funds should be displayed in a balance sheet format (assets equal liabilities plus fund balances). The statement of revenues, expenditures, and changes in fund balances should report information about the inflows, outflows, and balances of current financial resources of each major governmental fund and for the nonmajor governmental funds in the aggregate. Requirements for governmental fund reporting are discussed in paragraphs 78–90.

Illustrations

C-1: Balance sheets. This example presents the general fund and three major governmental funds. Nonmajor funds are aggregated in an "Other" column. The reconciliation to the statement of net assets is presented on the face of the statement. As illustrated in Exhibit A-4, in some limited circumstances (single-program governments) it is permissible to combine the presentation of the statement of net assets with the fund balance sheets.

C-2: Statements of revenues, expenditures, and changes in fund balances for the government in Exhibit C-1. The reconciliation to the statement of activities is presented as a separate schedule on the following page (Exhibit C-3). Again, some single-program governments may combine the presentation of this statement with the statement of activities, as illustrated in Exhibits B-6 and B-7.

C-3: Reconciliation as an accompanying schedule. The explanation of the differences between the net change in fund balances of governmental funds in Exhibit C-2 and the change in net assets in the statement of activities is presented as a separate schedule, rather than on the face of the statement as in C-1.

Sample City
Balance Sheet
Governmental Funds
December 31, 2002

	General	HUD Programs	Community Redevelopment
ASSETS			
Cash and cash equivalents	$3,418,485	$1,236,523	$ —
Investments	—	—	13,262,695
Receivables, net	3,644,561	2,953,438	353,340
Due from other funds	1,370,757	—	—
Receivables from other governments	—	119,059	—
Liens receivable	791,926	3,195,745	—
Inventories	182,821	—	—
Total assets	$9,408,550	$7,504,765	$13,616,035
LIABILITIES AND FUND BALANCES			
Liabilities:			
Accounts payable	$3,408,680	$ 129,975	$ 190,548
Due to other funds	—	25,369	—
Payable to other governments	94,074	—	—
Deferred revenue	4,250,430	6,273,045	250,000
Total liabilities (Note 2)	7,753,184	6,428,389	440,548
Fund balances:			
Reserved for:			
Inventories	182,821	—	—
Liens receivable	791,926	—	—
Encumbrances	40,292	41,034	119,314
Debt service	—		
Other purposes	—		
Unreserved, reported in:			
General fund	640,327		
Special revenue funds	—	1,035,342	—
Capital projects funds	—	—	13,056,173
Total fund balances	1,655,366	1,076,376	13,175,487
Total liabilities and fund balances	$9,408,550	$7,504,765	$13,616,035

"Designations" of unreserved fund balances may be displayed or disclosed in the notes.

Explanations of the reconciling amounts need not be as detailed as the ones illustrated here. In some cases, detailed explanations on the face of the statements may eliminate the need for further descriptions in the notes. On the other hand, long, complicated explanations on the statement may distract the users' attention from the other information presented. Preparers should weigh the advantages of eliminating the need for users to refer to the notes against the possible disadvantage of overloading the statement with information. In some situations, however, additional disclosure of reconciling items is required, as discussed in paragraph 77.

The reconciliation could be presented on an accompanying page, rather than on the face of the statement. (See the separate reconciliation example in C-3.)

C-1

Route 7 Construction	Other Governmental Funds (See H-1)	Total Governmental Funds
$ —	$ 5,606,792	$ 10,261,800
10,467,037	3,485,252	27,214,984
11,000	10,221	6,972,560
—	—	1,370,757
—	1,596,038	1,715,097
—	—	3,987,671
—	—	182,821
$10,478,037	$10,698,303	$ 51,705,690
$ 1,104,632	$ 1,074,831	$ 5,908,666
—	—	25,369
—	—	94,074
11,000	—	10,784,475
1,115,632	1,074,831	16,812,584
—	—	182,821
—	—	791,926
5,792,587	1,814,122	7,807,349
	3,832,062	3,832,062
	1,405,300	1,405,300
—	—	640,327
—	1,330,718	2,366,060
3,569,818	1,241,270	17,867,261
9,362,405	9,623,472	34,893,106
$10,478,037	$10,698,303	

Amounts reported for *governmental activities* in the statement of net assets (A-1) are different because (see Note 4, also):	
Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds.	161,082,708
Other long-term assets are not available to pay for current-period expenditures and therefore are deferred in the funds.	9,348,876
Internal service funds are used by management to charge the costs of certain activities, such as insurance and telecommunications, to individual funds. The assets and liabilities of the internal service funds are included in governmental activities in the statement of net assets (see D-1).	2,994,691
Long-term liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds (see Note 4a).	(84,760,507)
Net assets of governmental activities	$123,558,874

Sample City
Statement of Revenues, Expenditures, and Changes in Fund Balances
Governmental Funds
For the Year Ended December 31, 2002

	General	HUD Programs	Community Redevelopment
REVENUES			
Property taxes	$51,173,436	$ —	$ —
Franchise taxes	4,055,505	—	—
Public service taxes	8,969,887	—	—
Fees and fines	606,946	—	—
Licenses and permits	2,287,794	—	—
Intergovernmental	6,119,938	2,578,191	—
Charges for services	11,374,460	—	—
Investment earnings	552,325	87,106	549,489
Miscellaneous	881,874	66,176	—
Total revenues	86,022,165	2,731,473	549,489
EXPENDITURES			
Current:			
General government	8,630,835	—	417,814
Public safety	33,729,623	—	—
Public works	4,975,775	—	—
Engineering services	1,299,645	—	—
Health and sanitation	6,070,032	—	—
Cemetery	706,305	—	—
Culture and recreation	11,411,685	—	—
Community development	—	2,954,389	—
Education—payment to school district	21,893,273	—	—
Debt service:			
Principal	—	—	—
Interest and other charges	—	—	—
Capital outlay	—	—	2,246,671
Total expenditures	88,717,173	2,954,389	2,664,485
Excess (deficiency) of revenues over expenditures	(2,695,008)	(222,916)	(2,114,996)
OTHER FINANCING SOURCES (USES)			
Proceeds of refunding bonds	—	—	—
Proceeds of long-term capital-related debt	—	—	17,529,560
Payment to bond refunding escrow agent	—	—	—
Transfers in	129,323	—	—
Transfers out	(2,163,759)	(348,046)	(2,273,187)
Total other financing sources and uses	(2,034,436)	(348,046)	15,256,373
SPECIAL ITEM			
Proceeds from sale of park land	3,476,488	—	—
Net change in fund balances (see C-3)	(1,252,956)	(570,962)	13,141,377
Fund balances—beginning	2,908,322	1,647,338	34,110
Fund balances—ending	$ 1,655,366	$1,076,376	$13,175,487

C-2

Route 7 Construction	Other Governmental Funds (See H-2)	Total Governmental Funds
$ —	$ 4,680,192	$ 55,853,628
—	—	4,055,505
—	—	8,969,887
—	—	606,946
—	—	2,287,794
—	2,830,916	11,529,045
—	30,708	11,405,168
270,161	364,330	1,823,411
2,939	94	951,083
273,100	7,906,240	97,482,467
16,700	121,052	9,186,401
—	—	33,729,623
—	3,721,542	8,697,317
—	—	1,299,645
—	—	6,070,032
—	—	706,305
—	—	11,411,685
—	—	2,954,389
—	—	21,893,273
—	3,450,000	3,450,000
—	5,215,151	5,215,151
11,281,769	3,190,209	16,718,649
11,298,469	15,697,954	121,332,470
(11,025,369)	(7,791,714)	(23,850,003)
—	38,045,000	38,045,000
—	1,300,000	18,829,560
—	(37,284,144)	(37,284,144)
—	5,551,187	5,680,510
—	(219,076)	(5,004,068)
—	7,392,967	20,266,858
—	—	3,476,488
(11,025,369)	(398,747)	(106,657)
20,387,774	10,022,219	34,999,763
$ 9,362,405	$ 9,623,472	$ 34,893,106

The reconciliation of the net change in fund balances of governmental funds to the change in net assets in the statement of activities is presented in an accompanying schedule on the next page (see C-3).

Sample City **C-3**

Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances of Governmental Funds to the Statement of Activities

For the Year Ended December 31, 2002

Net change in fund balances—total governmental funds (from C-2)	$ (106,657)
Amounts reported for *governmental activities* in the statement of activities (B-1) are different because (see Note 5, also):	
Governmental funds report capital outlays as expenditures. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives as depreciation expense. This is the amount by which capital outlays exceeded depreciation in the current period.	14,039,717
In the statement of activities, only the *gain* on the sale of the park land is reported, whereas in the governmental funds, the proceeds from the sale increase financial resources. Thus, the change in net assets differs from the change in fund balance by the cost of the land sold.	(823,000)
Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds.	1,920,630
Bond proceeds provide current financial resources to governmental funds, but issuing debt increases long-term liabilities in the statement of net assets. Repayment of bond principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets. This is the amount by which proceeds exceeded repayments (see Note 5a).	(16,140,416)
Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds.	(1,245,752)
Internal service funds are used by management to charge the costs of certain activities, such as insurance and telecommunications, to individual funds. The net revenue (expense) of the internal service funds is reported with governmental activities (see D-3).	(758,808)
Change in net assets of governmental activities (see B-1)	$ (3,114,286)

> The reconciliation could be presented on the face of the statement, rather than on a separate page. (See the reconciliation in C-1.)

PROPRIETARY FUND FINANCIAL STATEMENTS

Assets and liabilities of proprietary funds should be presented in a classified format to distinguish between current and long-term assets and liabilities. Governments may use either a net assets format—*assets less liabilities equal net assets*—or a balance sheet format—*assets equal liabilities plus net assets.*

The operating results for proprietary funds should be presented in the statement of revenues, expenses, and changes in fund net assets. Revenues should be reported by major source and should identify revenues used as security for revenue bonds. This statement should also distinguish between operating and nonoperating revenues and expenses and present a separate subtotal for operating revenues, operating expenses, and operating income. Nonoperating revenues and expenses should be reported after operating income. Revenues from capital contributions and additions to the principal of permanent and term endowments; special and extraordinary items; and transfers should be reported separately, after nonoperating revenues and expenses.

The direct method of presenting cash flows from operating activities is required in the statement of cash flows.

Requirements for proprietary fund reporting are discussed in paragraphs 91–105.

Illustrations

D-1: Statement of net assets. Illustrates the net assets format, the balance sheet format (D-2) also may be used.

D-2: Balance sheet. Illustrates the balance sheet format, the net assets format (D-1) also may be used.

D-3: Statement of revenues, expenses, and changes in fund net assets.

D-4: Statement of cash flows, using the direct method for reporting cash flows from operating activities.

This statement illustrates the "net assets" format; the "balance sheet" format also is permitted (see D-2). Classification of assets and liabilities is required in either case.

Sample City
Statement of Net Assets
Proprietary Funds
December 31, 2002

D-1

	Business-type Activities—Enterprise Funds			Governmental Activities—Internal Service Funds (See H-3) (Note 4)
	Water and Sewer	Parking Facilities	Totals	
ASSETS				
Current assets:				
Cash and cash equivalents	$ 8,416,653	$ 369,168	$ 8,785,821	$ 3,336,099
Investments	—	—	—	150,237
Receivables, net	3,564,586	3,535	3,568,121	157,804
Due from other governments	41,494	—	41,494	—
Inventories	126,674	—	126,674	139,328
Total current assets	12,149,407	372,703	12,522,110	3,783,468
Noncurrent assets:				
Restricted cash and cash equivalents	—	1,493,322	1,493,322	—
Capital assets:				
Land	813,513	3,021,637	3,835,150	—
Distribution and collection systems	39,504,183	—	39,504,183	—
Buildings and equipment	106,135,666	23,029,166	129,164,832	14,721,786
Less accumulated depreciation	(15,328,911)	(5,786,503)	(21,115,414)	(5,781,734)
Total noncurrent assets	131,124,451	21,757,622	152,882,073	8,940,052
Total assets	143,273,858	22,130,325	165,404,183	12,723,520
LIABILITIES				
Current liabilities:				
Accounts payable	447,427	304,003	751,430	780,570
Due to other funds	175,000	—	175,000	1,170,388
Compensated absences	112,850	8,827	121,677	237,690
Claims and judgments	—	—	—	1,687,975
Bonds, notes, and loans payable	3,944,609	360,000	4,304,609	249,306
Total current liabilities	4,679,886	672,830	5,352,716	4,125,929
Noncurrent liabilities:				
Compensated absences	451,399	35,306	486,705	—
Claims and judgments	—	—	—	5,602,900
Bonds, notes, and loans payable	54,451,549	19,544,019	73,995,568	—
Total noncurrent liabilities	54,902,948	19,579,325	74,482,273	5,602,900
Total liabilities	59,582,834	20,252,155	79,834,989	9,728,829
NET ASSETS				
Invested in capital assets, net of related debt	72,728,293	360,281	73,088,574	8,690,746
Restricted for debt service	—	1,451,996	1,451,996	—
Unrestricted	10,962,731	65,893	11,028,624	(5,696,055)
Total net assets	$ 83,691,024	$ 1,878,170	$ 85,569,194	$ 2,994,691

Even though internal service funds are classified as proprietary funds, the nature of the activity accounted for in them is generally *governmental.* By reporting internal service funds separately from the proprietary funds that account for business-type activities, the information in the "Totals" column on this statement flows directly to the "Business-type Activities" column on the statement of net assets, and the need for a reconciliation on this statement is avoided.

This statement illustrates the "balance sheet" format; the "net assets" format is also permitted (see D-1). Classification of assets and liabilities is required in either case.

Sample City
Balance Sheet
Proprietary Funds
December 31, 2002

D-2

	Business-type Activities—Enterprise Funds			Governmental Activities—Internal Service Funds (See H-3) (Note 4)
	Water and Sewer	**Parking Facilities**	**Totals**	
ASSETS				
Current assets:				
Cash and cash equivalents	$ 8,416,653	$ 369,168	$ 8,785,821	$ 3,336,099
Investments	—	—	—	150,237
Receivables, net	3,564,586	3,535	3,568,121	157,804
Due from other governments	41,494	—	41,494	—
Inventories	126,674	—	126,674	139,328
Total current assets	12,149,407	372,703	12,522,110	3,783,468
Noncurrent assets:				
Restricted cash and cash equivalents	—	1,493,322	1,493,322	—
Capital assets:				
Land	813,513	3,021,637	3,835,150	—
Distribution and collection systems	39,504,183	—	39,504,183	—
Buildings and equipment	145,639,849	23,029,166	168,669,015	14,721,786
Less accumulated depreciation	(15,328,911)	(5,786,503)	(21,115,414)	(5,781,734)
Total noncurrent assets	131,124,451	21,757,622	152,882,073	8,940,052
Total assets	$143,273,858	$22,130,325	$165,404,183	$12,723,520
LIABILITIES				
Current liabilities:				
Accounts payable	$ 447,427	$ 304,003	$ 751,430	$ 780,570
Due to other funds	175,000	—	175,000	1,170,388
Compensated absences	112,850	8,827	121,677	237,690
Claims and judgments	—	—	—	1,687,975
Bonds, notes, and loans payable	3,944,609	360,000	4,304,609	249,306
Total current liabilities	4,679,886	672,830	5,352,716	4,125,929
Noncurrent liabilities:				
Compensated absences	451,399	35,306	486,705	—
Claims and judgments	—	—	—	5,602,900
Bonds, notes, and loans payable	54,451,549	19,544,019	73,995,568	—
Total noncurrent liabilities	54,902,948	19,579,325	74,482,273	5,602,900
Total liabilities	59,582,834	20,252,155	79,834,989	9,728,829
NET ASSETS				
Invested in capital assets, net of related debt	72,728,293	360,281	73,088,574	8,690,746
Restricted for debt service	—	1,451,996	1,451,996	—
Unrestricted	10,962,731	65,893	11,028,624	(5,696,055)
Total net assets	83,691,024	1,878,170	85,569,194	2,994,691
Total liabilities and net assets	$143,273,858	$22,130,325	$165,404,183	$12,723,520

Even though internal service funds are classified as proprietary funds, the nature of the activity accounted for in them is generally *governmental.* By reporting internal service funds separately from the proprietary funds that account for business-type activities, the information in the "Totals" column on this statement flows directly to the "Business-type Activities" column on the statement of net assets, and the need for a reconciliation on this statement is avoided.

Sample City **D-3**

Statement of Revenues, Expenses, and Changes in Fund Net Assets
Proprietary Funds
For the Year Ended December 31, 2002

	Business-type Activities— Enterprise Funds			Governmental Activities— Internal Service Funds (See H-3) (Note 5)
	Water and Sewer	Parking Facilities	Totals	
Operating revenues:				
Charges for services	$11,329,883	$ 1,340,261	$12,670,144	$15,256,164
Miscellaneous	—	3,826	3,826	1,066,761
Total operating revenues	11,329,883	1,344,087	12,673,970	16,322,925
Operating expenses:				
Personal services	3,400,559	762,348	4,162,907	4,157,156
Contractual services	344,422	96,032	440,454	584,396
Utilities	754,107	100,726	854,833	214,812
Repairs and maintenance	747,315	64,617	811,932	1,960,490
Other supplies and expenses	498,213	17,119	515,332	234,445
Insurance claims and expenses	—	—	—	8,004,286
Depreciation	1,163,140	542,049	1,705,189	1,707,872
Total operating expenses	6,907,756	1,582,891	8,490,647	16,863,457
Operating income (loss)	4,422,127	(238,804)	4,183,323	(540,532)
Nonoperating revenues (expenses):				
Interest and investment revenue	454,793	146,556	601,349	134,733
Miscellaneous revenue	—	104,925	104,925	20,855
Interest expense	(1,600,830)	(1,166,546)	(2,767,376)	(41,616)
Miscellaneous expense	—	(46,846)	(46,846)	(176,003)
Total nonoperating revenue (expenses)	(1,146,037)	(961,911)	(2,107,948)	(62,031)
Income (loss) before contributions and transfers	3,276,090	(1,200,715)	2,075,375	(602,563)
Capital contributions	1,645,919	—	1,645,919	18,788
Transfers out	(290,000)	(211,409)	(501,409)	(175,033)
Change in net assets	4,632,009	(1,412,124)	3,219,885	(758,808)
Total net assets—beginning	79,059,015	3,290,294	82,349,309	3,753,499
Total net assets—ending	$83,691,024	$ 1,878,170	$85,569,194	$ 2,994,691

Even though internal service funds are classified as proprietary funds, the nature of the activity accounted for in them is generally *governmental*. By reporting internal service funds separately from the proprietary funds that account for business-type activities, the information in the “Totals” column on this statement flows directly to the “Business-type Activities” column on the statement of net assets, and the need for a reconciliation on this statement is avoided.

Sample City
Statement of Cash Flows
Proprietary Funds
For the Year Ended December 31, 2002

CASH FLOWS FROM OPERATING ACTIVITIES
Receipts from customers
Payments to suppliers
Payments to employees
Internal activity—payments to other funds
Claims paid
Other receipts (payments)
Net cash provided by operating activities

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES
Operating subsidies and transfers to other funds

CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES
Proceeds from capital debt
Capital contributions
Purchases of capital assets
Principal paid on capital debt
Interest paid on capital debt
Other receipts (payments)
Net cash (used) by capital and related financing activities

CASH FLOWS FROM INVESTING ACTIVITIES
Proceeds from sales and maturities of investments
Interest and dividends
Net cash provided by investing activities
Net (decrease) in cash and cash equivalents
Balances—beginning of the year
Balances—end of the year

Reconciliation of operating income (loss) to net cash provided (used) by operating activities:
Operating income (loss)
Adjustments to reconcile operating income to net cash provided (used) by operating activities:
Depreciation expense
Change in assets and liabilities:
Receivables, net
Inventories
Accounts and other payables
Accrued expenses
Net cash provided by operating activities

Note: The required information about noncash investing, capital, and financing activities is not illustrated.

Business-type Activities— Enterprise Funds			Governmental Activities— Internal Service Funds (See H-5)
Water and Sewer	Parking Facilities	Totals	
$11,400,200	$ 1,345,292	$ 12,745,492	$15,326,343
(2,725,349)	(365,137)	(3,090,486)	(2,812,238)
(3,360,055)	(750,828)	(4,110,883)	(4,209,688)
(1,296,768)	—	(1,296,768)	—
—	—	—	(8,482,451)
(2,325,483)	—	(2,325,483)	1,061,118
1,692,545	229,327	1,921,872	883,084
(290,000)	(211,409)	(501,409)	(175,033)
4,041,322	8,660,778	12,702,100	—
1,645,919	—	1,645,919	—
(4,194,035)	(144,716)	(4,338,751)	(400,086)
(2,178,491)	(8,895,000)	(11,073,491)	(954,137)
(1,479,708)	(1,166,546)	(2,646,254)	41,616
—	19,174	19,174	131,416
(2,164,993)	(1,526,310)	(3,691,303)	(1,264,423)
—	—	—	15,684
454,793	143,747	598,540	129,550
454,793	143,747	598,540	145,234
(307,655)	(1,364,645)	(1,672,300)	(411,138)
8,724,308	3,227,135	11,951,443	3,747,237
$ 8,416,653	$ 1,862,490	$ 10,279,143	$ 3,336,099
$ 4,422,127	$ (238,804)	$ 4,183,323	$ (540,532)
1,163,140	542,049	1,705,189	1,707,872
653,264	1,205	654,469	31,941
2,829	—	2,829	39,790
(297,446)	(86,643)	(384,089)	475,212
(4,251,369)	11,520	(4,239,849)	(831,199)
$ 1,692,545	$ 229,327	$ 1,921,872	$ 883,084

FIDUCIARY FUND (AND SIMILAR COMPONENT UNITS) FINANCIAL STATEMENTS

Required financial statements for fiduciary funds are the statement of fiduciary net assets and the statement of changes in fiduciary net assets. Fiduciary fund financial statements should include information about all fiduciary funds of the primary government, as well as component units that are fiduciary in nature. The statements should provide a separate column for pension (and other employee benefit) trust funds, investment trust funds, private-purpose trusts, and agency funds. Requirements for fiduciary fund reporting are discussed in paragraphs 106–111.

Illustrations

E-1: Statement of fiduciary net assets

E-2: Statement of changes in fiduciary net assets

Sample City

E-1

Statement of Fiduciary Net Assets
Fiduciary Funds
December 31, 2002

	Employee Retirement Plan	Private-Purpose Trusts	Agency Funds
ASSETS			
Cash and cash equivalents	$ 1,973	$ 1,250	$ 44,889
Receivables:			
Interest and dividends	508,475	760	—
Other receivables	6,826	—	183,161
Total receivables	515,301	760	183,161
Investments, at fair value:			
U.S. government obligations	13,056,037	80,000	—
Municipal bonds	6,528,019	—	—
Corporate bonds	16,320,047	—	—
Corporate stocks	26,112,075	—	—
Other investments	3,264,009	—	—
Total investments	65,280,187	80,000	—
Total assets	65,797,461	82,010	$228,050
LIABILITIES			
Accounts payable	—	1,234	$ —
Refunds payable and others	1,358	—	228,050
Total liabilities	1,358	1,234	$228,050
NET ASSETS			
Held in trust for pension benefits and other purposes	$65,796,103	$80,776	

> Statements of individual pension plans and external investment pools are required to be presented in the notes to the financial statements if separate GAAP statements for those individual plans or pools are not available (see paragraph 106).

Sample City **E-2**

Statement of Changes in Fiduciary Net Assets

Fiduciary Funds

For the Year Ended December 31, 2002

	Employee Retirement Plan	**Private-Purpose Trusts**
ADDITIONS		
Contributions:		
Employer	$ 2,721,341	$ —
Plan members	1,421,233	—
Total contributions	4,142,574	—
Investment earnings:		
Net (decrease) in fair value of investments	(272,522)	—
Interest	2,460,871	4,560
Dividends	1,445,273	—
Total investment earnings	3,633,622	4,560
Less investment expense	216,428	—
Net investment earnings	3,417,194	4,560
Total additions	7,559,768	4,560
DEDUCTIONS		
Benefits	2,453,047	3,800
Refunds of contributions	464,691	—
Administrative expenses	87,532	678
Total deductions	3,005,270	4,478
Change in net assets	4,554,498	82
Net assets—beginning of the year	61,241,605	80,694
Net assets—end of the year	$65,796,103	$80,776

Statements of individual pension plans and external investment pools are required to be presented in the notes to the financial statements if separate GAAP statements for those individual plans or pools are not available (see paragraph 106).

COMBINING STATEMENTS FOR MAJOR COMPONENT UNITS

Paragraph 51 of Statement 14, as amended by this Statement, requires information about each major component unit to be provided in the basic financial statements of the reporting entity. Governments can satisfy that requirement by (a) presenting each major component unit in a separate column in the reporting entity's statements of net assets and activities, (b) including combining statements of major component units in the reporting entity's basic statements after the fund financial statements, or (c) presenting condensed financial statements in the notes to the reporting entity's financial statements.

Illustrations

F-1: Statement of net assets displaying the major component units (the combining statement approach). Nonmajor component units, if any, would be presented in the aggregate. This statement is part of the basic statements but is not required if the government presents each major component unit in a separate column in the reporting entity's statement of net assets, or presents condensed financial statements in the notes. The level of detail in this illustration exceeds the minimum requirements established in paragraph 127 for condensed financial statement disclosures. An illustration of the disclosure method is presented in Note 3.

F-2: Statement of activities displaying the major component units in a standard net cost format. Nonmajor component units, if any, would be presented in the aggregate. This statement is part of the basic statements, but is not required if the government presents each major component unit in a separate column in the reporting entity's statement of activities, or presents condensed financial statements in the notes. An illustration of the disclosure method is presented in Note 3.

Sample City
Statement of Net Assets
Component Units
December 31, 2002

	Sample City School District	Sample City Landfill	Total
ASSETS			
Cash and cash equivalents	$ 303,485	$ 450	$ 303,935
Investments	3,658,520	1,770,432	5,428,952
Receivables, net	3,717,026	325,264	4,042,290
Inventories	83,697	—	83,697
Restricted assets— landfill closure	—	2,000,000	2,000,000
Capital assets, net (Note 1)	34,759,986	2,984,800	37,744,786
Total assets	42,522,714	7,080,946	49,603,660
LIABILITIES			
Accounts payable	1,469,066	334,266	1,803,332
Deposits and deferred revenue	38,911	—	38,911
Long-term liabilities (Note 2):			
Due within one year	1,426,639	—	1,426,639
Due in more than one year	22,437,349	4,668,802	27,106,151
Total liabilities	25,371,965	5,003,068	30,375,033
NET ASSETS			
Invested in capital assets, net of related debt	12,921,592	2,984,800	15,906,392
Restricted for capital projects	492,445	—	492,445
Unrestricted	3,736,712	(906,922)	2,829,790
Total net assets	$17,150,749	$2,077,878	$19,228,627

Nonmajor component units would be aggregated into a single column. Combining statements of the nonmajor components would be accorded the same status as combining statements for nonmajor funds (supplementary information).

Sample City
Statement of Activities
Component Units
For the Year Ended December 31, 2002

		Program Revenues		
	Expenses	**Charges for Services**	**Operating Grants and Contributions**	**Capital Grants and Contributions**
Sample City School District				
Instructional	$16,924,321	$ 147,739	$2,825,109	$ —
Support services	7,972,559	300	751,711	—
Operation of non-instructional services	1,523,340	557,726	359,092	—
Facilities acquisition and construction services	48,136	—	1,171	—
Interest on long-term debt	546,382	—	—	—
Unallocated depreciation (Note F)	4,171,760	—	—	—
Total—Sample City School District	31,186,498	705,765	3,937,083	—
Sample City Landfill				
Landfill operations	3,382,157	3,857,858	—	11,397
Total component units	$34,568,655	$4,563,623	$3,937,083	$11,397

General revenues:
Payment from Sample City
Grants, entitlements, and contributions not restricted to specific programs
Investment earnings
Miscellaneous
Total general revenues
Change in net assets
Net assets—beginning
Net assets—ending

Net (Expense) Revenue and Changes in Net Assets		
School District	Landfill	Totals
$(13,951,473)	$ —	$(13,951,473)
(7,220,548)	—	(7,220,548)
(606,522)	—	(606,522)
(46,965)	—	(46,965)
(546,382)	—	(546,382)
(4,171,760)	—	(4,171,760)
(26,543,650)	—	—
—	487,098	487,098
		(26,056,552)
21,893,273	—	21,893,273
6,461,708	—	6,461,708
674,036	207,727	881,763
19,950	2,514	22,464
29,048,967	210,241	29,259,208
2,505,317	697,339	3,202,656
14,645,432	1,380,539	16,025,971
$ 17,150,749	$2,077,878	$ 19,228,627

NOTES TO THE FINANCIAL STATEMENTS

These sample note disclosures are presented only to illustrate the specific disclosure requirements of this Statement. Other disclosures such as the additional significant accounting policies that will result from implementing this Statement are not illustrated. NCGA Interpretation 6, as amended by this Statement and other pronouncements, provides the requirements for a complete set of notes. These sample notes are illustrative only and are not meant to imply that the specific terminology and formats presented are required.

Illustrations

Note 1: Information about capital assets. This disclosure is required by paragraph 117. It presents the beginning and ending balances and increases and decreases for the year for each major class of capital asset and the related accumulated depreciation. Also, paragraph 117d requires disclosure of the depreciation expense charged to each of the functions/programs in the statement of activities. For governments that have a significant amount of capital assets that are not being depreciated (see paragraph 20), separate disclosure of capital assets being depreciated and those that are not, is required (not illustrated here).

There are many different ways to present the required disclosures—only one method has been illustrated. For example, some governments may find it more informative to reverse the columns and rows in the disclosure; that is, present the assets categories as column headings and explain the changes going down the page. More complete explanations could be provided using that approach.

Note 2: Information about long-term liabilities. This disclosure is required by paragraph 119. It presents the beginning and ending balances and increases and decreases for the year for each major type of long-term liability. In addition, paragraphs 119c and d require disclosure of the portion of each item that is due within one year, and which governmental funds have liquidated the long-term operating liabilities in the past. Other presentation techniques may be used.

Note 3: Major component unit information. Paragraph 51 of Statement 14 requires information about each major component unit to be included in the basic financial statements of the reporting entity. Paragraph 126 of this Statement explains how to implement that requirement in this model. This sample disclosure illustrates the minimum requirements; governments may provide more details than illustrated.

Notes 4a and 5a: Detailed reconciliation information. Limited additional disclosure like this may be appropriate when the summary reconciliation on the face of the statement already provides adequate explanation of most items. The detailed explanations of net or combined adjustments are required by paragraph 77.

Notes 4b and 5b: Detailed reconciliation information. Additional disclosure may be appropriate when the summarized explanations on the face of the statement are not adequately descriptive, or when the reporting government believes the additional explanations are essential to the users' understanding of the reconciliation.

Note 5c: Detailed reconciliation information. This is another example of detailed disclosures that may be necessary if the summarized explanations on the face of the statement are not adequately descriptive. (Only Note 5 is illustrated; Note 4 would be presented in the same manner, but is not included here.)

Note 6: Disclosure of segment information. This disclosure is required by paragraph 122. The segments in this illustrative note comprise two departments (that meet the criteria as segments) reported in a single fund. If a segment is reported as a major fund, the required information is already presented; therefore, the disclosures illustrated here would not be required.

Note 1—Illustrative Disclosure of Information about Capital Assets

Capital asset activity for the year ended December 31, 2002 was as follows (in thousands):

	Primary Government			
	Beginning Balance	**Additions**	**Retirements**	**Ending Balance**
Governmental activities:				
Land†	$ 29,484	$ 2,020	$(4,358)	$ 27,146
Buildings and improvements	40,861	334	—	41,195
Equipment	32,110	1,544	(1,514)	32,140
Infrastructure†	94,575	13,220	—	107,795
Totals at historical cost	197,030	17,118	(5,872)	208,276
Less accumulated depreciation for:				
Buildings and improvements	(10,358)	(691)	—	(11,049)
Equipment	(9,247)	(2,676)	1,040	(10,883)
Infrastructure†	(15,301)	(1,020)	—	(16,321)
Total accumulated depreciation	(34,906)	(4,387)*	1,040	(38,253)
Governmental activities capital assets, net	$162,124	$12,731	$(4,832)	$170,023
Business-type activities:				
Land†	$ 3,691	$ 145	$ —	$ 3,836
Distribution and collection systems	36,977	2,527	—	39,504
Buildings and equipment	126,370	2,827	(32)	129,165
Totals at historical cost	167,038	5,499	(32)	172,505
Less accumulated depreciation for:				
Distribution and collection systems	(7,654)	(897)	—	(8,551)
Buildings and equipment	(11,789)	(808)	32	(12,565)
Business-type activities capital assets, net	$147,595	$ 3,794	$ 0	$151,389

*Depreciation expense was charged to governmental functions as follows:

General government	$ 275
Public safety	330
Public works, which includes the depreciation of general infrastructure assets†	1,315
Health and sanitation	625
Cemetery	29
Culture and recreation	65
Community development	40
In addition, depreciation on capital assets held by the City's internal service funds (see D-3) is charged to the various functions based on their usage of the assets.	1,708
Total depreciation expense	$4,387

†Capital assets that are not being depreciated, as discussed in paragraph 20, would be reported separately in this note. In addition, there would be no accumulated depreciation or depreciation expense for infrastructure assets subject to the modified approach.

Note: Disclosures similar to those above for component units' balances and changes would be made in accordance with the guidelines set forth in paragraph 63 of Statement 14, as amended.

Note 2—Illustrative Disclosure of Information about Long-term Liabilities

Long-term liability activity for the year ended December 31, 2002 was as follows (in thousands):

	Beginning Balance	Additions	Reductions	Ending Balance†	Amounts Due within One Year
GOVERNMENTAL ACTIVITIES					
Bonds and notes payable:					
General obligation debt	$32,670	$22,205	$(22,300)	$32,575	$2,729
Revenue bonds	14,485	15,840	(14,485)	15,840	1,040
Redevelopment agency bonds	14,965	18,000	(540)	32,425	1,300
Special assessment bonds	—	1,300	—	1,300	92
Equipment note	1,203	—	(954)	249	249
	63,323	57,345	(38,279)	82,389	5,410
Less deferred amount on refundings	—	(3,409)	341	(3,068)	—
Total bonds and notes payable	63,323	53,936	(37,938)	79,321	5,410
Other liabilities:					
Compensated absences	5,537	2,744	(2,939)	5,342	2,138
Claims and judgments	8,070	2,669	(2,864)	7,875	1,688
Total other liabilities	13,607	5,413	(5,803)	13,217	3,826
Governmental activities long-term liabilities	$76,930	$59,349	$(43,741)	$92,538	$9,236

†As explained in more detail in Notes 8, 9, and 10 (not illustrated), payments on the bonds and notes payable that pertain to the City's governmental activities are made by the debt service funds, except for the equipment note, which is being repaid directly from the Telecommunications internal service fund. The compensated absences liability attributable to the governmental activities will be liquidated by several of the City's governmental and internal service funds. In the past, approximately 65% has been paid by the General Fund, 10% by the HUD Programs Fund, 10% by the Route 7 Construction Fund, and the remainder by the other governmental and internal service funds.

The claims and judgments liability will generally be liquidated through the City's Casualty Insurance internal service fund (see Note 4, also). The Casualty Insurance Fund will finance the payment of those claims by charging the other funds based on management's assessment of the relative insurance risk that should be assumed by individual funds. Currently, the General Fund bears approximately 85% of the casualty insurance costs; no other individual fund is charged more than 5% of the total amount.

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due within One Year
BUSINESS-TYPE ACTIVITIES					
Bonds and notes payable:					
Water and sewer debt	$56,975	$ 3,600	$ (2,178)	$58,397	$3,944
Parking facilities debt	21,567	9,514	(8,895)	22,186	360
	78,542	13,114	(11,073)	80,583	4,304
Less deferred amount on refundings	(1,207)	(1,329)	254	(2,282)	—
Total bonds and notes payable	77,335	11,785	(10,819)	78,301	4,304
Compensated absences	572	1,286	(1,250)	608	122
Business-type activities long-term liabilities	$77,907	$13,071	$(12,069)	$78,909	$4,426

Note: Disclosures similar to these for component units' balances and changes would be made in accordance with the guidelines set forth in paragraph 63 of Statement 14, as amended.

This schedule need not duplicate the information required to be disclosed by Statement 27. However, if the reporting government has an unpaid pension obligation, that liability should be added to the ending balance so that this schedule agrees with the statement of net assets, if a single amount is reported as long-term liabilities.

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Note 3—Illustrative Disclosure of Major Component Unit Information

This note is required only if the reporting government does not display major component units in separate columns in the government-wide statements or does not include a combining statement in the basic statements. (See F-1 and F-2 for illustrations of the combining statements.)

Condensed Statement of Net Assets

	Sample City School District	Sample City Landfill	Total Component Units
Assets:			
Cash, investments, and other assets	$ 7,762,728	$4,096,146	$11,858,874
Capital assets, net	34,759,986	2,984,800	37,744,786
Total assets	42,522,714	7,080,946	49,603,660
Liabilities:			
Accounts payable and other current liabilities	1,507,977	334,266	1,842,243
Long-term liabilities	23,863,988	4,668,802	28,532,790
Total liabilities	25,371,965	5,003,068	30,375,033
Net assets:			
Invested in capital, net of related debt	12,921,592	2,984,800	15,906,392
Restricted	492,445	—	492,445
Unrestricted (deficit)	3,736,712	(906,922)	2,829,790
Total net assets	$17,150,749	$2,077,878	$19,228,627

Condensed Statement of Activities

		Program Revenues		
	Expenses	**Charges for Services**	**Operating Grants and Contributions**	**Capital Grants and Contributions**
Sample City School District				
Instructional	$16,924,321	$ 147,739	$2,825,109	$ —
Support services	7,972,559	300	751,711	—
Operation of non-instructional services	1,523,340	557,726	359,092	—
Facilities acquisition and construction services	48,136	—	1,171	—
Interest on long-term debt	546,382	—	—	—
Unallocated depreciation (Note F)	4,171,760	—	—	—
Total—Sample City School District	31,186,498	705,765	3,937,083	—
Sample City Landfill				
Landfill operations	3,382,157	3,857,858	—	11,397
Total component units	$34,568,655	$4,563,623	$3,937,083	$11,397

General revenues:
Payment from Sample City
Grants, entitlements, and contributions not restricted to specific programs
Other general revenues
Total general revenues
Change in net assets
Net assets—beginning
Net assets—ending

Net (Expense) Revenue and Changes in Net Assets		
School District	Landfill	Totals
$(13,951,473)	$ —	$(13,951,473)
(7,220,548)	—	(7,220,548)
(606,522)	—	(606,522)
(46,965)	—	(46,965)
(546,382)	—	(546,382)
(4,171,760)	—	(4,171,760)
(26,543,650)	—	—
—	487,098	487,098
		(26,056,552)
21,893,273	—	21,893,273
6,461,708	—	6,461,708
693,986	210,241	904,227
29,048,967	210,241	29,259,208
2,505,317	697,339	3,202,656
14,645,432	1,380,539	16,025,971
$ 17,150,749	$2,077,878	$ 19,228,627

Note 4a—Explanation of Certain Differences between Governmental Fund Balance Sheets and the Statement of Net Assets

Long-term liabilities applicable to the City's governmental activities are not due and payable in the current period and accordingly are not reported as fund liabilities. All liabilities—both current and long-term—are reported in the statement of net assets. Also, during the year the City refunded some of its existing debt. The amount borrowed is received in the governmental funds and increases fund balance. The amount that was sent to the paying agent ($37,284,144) to be escrowed for payment of the old debt ($33,875,000) as it comes due is paid out of governmental funds and reduces fund balance. The difference between those amounts was $3,409,144 and will be amortized as an adjustment of interest expense in the statement of activities over the remaining life of the refunded debt (ten years). Balances at December 31, 2002, were:

Bonds and notes payable	$ 82,140,000
Less deferred interest from refunding	(3,068,230)
Compensated absences	5,104,433
Litigation settlement—general fund	584,304
Net adjustment	$(84,760,507)

This explanation and the one in Note 4a are examples of the disclosure that are required if the summarized reconciliation obscures the nature of the individual elements of a particular reconciling item.

Note 5a—Explanation of Certain Differences between Governmental Fund Statement of Revenues, Expenditures, and Changes in Fund Balances and the Statement of Activities

Bond proceeds are reported as financing sources in governmental funds and thus contribute to the change in fund balance. In the statement of net assets, however, issuing debt increases long-term liabilities and does not affect the statement of activities. Similarly, repayment of principal is an expenditure in the governmental funds, but reduces the liability in the statement of net assets.

Proceeds received:	
Refunding general obligation bonds	$ 22,205,000
Refunding revenue bonds	15,840,000
Redevelopment agency bonds, net of $470,440 accrued interest	17,529,560
Special assessment bonds	1,300,000
Total proceeds	56,874,560
Repayments:	
To paying agent:	
For bond principal	(33,875,000)
Additional amount—deferred interest	(3,409,144)
Total to the paying agent	(37,284,144)
To bondholders	(3,450,000)
Total repayments	(40,734,144)
Net adjustment	$ 16,140,416

This explanation and the one in Note 4a are examples of the disclosure that are required if the summarized reconciliation obscures the nature of the individual elements of a particular reconciling item.

Note 4b—Explanation of Differences between Governmental Funds Balance Sheet and the Statement of Net Assets

"Total fund balances" of the City's governmental funds ($34,893,106) in C-1 differs from "net assets" of governmental activities ($123,558,874) reported in the statement of net assets in A-1. This difference primarily results from the long-term economic focus of the statement of net assets versus the current financial resources focus of the governmental fund balance sheets.

Balance Sheet/Statement of Net Assets

	Total Governmental Funds	Long-term Assets, Liabilities (1)	Internal Service Funds (2)
ASSETS			
Cash and cash equivalents	$10,261,800	$ —	$ 3,336,099
Investments	27,214,984	—	150,237
Receivables, net	6,972,560	—	157,804
Due from other funds	1,370,757	—	—
Due from other governments	1,715,097	—	—
Liens receivable	3,987,671	—	—
Inventories	182,821	—	139,328
Capital assets	—	161,082,708	8,940,052
Total assets	$51,705,690	$161,082,708	$12,723,520
LIABILITIES			
Accounts payable	$ 5,908,666	$ —	$ 780,570
Due to other funds	25,369	—	1,170,388
Due to other governments	94,074	—	—
Deferred revenue	10,784,475	(9,348,876)	—
Long-term liabilities	—	84,760,507	7,777,871
Total liabilities	16,812,584	75,411,631	9,728,829
FUND BALANCES/NET ASSETS			
Total fund balances/net assets	34,893,106	85,671,077	2,994,691
Total liabilities and fund balances/net assets	$51,705,690	$161,082,708	$12,723,520

Reclassifications and Eliminations	Statement of Net Assets Totals
$ —	$ 13,597,899
—	27,365,221
5,702,768	12,833,132
(1,195,757)	175,000
(1,715,097)	—
(3,987,671)	—
—	322,149
—	170,022,760
$(1,195,757)	$224,316,161
$ 94,074	$ 6,783,310
(1,195,757)	—
(94,074)	—
—	1,435,599
—	92,538,378
(1,195,757)	100,757,287
—	123,558,874
$(1,195,757)	$224,316,161

1. When capital assets (land, buildings, equipment) that are to be used in governmental activities are purchased or constructed, the cost of those assets are reported as expenditures in governmental funds. However, the statement of net assets includes those capital assets among the assets of the City as a whole.

Cost of capital assets	$199,336,115
Accumulated depreciation	(38,253,407)
	$161,082,708

Because the focus of governmental funds is on short-term financing, some assets will not be available to pay for current-period expenditures. Those assets (for example, receivables) are offset by deferred revenue in the governmental funds, and thus are not included in fund balance.

Adjustment of deferred revenue	$9,348,876

Long-term liabilities applicable to the City's governmental activities are not due and payable in the current period and accordingly are not reported as fund liabilities. All liabilities—both current and long-term—are reported in the statement of net assets. Also, during the year the City refunded some of its existing debt. The amount borrowed is received in the governmental funds and increases fund balance. The amount that was sent to the paying agent ($37,284,144) to be escrowed for payment of the old debt ($33,875,000) as it comes due is paid out of governmental funds and reduces fund balance. The difference between those amounts was $3,409,144 and will be amortized as an adjustment of interest expense in the statement of activities over the remaining life of the refunded debt (ten years). Balances at December 31, 2002 were:

Bonds and notes payable	$82,140,000
Less deferred interest from refunding	(3,068,230)
Compensated absences	5,104,433
Litigation settlement—general fund	584,304
	$84,760,507

2. Internal service funds are used by management to charge the costs of certain activities, such as insurance and telecommunications, to individual funds. The assets and liabilities of the internal service funds are included in governmental activities in the statement of net assets.

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Note 5b—Explanation of Differences between Governmental Fund Operating Statements and the Statement of Activities

The "net change in fund balances" for governmental funds (-$106,657) in C-2 differs from the "change in net assets" for governmental activities (-$3,114,286) reported in the statement of activities in B-1. The differences arise primarily from the long-term economic focus of the statement of activities versus the current financial resources focus of the governmental funds. The effect of the differences is illustrated below.

Statement of Revenues, Expenditures, and Changes in Fund Balance/Statement of Activities

	Total Governmental Funds	Long-term Revenue, Expenses (3)	Capital Related Items (4)
REVENUES AND OTHER SOURCES			
Taxes	$ 68,879,020	$ 566,189	$ —
Fees and fines	606,946	—	—
Licenses and permits	2,287,794	1,354,441	—
Intergovernmental	11,529,045	—	—
Charges for services	11,405,168	—	—
Interest	1,823,411	—	—
Miscellaneous	951,083	—	—
Other sources:			
Bond proceeds	56,874,560	—	—
Sale of park land	3,476,488	—	(823,000)
Total	157,833,515	1,920,630	(823,000)
EXPENDITURES/EXPENSES			
Current:			
General government	9,186,401	(25,369)	275,000
Public safety	33,729,623	514,368	330,000
Public works	8,697,317	(19,201)	1,315,044
Engineering services	1,299,645	—	—
Health and sanitation	6,070,032	(24,049)	625,000
Cemetery	706,305	673	28,888
Culture and recreation	11,411,685	(12,024)	65,000
Community development	2,954,389	—	40,000
Education—payment to school district	21,893,273	—	—
Debt service:			
Principal	3,450,000	—	—
Interest and other charges	5,215,151	811,354	—
Capital outlay	16,718,649	—	(16,718,649)
Total expenditures/expenses	121,332,470	1,245,752	(14,039,717)
Other financing uses/changes in net assets:			
Net transfers to (from) other funds	(676,442)	—	—
Debt refunding	37,284,144	—	—
Total	157,940,172	1,245,752	(14,039,717)
Net change for the year	$ (106,657)	$ 674,878	$ 13,216,717

Internal Service Funds (5)	Long-term Debt Transactions (6)	Statement of Activities Totals
$ —	$ —	$ 69,445,209
—	—	606,946
—	—	3,642,235
—	—	11,529,045
—	—	11,405,168
134,733	—	1,958,144
—	—	951,083
—	(56,874,560)	—
—	—	2,653,488
134,733	(56,874,560)	102,191,318
135,378	—	9,571,410
270,758	—	34,844,749
135,378	—	10,128,538
—	—	1,299,645
67,689	—	6,738,672
—	—	735,866
67,689	—	11,532,350
—	—	2,994,389
—	—	21,893,273
—	(3,450,000)	—
41,616	—	6,068,121
—	—	—
718,508	(3,450,000)	105,807,013
175,033	—	(501,409)
—	(37,284,144)	—
893,541	(40,734,144)	105,305,604
$(758,808)	$(16,140,416)	$ (3,114,286)

3. Because some property taxes will not be collected for several months after the City's fiscal year ends, they are not considered as "available" revenues in the governmental funds. Similarly, certain license and permit revenues not currently available at year-end are not reported as revenue in the governmental funds.

Property taxes	$ 566,189
Licenses and permits	1,354,441
	1,920,630

Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds.

Net change in operating expense accruals	434,398

Interest expense in the statement of activities differs from the amount reported in governmental funds for two reasons. Accrued interest was deducted from the Redevelopment Agency bond proceeds and the difference arising from the advance refunding mentioned in Note 4b (1) above, is being amortized (added to interest expense for the year).

Accrued interest deducted	470,440
Advance refunding difference	340,914
Total interest adjustment	811,354
Total expenditure adjustment	$1,245,752

4. The proceeds from the sale of land are reported as revenue (as a special item) in the governmental funds. However, the cost of the land sold is removed from the capital assets account in the statement of net assets and offset against the sale proceeds resulting in a "gain on sale of land" in the statement of activities. Thus, more revenue is reported in the governmental funds than gain in the statement of activities.

Cost of land sold	$ 823,000

When capital assets that are to be used in governmental activities are purchased or constructed, the resources expended for those assets are reported as expenditures in governmental funds. However, in the statement of activities, the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. As a result, fund balance decreases by the amount of financial resources expended, whereas net assets decreases by the amount of depreciation expense charged for the year.

Capital outlay	$16,718,649
Depreciation expense	(2,678,932)
Difference	$14,039,717

5. Internal service funds are used by management to charge the costs of certain activities, such as insurance and telecommunications, to individual funds. The adjustments for internal service funds "closes" those funds by charging additional amounts to participating governmental activities to completely cover the internal service funds' costs for the year.

6. Bond proceeds are reported as financing sources in governmental funds and thus contribute to the change in fund balance. In the government-wide statements, however, issuing debt increases long-term liabilities in the statement of net assets and does not affect the statement of activities. Proceeds were received from:

Refunding general obligation bonds	$22,205,000
Refunding revenue bonds	15,840,000
Redevelopment agency bonds, net of $470,440 accrued interest	17,529,560
Special assessment bonds	1,300,000
	$56,874,560

Repayment of bond principal is reported as an expenditure in governmental funds and, thus, has the effect of reducing fund balance because current financial resources have been used. For the City as a whole, however, the principal payments reduce the liabilities in the statement of net assets and do not result in an expense in the statement of activities. The City's bonded debt was reduced in two ways—principal payments were made to bond holders and resources were sent to the bond paying agent for the advance refunding of outstanding bonds.

Transferred to the paying agent:	
For bond principal	$33,875,000
Additional amount—deferred interest	3,409,144
Total to the paying agent	37,284,144
Principal payments made	3,450,000
	$40,734,144

Note 5c—Explanation of Differences between Governmental Fund Operating Statements and the Statement of Activities

Total revenues and other financing sources ($158,509,957) in the governmental funds differs from total revenues for governmental activities ($102,692,727) in the statement of activities. The differences result primarily from the long-term economic focus of the statement of activities versus the current financial resources focus of the governmental funds. The main components of the difference are described below.

Total revenues and other financing sources of the governmental funds (C-2) is composed of:

Revenues	$ 97,482,467
Proceeds of refunding bonds	38,045,000
Proceeds of long-term capital debt	18,829,560
Proceeds from sale of park land	3,476,488
Transfers in (net)	676,442
Total revenues and other sources—governmental funds	158,509,957

Because some property taxes ($566,189) will not be collected for several months after the City's fiscal year ends, they are not considered as "available" revenues in the governmental funds. Similarly, certain license and permit revenues ($1,354,441) are not currently available at year-end and are not reported as revenue in the governmental funds.	1,920,630
The proceeds from the sale of land ($3,476,488) are reported as revenue (as a special item) in the governmental funds. However, the cost of the land sold ($823,000) is removed from the capital assets account in the statement of net assets and offset against the sale proceeds resulting in a "gain on sale of land" in the statement of activities. Thus, more revenue is reported in the governmental funds than the gain in the statement of activities.	(823,000)

Internal service funds are used by management to charge the costs of certain activities, such as insurance and telecommunications to individual funds. The investment earnings ($134,733) of the internal service funds and the net interfund transfers (-$175,033) are reported with governmental activities (see D-3).	(40,300)
Bond proceeds are reported as financing sources in governmental funds and thus contribute to the change in fund balances. In the government-wide statements, however, issuing debt increases long-term liabilities in the statement of net assets and does not affect the statement of activities. Total proceeds ($57,345,000) less $470,440 of accrued interest were:	(56,874,560)

Total revenues of governmental activities in the statement of activities (B-1) comprise:

Charges for services	$15,720,525	
Operating grants and contributions	5,176,310	
Capital grants and contributions	4,894,915	
General revenues, special items, and transfers	76,900,977	
Total revenues of governmental activities		$102,692,727

Total expenditures ($121,332,470) and other financing uses ($37,284,144) of the governmental funds differ from total expenses of governmental activities ($105,807,013) reported in the statement of activities. The difference is attributable primarily to the long-term economic focus of governmental activities versus the current financial resources focus of governmental funds. The main components of the differences are described below.	$158,616,614
Some expenses reported in the statement of activities do not require the use of current financial resources ($434,398) and therefore are not reported as expenditures in governmental funds. Interest expense in the statement of activities differs from the amount reported in governmental funds for two reasons. Accrued interest ($470,440) was deducted from the Redevelopment Agency bond proceeds, and the difference arising from the advance refunding ($340,914 per year), noted below, is being amortized (added to interest expense).	1,245,752
When capital assets that are to be used in governmental activities are purchased or constructed, the resources expended for those assets are reported as expenditures in governmental funds. However, in the statement of activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which capital expenditures ($16,718,649) exceeded depreciation ($2,678,932) in the current period.	(14,039,717)
Internal service funds are “closed” by charging additional amounts to participating governmental activities to completely cover the internal service funds’ costs for the year (see D-3 and the revenue adjustment [$40,300], above).	718,508
Repayment of bond principal is reported as an expenditure in governmental funds. For the City as a whole, however, the principal payments reduce the liabilities in the statement of net assets and do not result in an expense in the statement of activities. The City’s bonded debt was reduced in two ways—principal payments were made to bond holders ($3,450,000), and resources ($37,284,144) were sent to the bond paying agent for the advance refunding of outstanding bonds ($33,875,000). The difference between those amounts was $3,409,144 and will be amortized as an adjustment of interest expense in the statement of activities over the remaining life of the refunded debt (ten years).	(40,734,144)
Total expenses of governmental activities	$105,807,013

Note 6—Illustrative Disclosure of Segment Information

The City issues separate revenue bonds to finance its water and sewer departments. The two departments are accounted for in a single fund, but investors in those bonds rely solely on the revenue generated by the individual activities for repayment. Summary financial information for each department is presented below. The Water Department operates the City's water supply system. The Sewer Department operates the City's sewage treatment plant, sewage pumping stations, and collection systems.

	Water Department	Sewer Department
CONDENSED STATEMENT OF NET ASSETS		
Assets		
Current assets	$ 5,229,593	$ 6,919,814
Capital assets	38,952,991	92,171,460
Total assets	44,182,584	99,091,274
Liabilities		
Interfund payables	—	175,000
Other current liabilities	1,520,672	2,984,214
Noncurrent liabilities	5,476,120	49,426,828
Total liabilities	6,996,792	52,586,042
Net assets		
Invested in capital assets, net of related debt	32,772,337	39,955,956
Unrestricted	4,413,455	6,549,276
Total net assets	$37,185,792	$46,505,232
CONDENSED STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS		
Operating revenues	$ 4,159,350	$ 7,170,533
Depreciation expense	549,987	613,153
Other operating expenses	2,642,774	3,101,842
Operating income	966,589	3,455,538
Nonoperating revenues (expenses):		
Investment income	217,378	237,415
Interest expense	(402,972)	(1,197,858)
Capital contributions	1,159,909	486,010
Transfers out	—	(290,000)
Change in net assets	1,940,904	2,691,105
Beginning net assets	35,244,888	43,814,127
Ending net assets	$37,185,792	$46,505,232

	Water Department	Sewer Department
CONDENSED STATEMENT OF CASH FLOWS		
Net cash provided (used) by:		
Operating activities	$ 841,902	$ 850,643
Noncapital financing activities	—	(290,000)
Capital and related financing activities	(523,876)	(1,641,117)
Investing activities	217,378	237,415
Net increase (decrease)	535,404	(843,059)
Beginning cash and cash equivalents	3,089,534	5,634,774
Ending cash and cash equivalents	$3,624,938	$ 4,791,715

BUDGETARY COMPARISON REPORTING

Budgetary comparison schedules should be presented as required supplementary information (RSI) for the general fund and for each major special revenue fund that has a legally adopted annual budget. The budgetary comparison schedule should present both (a) the original and (b) the final appropriated budgets for the reporting period as well as (c) actual inflows, outflows, and balances, stated on the government's budgetary basis. A separate column to report the variance between the final budget and actual amounts is encouraged, but not required. Governments also may report the variance between original and final budget amounts. Governments may elect to report the budgetary comparison information in a budgetary comparison *statement* as part of the basic financial statements, rather than RSI.

Governments may present the budgetary comparison schedule using the same format, terminology, and classifications as the budget document, or using the format, terminology, and classifications in a statement of revenues, expenditures, and changes in fund balances.

Illustrations

G-1: Budget-to-actual comparison schedule for the general fund in the budget document format.

G-2: Budget-to-actual comparison schedule for a major special revenue fund, also in the budget document format.

G-3: Budget-to-GAAP reconciliation for the comparison schedules in Exhibits G-1 and G-2. This separate schedule may be presented on a separate page, as depicted here, or included on the face of the comparison schedule—if space permits.

G-4: Budget-to-actual comparison schedule for the general fund in a revenues, expenditures, and changes in fund balances format. Note that the GAAP reconciliation in Exhibit G-3 is presented in a separate column, and the optional "variance" column is not presented.

Sample City
Budgetary Comparison Schedule **G-1**
General Fund
For the Year Ended December 31, 2002

The variance column is optional.

	Budgeted Amounts		Actual Amounts (Budgetary Basis) (See Note A)	Variance with Final Budget Positive (Negative)
	Original	Final		
Budgetary fund balance, January 1	$ 3,528,750	$ 2,742,799	$ 2,742,799	$ —
Resources (inflows):				
Property taxes	52,017,833	51,853,018	51,173,436	(679,582)
Franchise taxes	4,546,209	4,528,750	4,055,505	(473,245)
Public service taxes	8,295,000	8,307,274	8,969,887	662,613
Licenses and permits	2,126,600	2,126,600	2,287,794	161,194
Fines and forfeitures	718,800	718,800	606,946	(111,854)
Charges for services	12,392,972	11,202,150	11,374,460	172,310
Grants	6,905,898	6,571,360	6,119,938	(451,422)
Sale of land	1,355,250	3,500,000	3,476,488	(23,512)
Miscellaneous	3,024,292	1,220,991	881,874	(339,117)
Interest received	1,015,945	550,000	552,325	2,325
Transfers from other funds	939,525	130,000	129,323	(677)
Amounts available for appropriation	96,867,074	93,451,742	92,370,775	(1,080,967)
Charges to appropriations (outflows)				
General government:				
Legal	665,275	663,677	632,719	30,958
Mayor, legislative, city manager	3,058,750	3,192,910	2,658,264	534,646
Finance and accounting	1,932,500	1,912,702	1,852,687	60,015
City clerk and elections	345,860	354,237	341,206	13,031
Employee relations	1,315,500	1,300,498	1,234,232	66,266
Planning and economic development	1,975,600	1,784,314	1,642,575	141,739
Public safety:				
Police	19,576,820	20,367,917	20,246,496	121,421
Fire department	9,565,280	9,559,967	9,559,967	—
Emergency medical services	2,323,171	2,470,127	2,459,866	10,261
Inspections	1,585,695	1,585,695	1,533,380	52,315
Public works:				
Public works administration	388,500	385,013	383,397	1,616
Street maintenance	2,152,750	2,233,362	2,233,362	—
Street lighting	762,750	759,832	759,832	—
Traffic operations	385,945	374,945	360,509	14,436
Mechanical maintenance	1,525,685	1,272,696	1,256,087	16,609
Engineering services:				
Engineering administration	1,170,650	1,158,023	1,158,023	—
Geographical information system	125,625	138,967	138,967	—
Health and sanitation:				
Garbage pickup	5,756,250	6,174,653	6,174,653	—
Cemetery:				
Personal services	425,000	425,000	422,562	2,438
Purchases of goods and services	299,500	299,500	283,743	15,757
Culture and recreation:				
Library	985,230	1,023,465	1,022,167	1,298
Parks and recreation	9,521,560	9,786,397	9,756,618	29,779
Community communications	552,350	558,208	510,361	47,847
Nondepartmental:				
Miscellaneous	—	259,817	259,817	—
Contingency	2,544,049	—	—	—
Transfers to other funds	2,970,256	2,163,759	2,163,759	—
Funding for school district	22,000,000	22,000,000	21,893,273	106,727
Total charges to appropriations	93,910,551	92,205,681	90,938,522	1,267,159
Budgetary fund balance, December 31	$ 2,956,523	$ 1,246,061	$ 1,432,253	$ 186,192

Sample City G-2

Budgetary Comparison Schedule
HUD Programs Fund
For the Year Ended December 31, 2002

	Budgeted Amounts		Actual Amounts (Budgetary Basis)	Variance with Final Budget Positive
	Original	Final	(See Note A)	(Negative)
Budgetary fund balances, January 1	$1,600,000	$1,618,441	$1,618,441	$ —
Resources (inflows):				
Federal grants	2,000,000	2,000,000	1,963,526	(36,474)
State grants	—	600,000	614,665	14,665
Interest on investments	85,000	85,000	87,106	2,106
Miscellaneous	50,000	50,000	66,176	16,176
Amounts available for appropriation	3,735,000	4,353,441	4,349,914	(3,527)
Charges to appropriations (outflows):				
Community development:				
Ombudsman office	1,725,000	1,725,000	1,687,422	37,578
Weatherization program	700,000	1,300,000	1,279,104	20,896
Transfers to other funds	350,000	350,000	348,046	1,954
Total	2,775,000	3,375,000	3,314,572	60,428
Budgetary fund balances, December 31	$ 960,000	$ 978,441	$1,035,342	$ 56,901

Budgetary Comparison Schedule G-3
Budget-to-GAAP Reconciliation

Note A—Explanation of Differences between Budgetary Inflows and Outflows and GAAP Revenues and Expenditures

	General Fund	HUD Programs Fund
Sources/inflows of resources		
Actual amounts (budgetary basis) "available for appropriation" from the budgetary comparison schedule (G-1 and G-2)	$92,370,775	$ 4,349,914
Differences—budget to GAAP:		
The fund balance at the beginning of the year is a budgetary resource but is not a current-year revenue for financial reporting purposes.	(2,742,799)	(1,618,441)
Transfers from other funds are inflows of budgetary resources but are not *revenues* for financial reporting purposes.	(129,323)	—
The proceeds from the sale of the park land are budgetary resources but are regarded as a *special item,* rather than revenue, for financial reporting purposes.	(3,476,488)	—
Total revenues as reported on the statement of revenues, expenditures, and changes in fund balances—governmental funds (C-2).	$86,022,165	$ 2,731,473
Uses/outflows of resources		
Actual amounts (budgetary basis) "total charges to appropriations" from the budgetary comparison schedule (G-1 and G-2).	$90,938,522	$ 3,314,572
Differences—budget to GAAP:		
The City budgets for claims and compensated absences only to the extent expected to be paid, rather than on the modified accrual basis.	129,100	3,900
Encumbrances for supplies and equipment ordered but not received is reported in the year the order is placed for *budgetary* purposes, but in the year the supplies are received for *financial reporting* purposes.	(186,690)	(16,037)
Transfers to other funds are outflows of budgetary resources but are not *expenditures* for financial reporting purposes.	(2,163,759)	(348,046)
Total expenditures as reported on the statement of revenues, expenditures, and changes in fund balances—governmental funds (C-2).	$88,717,173	$ 2,954,389

This illustration includes examples of basis, timing, and perspective differences, as discussed in NCGA Interpretation 10, paragraphs 15–25. There were no "entity" differences in the sample government illustrated here.

The reconciliation could be presented on the same page as the budget-to-actual comparison, rather than on a separate page, as shown here. Available space and the complexity of the reconciliation may influence the preparer's choice as to location.

Sample City
Statement of Revenues, Expenditures, and
Changes in Fund Balances—Budget and Actual
General Fund
For the Year Ended December 31, 2002

	Budgeted Amounts	
	Original	**Final**
REVENUES		
Property taxes	$52,017,833	$51,853,018
Other taxes—franchise and public service	12,841,209	12,836,024
Fees and fines	718,800	718,800
Licenses and permits	2,126,600	2,126,600
Intergovernmental	6,905,898	6,571,360
Charges for services	12,392,972	11,202,150
Interest	1,015,945	550,000
Miscellaneous	3,024,292	1,220,991
Total revenues	91,043,549	87,078,943
EXPENDITURES		
Current:		
General government (including contingencies and miscellaneous)	11,837,534	9,468,155
Public safety	33,050,966	33,983,706
Public works	5,215,630	5,025,848
Engineering services	1,296,275	1,296,990
Health and sanitation	5,756,250	6,174,653
Cemetery	724,500	724,500
Culture and recreation	11,059,140	11,368,070
Education—payment to school district	22,000,000	22,000,000
Total expenditures	90,940,295	90,041,922
Excess (deficiency) of revenues over expenditures	103,254	(2,962,979)
OTHER FINANCING SOURCES (USES)		
Transfers in	939,525	130,000
Transfers out	(2,970,256)	(2,163,759)
Total other financing sources and uses	(2,030,731)	(2,033,759)
SPECIAL ITEM		
Proceeds from sale of park land	1,355,250	3,500,000
Net change in fund balance	(572,227)	(1,496,738)
Fund balances—beginning	3,528,750	2,742,799
Fund balances—ending	$ 2,956,523	$ 1,246,061

Explanation of differences:

(1) The City budgets for claims and compensated absences only to the extent expected to be paid, rather than on the modified accrual basis.

Encumbrances for equipment and supplies ordered but not received are reported in the year *the orders are placed* for budgetary purposes, but are reported in the year the equipment and supplies are received for GAAP purposes.

Net increase in fund balance—budget to GAAP

(2) The amount reported as "fund balance" on the budgetary basis of accounting derives from the basis of accounting used in preparing the City's budget. (See Note XX for a description of the City's budgetary accounting method.) This amount differs from the fund balance reported in the statement of revenues, expenditures, and changes in fund balances (C-2) because of the cumulative effect of transactions such as those described above.

Actual Amounts Budgetary Basis		Budget to GAAP Differences Over (Under)	Actual Amounts GAAP Basis
$51,173,436		$ —	$51,173,436
13,025,392		—	13,025,392
606,946		—	606,946
2,287,794		—	2,287,794
6,119,938		—	6,119,938
11,374,460		—	11,374,460
552,325		—	552,325
881,874		—	881,874
86,022,165		—	86,022,165
8,621,500	(1)	(9,335)	8,630,835
33,799,709	(1)	70,086	33,729,623
4,993,187	(1)	17,412	4,975,775
1,296,990	(1)	(2,655)	1,299,645
6,174,653	(1)	104,621	6,070,032
706,305		—	706,305
11,289,146	(1)	(122,539)	11,411,685
21,893,273		—	21,893,273
88,774,763		57,590	88,717,173
(2,752,598)		57,590	(2,695,008)
129,323		—	129,323
(2,163,759)		—	(2,163,759)
(2,034,436)		—	(2,034,436)
3,476,488		—	3,476,488
(1,310,546)		57,590	(1,252,956)
2,742,799	(2)	165,523	2,908,322
$ 1,432,253		$ 223,113	$ 1,655,366
		$(129,100)	
		186,690	
		$ 57,590	

MODIFIED APPROACH FOR REPORTING INFRASTRUCTURE ASSETS

Governments should present the following schedules, derived from the asset management system, as RSI for all eligible infrastructure assets that are reported using the modified approach.

Illustration

G-5:

a. The assessed condition of eligible infrastructure assets, performed at least every three years, for at least the three most recent complete condition assessments, with the dates of the assessments
b. The estimated annual amount, calculated at the beginning of the fiscal year, to maintain and preserve eligible infrastructure assets at the condition level established and disclosed by the government compared with the amounts actually expensed for each of the past five reporting periods.

The following disclosures should accompany the schedules:

a. The measurement scale and the basis for the condition measurement used to assess and report condition.
b. The condition level at which the government intends to preserve its eligible infrastructure assets reported using the modified approach.
c. Factors that significantly affect trends in the information reported in the required schedules, including any changes in the measurement scale, the basis for the condition measurement, or the condition assessment methods used during the periods covered by the schedules. If there is a change in the condition level at which the government intends to preserve eligible infrastructure assets, an estimate of the effect of the change on the estimated annual amount to maintain and preserve those assets for the current period should also be disclosed.

Condition Rating of the City's Street System

	Percentage of Lane-Miles in Good or Better Condition		
	2002	2001	2000
Main arterial	93.2%	91.5%	92.0%
Arterial	85.2%	81.6%	84.3%
Secondary	87.2%	84.5%	86.8%
Overall system	87.0%	85.5%	87.3%

	Percentage of Lane-Miles in Substandard Condition		
	2002	2001	2000
Main arterial	1.7%	2.6%	3.1%
Arterial	3.5%	6.4%	5.9%
Secondary	2.1%	3.4%	3.8%
Overall system	2.2%	3.6%	3.9%

Comparison of Needed-to-Actual Maintenance/Preservation (in Thousands)

	2002	2001	2000	1999	1998
Main arterial:					
Needed	$2,476	$2,342	$2,558	$2,401	$2,145
Actual	2,601	2,552	2,432	2,279	2,271
Arterial:					
Needed	1,485	1,405	1,535	1,441	1,287
Actual	1,560	1,531	1,459	1,367	1,362
Secondary:					
Needed	990	937	1,023	960	858
Actual	1,040	1,021	972	911	908
Overall system:					
Needed	4,951	4,684	5,116	4,802	4,290
Actual	5,201	5,104	4,863	4,557	4,541
Difference	250	420	(253)	(245)	251

Note: The condition of road pavement is measured using the XYZ pavement management system, which is based on a weighted average of six distress factors found in pavement surfaces. The XYZ pavement management system uses a measurement scale that is based on a condition index ranging from zero for a failed pavement to 100 for a pavement in perfect condition. The condition index is used to classify roads in good or better condition (70–100), fair condition (50–69), and substandard condition (less than 50). It is the City's policy to maintain at least 85 percent of its street system at a good or better condition level. No more than 10 percent should be in a substandard condition. Condition assessments are determined every year.

SUPPLEMENTARY INFORMATION

The focus of governmental and proprietary fund financial statements is on major funds. Fund statements should present the financial information of each major fund in a separate column. Nonmajor funds should be aggregated and displayed in a single column. Combining statements for nonmajor funds are not required, but may be presented as supplementary information.

Illustrations

H-1 and H-2: Combining statements for nonmajor governmental funds. This illustration presents all nonmajor governmental funds, with fund-type subtotals, on a single page. Combining statements for each fund type could be presented on separate pages with a lead page aggregating the fund-type totals to tie to the nonmajor funds columns in the basic statements.

H-3, H-4, and H-5: Combining statements for internal service funds. Because internal service funds are exempt from the major fund reporting requirements, all funds are presented in these combining statements.

Sample City
Combining Balance Sheet
Nonmajor Governmental Funds
December 31, 2002

	Special Revenue Funds			
	Impact Fees	Local Gas Tax	Historic District	Total
ASSETS				
Cash and cash equivalents	$371,413	$1,999,819	$189,880	$2,561,112
Investments	—	—	—	—
Receivables, net	—	10,221	—	10,221
Receivable from other governments	—	129,883	4,836	134,719
Total assets	$371,413	$2,139,923	$194,716	$2,706,052
LIABILITIES AND FUND BALANCES				
Liabilities:				
Accounts payable	$ 61,165	$ 170,615	$ 4,836	$ 236,616
Total liabilities	61,165	170,615	4,836	236,616
Fund balances:				
Reserved for:				
Encumbrances	176,487	962,231	—	1,138,718
Debt service	—	—	—	—
Other purposes	—	—	—	—
Unreserved	133,761	1,007,077	189,880	1,330,718
Total fund balances	310,248	1,969,308	189,880	2,469,436
Total liabilities and fund balances	$371,413	$2,139,923	$194,716	$2,706,052

In the previous model, separate combining statements were presented for each *fund type.* This Statement modifies that requirement to exclude major funds from the combining statements, in recognition of the requirement to display them in the basic statements. This illustration shows all *nonmajor* governmental funds in a single statement, but still grouped (including subtotals) by fund type. The "single-page" treatment shown here is not required—separate combining statements, by fund type, could be presented (building in a pyramid fashion to a summary of fund-type totals that ties to the nonmajor fund column in the basic statements).

Debt Service Funds			Capital Projects Fund	Permanent Fund	Total Nonmajor Governmental Funds (See C-1)
Central City Development	Community Redevelopment	Total	Bridge	Cemetery Care	
$ 677,143	$ 164,861	$ 842,004	$1,141,648	$1,062,028	$ 5,606,792
941,510	2,200,470	3,141,980	—	343,272	3,485,252
—	—	—	—	—	10,221
—	—	—	1,461,319	—	1,596,038
$1,618,653	$2,365,331	$3,983,984	$2,602,967	$1,405,300	$10,698,303
$ 151,922	$ —	$ 151,922	$ 686,293	$ —	$ 1,074,831
151,922	—	151,922	686,293	—	1,074,831
—	—	—	675,404	—	1,814,122
1,466,731	2,365,331	3,832,062	—	—	3,832,062
—	—	—	—	1,405,300	1,405,300
—	—	—	1,241,270	—	2,571,988
1,466,731	2,365,331	3,832,062	1,916,674	1,405,300	9,623,472
$1,618,653	$2,365,331	$3,983,984	$2,602,967	$1,405,300	$10,698,303

Sample City
Combining Statement of Revenues, Expenditures, and Changes in Fund Balances
Nonmajor Government Funds
For the Year Ended December 31, 2002

	Special Revenue Funds			
	Impact Fees	Local Gas Tax	Historic District	Total
REVENUES				
Property taxes	$ —	$ —	$ —	$ —
Intergovernmental	—	1,312,670	60,426	1,373,096
Charges for services	30,708	—	—	30,708
Investment earnings	4,543	123,329	226	128,098
Miscellaneous	—	94	—	94
Total revenues	35,251	1,436,093	60,652	1,531,996
EXPENDITURES				
Current:				
General government	50,000	3,622	—	53,622
Public works	705,487	2,968,283	47,772	3,721,542
Debt service:				
Principal	—	—	—	—
Interest and other charges	—	—	—	—
Capital outlay	—	—	—	—
Total expenditures	755,487	2,971,905	47,772	3,775,164
Excess (deficiency) of revenues over expenditures	(720,236)	(1,535,812)	12,880	(2,243,168)
OTHER FINANCING SOURCES (USES)				
Proceeds of long-term debt	—	—	—	—
Payment to bond refunding escrow agent	—	—	—	—
Transfers in	—	—	177,000	177,000
Transfers out	—	(42,500)	—	(42,500)
Total other financing sources and uses	—	(42,500)	177,000	134,500
Net change in fund balances	(720,236)	(1,578,312)	189,880	(2,108,668)
Fund balances—beginning	1,030,484	3,547,620	—	4,578,104
Fund balances—ending	$ 310,248	$ 1,969,308	$189,880	$ 2,469,436

Debt Service Funds			Capital Projects Funds			Permanent Fund	
Central City Development	Community Redevelopment	Total	Culvert Project	Bridge	Total	Cemetery Care	Total Nonmajor Governmental Funds (See C-2)
$ 4,680,192	$ —	$ 4,680,192	$ —	$ —	$ —	$ —	$ 4,680,192
—	—	—	1,457,820	—	1,457,820	—	2,830,916
—	—	—	—	—	—	—	30,708
103,631	42,973	146,604	13,878	3,061	16,939	72,689	364,330
—	—	—	—	—	—	—	94
4,783,823	42,973	4,826,796	1,471,698	3,061	1,474,759	72,689	7,906,240
8,920	2,900	11,820	13,460	42,150	55,610	—	121,052
—	—	—	—	—	—	—	3,721,542
2,910,000	540,000	3,450,000	—	—	—	—	3,450,000
3,885,191	1,329,960	5,215,151	—	—	—	—	5,215,151
—	—	—	1,961,440	1,228,769	3,190,209	—	3,190,209
6,804,111	1,872,860	8,676,971	1,974,900	1,270,919	3,245,819	—	15,697,954
(2,020,288)	(1,829,887)	(3,850,175)	(503,202)	(1,267,858)	(1,771,060)	72,689	(7,791,714)
38,045,000	—	38,045,000	—	1,300,000	1,300,000	—	39,345,000
(37,284,144)	—	(37,284,144)	—	—	—	—	(37,284,144)
1,604,149	2,387,149	3,991,298	—	1,382,889	1,382,889	—	5,551,187
—	—	—	(113,167)	—	(113,167)	(63,409)	(219,076)
2,365,005	2,387,149	4,752,154	(113,167)	2,682,889	2,569,722	(63,409)	7,392,967
344,717	557,262	901,979	(616,369)	1,415,031	798,662	9,280	(398,747)
1,122,014	1,808,069	2,930,083	616,369	501,643	1,118,012	1,396,020	10,022,219
$ 1,466,731	$ 2,365,331	$ 3,832,062	$ 0	$ 1,916,674	$ 1,916,674	$1,405,300	$ 9,623,472

Sample City
Combining Statement of Net Assets
Internal Service Funds
December 31, 2002

	Casualty Insurance	Fleet Management	Health/Life Insurance
ASSETS			
Current assets:			
Cash and cash equivalents	$ 632,008	$1,845,325	$428,398
Investments	—	—	—
Receivables, net	9,837	11,363	114,930
Inventories	—	127,140	—
Total current assets	641,845	1,983,828	543,328
Capital assets:			
Buildings and equipment, net	21,383	2,821,024	—
Total assets	663,228	4,804,852	543,328
LIABILITIES			
Current liabilities:			
Accounts payable	195,988	77,931	312,622
Due to other funds	—	—	—
Compensated absences	11,123	69,714	—
Claims and judgments	1,687,975	—	—
Bonds, notes, and loans payable	—	—	—
Total current liabilities	1,895,086	147,645	312,622
Noncurrent liabilities:			
Claims and judgments	5,602,900	—	—
Total liabilities	7,497,986	147,645	312,622
NET ASSETS			
Invested in capital assets, net of related debt	21,383	2,821,024	—
Unrestricted	(6,856,141)	1,836,183	230,706
Total net assets	$(6,834,758)	$4,657,207	$230,706

Telecommunications	Data Processing	Total (See D-1)
$ 6,645	$ 423,723	$ 3,336,099
—	150,237	150,237
203	21,471	157,804
—	12,188	139,328
6,848	607,619	3,783,468
5,526,642	571,003	8,940,052
5,533,490	1,178,622	12,723,520
144,840	49,189	780,570
970,252	200,136	1,170,388
97,449	59,404	237,690
—	—	1,687,975
249,306	—	249,306
1,461,847	308,729	4,125,929
—	—	5,602,900
1,461,847	308,729	9,728,829
5,277,336	571,003	8,690,746
(1,205,693)	298,890	(5,696,055)
$ 4,071,643	$ 869,893	$ 2,994,691

Sample City
Combining Statement of Revenues, Expenses, and Changes in Fund Net Assets
Internal Service Funds
For the Year Ended December 31, 2002

	Casualty Insurance	Fleet Management	Health/Life Insurance
Operating revenues:			
Charges for services	$ 1,886,451	$4,096,753	$4,488,619
Miscellaneous	18,907	—	1,047,854
Total operating revenues	1,905,358	4,096,753	5,536,473
Operating expenses:			
Personal services	169,866	1,248,271	—
Contractual services	176,486	62,449	24,402
Utilities	—	2,616	—
Repairs and maintenance	2,497	1,523,774	—
Other supplies and expenses	55,041	23,656	—
Insurance claims and expenses	2,085,306	—	5,918,980
Depreciation	5,541	448,944	—
Total operating expenses	2,494,737	3,309,710	5,943,382
Operating income (loss)	(589,379)	787,043	(406,909)
Nonoperating revenues (expenses):			
Interest and investment revenue	48,570	52,925	10,338
Miscellaneous revenue	9,544	732	—
Interest expense	—	—	—
Miscellaneous expense	(14,948)	(39,790)	—
Total nonoperating revenues (expenses)	43,166	13,867	10,338
Income (loss) before contributions and transfers	(546,213)	800,910	(396,571)
Capital contributions	—	3,364	—
Transfers in	10,000	—	—
Transfers out	—	—	(50,319)
Change in net assets	(536,213)	804,274	(446,890)
Net assets—beginning	(6,298,545)	3,852,933	677,596
Net assets—ending	$(6,834,758)	$4,657,207	$ 230,706

Telecommunications	Data Processing	Total (See D-3)
$3,542,116	$1,242,225	$15,256,164
—	—	1,066,761
3,542,116	1,242,225	16,322,925
1,850,222	888,797	4,157,156
22,843	298,216	584,396
212,196	—	214,812
389,132	45,087	1,960,490
89,252	66,496	234,445
—	—	8,004,286
938,251	315,136	1,707,872
3,501,896	1,613,732	16,863,457
40,220	(371,507)	(540,532)
—	22,900	134,733
10,579	—	20,855
(35,185)	(6,431)	(41,616)
(120,949)	(316)	(176,003)
(145,555)	16,153	(62,031)
(105,335)	(355,354)	(602,563)
1,222	14,202	18,788
9,008	—	19,008
—	(143,722)	(194,041)
(95,105)	(484,874)	(758,808)
4,166,748	1,354,767	3,753,499
$4,071,643	$ 869,893	$ 2,994,691

Sample City
Combining Statement of Cash Flows
Internal Service Funds
For the Year Ended December 31, 2002

	Casualty Insurance	Fleet Management	Health/Life Insurance
CASH FLOWS FROM OPERATING ACTIVITIES			
Receipts from customers	$ 1,905,870	$ 4,098,790	$ 4,549,558
Payments to suppliers	(129,409)	(1,671,378)	—
Payments to employees	(166,729)	(1,236,855)	—
Claims paid	(2,863,973)	—	(5,618,478)
Other receipts (payments)	18,907	—	1,023,452
Net cash provided (used) by operating activities	(1,235,334)	1,190,557	(45,468)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES			
Operating subsidies and transfers to other funds	10,000	—	(50,319)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES			
Purchases of capital assets	(13,578)	(237,054)	—
Principal paid on capital debt	—	—	—
Interest paid on capital debt	—	—	—
Other receipts (payments)	25,167	(39,058)	—
Net cash provided (used) by capital and related financing activities	11,589	(276,112)	—
CASH FLOWS FROM INVESTING ACTIVITIES			
Proceeds from sales and maturities of investments	—	—	—
Interest and dividends	48,570	47,742	10,338
Net cash provided by investing activities	48,570	47,742	10,338
Net increase (decrease) in cash and cash equivalents	(1,165,175)	962,187	(85,449)
Balances—beginning of the year	1,797,183	883,138	513,847
Balances—end of the year	$ 632,008	$ 1,845,325	$ 428,398

Note: The required reconciliation to operating income and the required information about noncash investing, capital, and financing activities are not illustrated.

Telecommunications	Data Processing	Total (See D-4)
$ 3,542,157	$1,229,968	$15,326,343
(656,961)	(354,490)	(2,812,238)
(1,910,948)	(895,156)	(4,209,688)
—	—	(8,482,451)
—	18,759	1,061,118
974,248	(919)	883,084
9,008	(143,722)	(175,033)
(132,596)	(16,858)	(400,086)
(954,137)	—	(954,137)
(35,185)	(6,431)	(41,616)
145,307	—	131,416
(976,611)	(23,289)	(1,264,423)
—	15,684	15,684
—	22,900	129,550
—	38,584	145,234
6,645	(129,346)	(411,138)
—	553,069	3,747,237
$ 6,645	$ 423,723	$ 3,336,099

OTHER ILLUSTRATIONS

This section presents the financial statements from the separately issued reports of the two component units. They contain the data included in the Sample City reporting entity's financial statements. The school district is a special-purpose government engaged in both governmental (multiprogram) and business-type activities (see paragraphs 135–137). The landfill is a special-purpose government engaged only in business-type activities (see paragraph 138). These statements are not required to be included in Sample City's financial statements, but are presented here to illustrate the "special-purpose government" provisions of this Statement and to demonstrate the articulation between the primary government's financial statements and those of its discretely presented component units.

Illustrations

I-1 and I-2 present the government-wide statements from the separately issued financial statements of the school district component unit.

I-3 and I-4 present the financial statements (excluding its statement of cash flows) from the separately issued report of the landfill component unit.

I-1

Sample City School District
(A Component Unit of Sample City)
Statement of Net Assets
December 31, 2002

	Governmental Activities	Business-type Activities	Total†
ASSETS			
Cash and cash equivalents	$ 189,960	$113,525	$ 303,485
Investments	3,552,148	106,372	3,658,520
Receivables, net	3,702,865	14,161	3,717,026
Internal receivables	60,785	—	—
Inventories	43,303	40,394	83,697
Capital assets, net (Note X)	34,554,609	205,377	34,759,986
Total assets	42,103,670	479,829	42,522,714
LIABILITIES			
Accounts payable	1,469,066	—	1,469,066
Internal payables	—	60,785	—
Deposits and deferred revenue	38,911	—	38,911
Long-term liabilities (Note Y):			
Due within one year	1,426,639	—	1,426,639
Due in more than one year	22,437,349	—	22,437,349
Total liabilities	25,371,965	60,785	25,371,965
NET ASSETS			
Invested in capital assets, net of related debt	12,716,215	205,377	12,921,592
Restricted for capital projects	492,445	—	492,445
Unrestricted	3,523,045	213,667	3,736,712
Total net assets	$16,731,705	$419,044	$17,150,749

†After internal receivables and payables have been eliminated.

The amounts in the "Total" column should be combined with the totals from all other discretely presented component units for inclusion in the reporting entity's statement of net assets. If the component unit has component units of its own, the total carried forward to the reporting entity's statement should include those components in accordance with Statement 14, paragraph 43.

Sample City School District
(A Component Unit of Sample City)
Statement of Activities
For the Year Ended December 31, 2002

		Program Revenues	
	Expenses	**Charges for Services**	**Operating Grants**
Instructional:			
Regular instruction	$12,328,240	$147,739	$1,095,297
Special instruction	3,346,325	—	1,299,004
Vocational education	819,435	—	54,146
Other instructional programs	405,732	—	376,064
Adult education	24,589	—	598
Support services:			
Pupil services	822,871	—	20,025
Instructional services	443,624	—	31,667
Administrative services	1,680,317	—	40,891
Health services	311,522	—	88,432
Business services	513,064	—	48,431
Plant operations and maintenance	2,905,095	300	70,697
Transportation	804,503	—	439,606
Other support services	491,563	—	11,962
Operation of noninstructional services:			
Athletic programs	497,304	16,343	12,102
Community services	117,773	—	2,866
Food services	908,263	541,383	344,124
Facilities acquisition and construction services:			
Building improvement services	48,136	—	1,171
Interest on long-term debt	546,382	—	—
Depreciation	4,171,760	—	—
Total	$31,186,498	$705,765	$3,937,083

General revenues:
Payment from Sample City
Grants and entitlements not restricted to specific programs
Unrestricted contributions
Investment earnings
Miscellaneous
Total general revenues
Excess (deficiency) of revenues over expenses
Net assets—beginning
Net assets—ending

The totals from these three columns are displayed separately on the reporting entity's statement of activities (B-1).

Net (Expense) Revenue and Changes in Net Assets		
Governmental Activities	Business-type Activities	Total
$(11,085,204)	$ —	$(11,085,204)
(2,047,321)	—	(2,047,321)
(765,289)	—	(765,289)
(29,668)	—	(29,668)
(23,991)	—	(23,991)
(802,846)	—	(802,846)
(411,957)	—	(411,957)
(1,639,426)	—	(1,639,426)
(223,090)	—	(223,090)
(464,633)	—	(464,633)
(2,834,098)	—	(2,834,098)
(364,897)	—	(364,897)
(479,601)	—	(479,601)
(468,859)	—	(468,859)
(114,907)	—	(114,907)
—	(22,756)	(22,756)
(46,965)	—	(46,965)
(546,382)	—	(546,382)
(4,171,760)	—	(4,171,760)
(26,520,894)	(22,756)	(26,543,650)
21,893,273	—	21,893,273
6,176,108	—	6,176,108
285,600	—	285,600
667,742	6,294	674,036
19,950	—	19,950
29,042,673	6,294	29,048,967
2,521,779	(16,462)	2,505,317
14,209,926	435,506	14,645,432
$ 16,731,705	$419,044	$ 17,150,749

Sample City Landfill
(A Component Unit of Sample City)
Statement of Net Assets
December 31, 2002

ASSETS	
Current assets:	
Cash and cash equivalents	$ 450
Investments	1,770,432
Receivables, net	325,264
Total current assets	2,096,146
Noncurrent assets:	
Restricted assets—landfill closure	2,000,000
Capital assets:	
Land	528,029
Buildings and equipment	4,144,575
Less accumulated depreciation	(1,687,804)
Total noncurrent assets	4,984,800
Total assets	7,080,946
LIABILITIES	
Current liabilities:	
Accounts payable	334,266
Noncurrent liabilities:	
Landfill closure and postclosure care	4,668,802
Total liabilities	5,003,068
NET ASSETS	
Invested in capital assets	2,984,800
Unrestricted (deficit)	(906,922)
Total net assets	$ 2,077,878

Sample City Landfill

I-4

(A Component Unit of Sample City)
Statement of Revenues, Expenses, and Changes in Net Assets
For the Year Ended December 31, 2002

Operating revenues:	
Charges for sales and services	$3,853,903
Miscellaneous	3,955
Total operating revenues	3,857,858
Operating expenses:	
Salaries and wages	1,487,927
Employee benefits	142,876
Supplies	68,800
Contractual services	18,345
Maintenance—structures and equipment	587,489
Utilities	18,827
Administrative and general	772,326
Miscellaneous	20,175
Depreciation	265,392
Total operating expenses	3,382,157
Operating income	475,701
Nonoperating revenues:	
Investment earnings	207,727
State grant	11,397
Miscellaneous	2,514
Total nonoperating revenues	221,638
Change in net assets	697,339
Net assets—beginning of the year	1,380,539
Net assets—end of the year	$2,077,878

These two amounts are reported separately as program revenues in the reporting entity's statement of activities (B-1).

Special-purpose governments engaged only in business-type activities, such as this landfill, should present only the financial statements required for enterprise funds; thus, a statement of activities is not required (paragraph 138).

Appendix D

CODIFICATION INSTRUCTIONS

478. The sections that follow update the June 30, 1999, *Codification of Governmental Accounting and Financial Reporting Standards* for the effects of this Statement. Only the paragraph number of the Statement is listed if the paragraph will be cited in full in the Codification. In addition, no Codification instructions have been provided for the nonauthoritative portions of sections—those beginning at paragraph .901.

* * *

SUMMARY STATEMENT OF PRINCIPLES **SECTION 1100**

[Revise entire section as follows:]

Sources: NCGA Statement 1
GASB Statement 14
GASB Statement 34

Accounting and Reporting Capabilities

(See Section 1200, "Generally Accepted Accounting Principles and Legal Compliance.")

.101 A governmental accounting system must make it possible both: (a) to present fairly and with full disclosure the funds and activities of the government in conformity with generally accepted accounting principles, and (b) to determine and demonstrate compliance with finance-related legal and contractual provisions.

Fund Accounting Systems

(See Section 1300, "Fund Accounting.")

.102 Governmental accounting systems should be organized and operated on a fund basis. A fund is defined as a fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with all related liabilities and residual equities or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations. Fund financial statements should be used to report detailed information about the primary government, including its blended component units. The focus of governmental and proprietary fund financial statements is on *major* funds.

Fund Types

(See Section 1300.)

.103 In fund financial statements, governments should report governmental, proprietary, and fiduciary funds to the extent that they have activities that meet the criteria for using those funds.

a. Governmental funds (emphasizing major funds)
   (1) The general fund
   (2) Special revenue funds
   (3) Capital projects funds
   (4) Debt service funds
   (5) Permanent funds
b. Proprietary funds
   (6) Enterprise funds (emphasizing major funds)
   (7) Internal service funds
c. Fiduciary funds (and similar component units)
   (8) Pension (and other employee benefit) trust funds
   (9) Investment trust funds
   (10) Private-purpose trust funds
   (11) Agency funds.

Number of Funds

(See Section 1300.)

.104 Governmental units should establish and maintain those funds required by law and sound financial administration. Only the minimum number of funds consistent with legal and operating requirements should be established, however, because unnecessary funds result in inflexibility, undue complexity, and inefficient financial administration.

Reporting Capital Assets

(See Section 1400, "Reporting Capital Assets.")

.105 A clear distinction should be made between general capital assets and capital assets of proprietary and fiduciary funds. Capital assets of proprietary funds should be reported in both the government-wide and fund financial statements. Capital assets of fiduciary funds should be reported only in the statement of fiduciary net assets. All other capital assets of the governmental unit are general capital assets. They should not be reported as assets in governmental funds but should be reported in the governmental activities column in the government-wide statement of net assets.

Valuation of Capital Assets

(See Section 1400.)

.106 Capital assets should be reported at historical cost. The cost of a capital asset should include capitalized interest and ancillary charges necessary to place the asset into its intended location and condition for use. Donated capital assets should be reported at their estimated fair value at the time of acquisition plus ancillary charges, if any.

Depreciation of Capital Assets

(See Section 1400.)

.107 Capital assets should be depreciated over their estimated useful lives unless they are either inexhaustible or are infrastructure assets using the modified approach as set forth in Section 1400. Inexhaustible assets such as land and land improvements should not be depreciated. Depreciation expense should be reported in the government-wide statement of activities; the proprietary fund statement of revenues, expenditures, and changes in fund net assets; and the statement of changes in fiduciary net assets.

Reporting Long-term Liabilities

(See Section 1500, "Reporting Liabilities.")

.108 A clear distinction should be made between fund long-term liabilities and general long-term liabilities. Long-term liabilities directly related to and expected to be paid from proprietary funds should be reported in the proprietary fund statement of net assets and in the government-wide statement of net assets. Long-term liabilities directly related to and expected to be paid from fiduciary funds should be reported in the statement of fiduciary net assets. All other unmatured general long-term liabilities of the governmental unit should not be reported in governmental funds but should be reported in the governmental activities column in the government-wide statement of net assets.

Measurement Focus and Basis of Accounting in the Basic Financial Statements

(See Section 1600, “Measurement Focus and Basis of Accounting.”)

Government-wide Financial Statements

.109 The government-wide statement of net assets and statement of activities should be prepared using the economic resources measurement focus and the accrual basis of accounting. Revenues, expenses, gains, losses, assets, and liabilities resulting from exchange and exchange-like transactions should be recognized when the exchange takes place. Revenues, expenses, assets, and liabilities resulting from nonexchange transactions should be recognized in accordance with Section N50, “Nonexchange Transactions.”

Fund Financial Statements

.110 In fund financial statements, the modified accrual or accrual basis of accounting, as appropriate, should be used in measuring financial position and operating results.

a. Financial statements for governmental funds should be presented using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues should be recognized in the accounting period in which they become available and measurable. Expenditures should be recognized in the accounting period in which the fund liability is incurred, if measurable, except for unmatured interest on general long-term liabilities, which should be recognized when due.
b. Proprietary fund statements of net assets and revenues, expenses, and changes in fund net assets should be presented using the economic resources measurement focus and the accrual basis of accounting.
c. Financial statements of fiduciary funds should be reported using the economic resources measurement focus and the accrual basis of accounting, except for the recognition of certain liabilities of defined benefit pension plans and certain postemployment healthcare plans, as discussed in Sections P20, “Pension Activities—Employer Reporting,” and P50, “Postemployment Benefits Other Than Pension Benefits—Employer Reporting.”

d. Transfers should be reported in the accounting period in which the interfund receivable and payable arise.

Budgeting, Budgetary Control, and Budgetary Reporting

(See Section 1700, "The Budget and Budgetary Accounting," and Section 2400, "Budgetary Reporting.")

.111

a. An annual budget(s) should be adopted by every governmental unit.
b. The accounting system should provide the basis for appropriate budgetary control.
c. Budgetary comparison schedules should be presented as required supplementary information for the general fund and for each major special revenue fund that has a legally adopted annual budget. The budgetary comparison schedule should present both (a) the original and (b) the final appropriated budgets for the reporting period as well as (c) actual inflows, outflows, and balances, stated on the government's budgetary basis.

Transfer, Revenue, Expenditure, and Expense Account Classification

(See Section 1800, "Classification and Terminology.")

.112

a. Transfers should be classified separately from revenues and expenditures or expenses in the basic financial statements.
b. Proceeds of general long-term debt issues should be classified separately from revenues and expenditures in the governmental fund financial statements.
c. Governmental fund revenues should be classified by fund and source. Expenditures should be classified by fund, function (or program), organization unit, activity, character, and principal classes of objects.
d. Proprietary fund revenues should be reported by major sources, and expenses should be classified in essentially the same manner as those of similar business organizations, functions, or activities.
e. The statement of activities should present *governmental* activities at least at the level of detail required in the governmental fund statement of revenues, expenditures, and changes in fund balances—at a minimum by *function.* Governments should present *business-type* activities at least by *segment,* as discussed in Section 2500, "Segment Information."

Common Terminology and Classification

(See Section 1800.)

.113 A common terminology and classification should be used consistently throughout the budget, the accounts, and the financial reports of each fund.

Annual Financial Reports

(See Section 2200, "Comprehensive Annual Financial Report," and Sections 2100–2800.)

.114

a. A comprehensive annual financial report should be prepared and published, covering all activities of the primary government (including its blended component units) and providing an overview of all discretely presented component units of the reporting entity—including introductory section, management's discussion and analysis (MD&A), basic financial statements, required supplementary information other than MD&A, combining and individual fund statements, schedules, narrative explanations, and statistical section. The reporting entity is the primary government (including its blended component units) and all discretely presented component units presented in accordance with Section 2100, "Defining the Financial Reporting Entity."
b. The minimum requirements for MD&A, basic financial statements, and required supplementary information other than MD&A are:
   (1) Management's discussion and analysis.
   (2) Basic financial statements. The basic financial statements should include:
      (a) Government-wide financial statements.
      (b) Fund financial statements.
      (c) Notes to the financial statements.
   (3) Required supplementary information other than MD&A.
c. As discussed in Section 2100, the financial reporting entity consists of (1) the primary government, (2) organizations for which the primary government is financially accountable, and (3) other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity's basic financial statements to be misleading or incomplete. The reporting entity's government-wide financial statements should display information about the reporting government as a whole distinguishing between the total primary government and its discretely presented component units as well as between the primary government's governmental and business-type activities. The reporting entity's fund financial statements should present the primary government's (including its blended

component units, which are, in substance, part of the primary government) major funds individually and nonmajor funds in the aggregate. Funds and component units that are fiduciary in nature should be reported only in the statements of fiduciary net assets and changes in fiduciary net assets.

d. The nucleus of a financial reporting entity usually is a primary government. However, a governmental organization other than a primary government (such as a component unit, joint venture, jointly governed organization, or other stand-alone government) serves as the nucleus for its own reporting entity when it issues separate financial statements. For all of these entities, the provisions of Section 2100 should be applied in layers "from the bottom up." At each layer, the definition and display provisions should be applied before the layer is included in the financial statements of the next level of the reporting government.

[NCGAS 1, pp. 2–4, as amended by GASBS 6, ¶15 and GASBS 34, ¶6, ¶15, and ¶82; GASBS 14, ¶11, ¶12, ¶19, ¶43, ¶65, and ¶66; GASBS 34, ¶6, ¶13, ¶15, ¶16, ¶18, ¶21, ¶22, ¶39, ¶53, ¶63, ¶75, ¶79, ¶80, ¶82, ¶88, ¶92, ¶100, ¶107, ¶112, and ¶125]

* * *

GENERALLY ACCEPTED ACCOUNTING PRINCIPLES AND LEGAL COMPLIANCE — SECTION 1200

Sources: [Add the following:] GASB Statement 34

[Revise Statement of Principle as follows:]

Statement of Principle
Accounting and Reporting Capabilities

A governmental accounting system must make it possible both: (a) to present fairly and with full disclosure the funds and activities of the government in conformity with generally accepted accounting principles, and (b) to determine and demonstrate compliance with finance-related legal and contractual provisions. [NCGAS 1, ¶2, as amended by GASBS 34, ¶15, ¶80, and ¶82]

Generally Accepted Accounting Principles

.101 [Revise paragraph as follows:] Generally accepted accounting principles (GAAP) are uniform minimum standards of and guidelines to financial accounting and reporting. Adherence to GAAP assures that financial reports of all state and local governments—regardless of jurisdictional legal provisions and customs—contain the same types of financial statements and disclosures, for the same activities and the same categories and types of funds, based on the appropriate measurement and classification criteria. [NCGAS 1, ¶3, as amended by GASBS 34, ¶15, ¶63, ¶80, and ¶82]

.102 [Revise paragraph as follows:] Adherence to GAAP is essential to assuring a reasonable degree of comparability among the financial reports of state and local governmental units. Governmental accounting systems thus must provide data that permit reporting on the financial status and operations of a government in conformity with GAAP. This Codification sets forth the application of GAAP to state and local governmental units. It establishes standards for comprehensive annual financial reports as well as management's discussion and analysis (MD&A), basic financial statements, and required supplementary information other than MD&A. [NCGAS 1, ¶4; GASBS 34, ¶6]

* * *

FUND ACCOUNTING — SECTION 1300

[Revise entire section as follows:]

Sources: NCGA Statement 1
GASB Statement 6
GASB Statement 14
GASB Statement 34

Statement of Principle
Fund Accounting Systems

Governmental accounting systems should be organized and operated on a fund basis. A fund is defined as a fiscal and accounting entity with a self-balancing set of accounts recording cash and other financial resources, together with all related liabilities and residual equities or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations. Fund financial statements should be used to report detailed information about the primary government, including its blended component units. The focus of governmental and proprietary fund financial statements is on *major* funds. [NCGAS 1, ¶16; GASBS 34, ¶6 and ¶75]

Governmental Environment

.101 [Insert current Codification paragraph .101, omitting the phrase *and account group* from second sentence and the phrase *of other funds and account groups* from last sentence.] [NCGAS 1, ¶17, as amended by GASBS 34, ¶80 and ¶82]

Fund Categories

.102 Fund financial statements should be used to report detailed information about the primary government. Governments should report governmental, proprietary, and fiduciary funds to the extent that they have activities that meet the criteria for using those funds.

a. *Governmental fund* reporting focuses primarily on the sources, uses, and balances of current financial resources and often has a budgetary orientation. The governmental fund category includes the general fund, special revenue funds, capital projects funds, debt service funds, and permanent funds.

   Governmental funds are, in essence, accounting segregations of financial resources. Expendable assets are assigned to the various governmental funds according to the purposes for which they may or must be used; current liabilities are assigned to the fund from which they are to be paid; and the difference between governmental fund assets and liabilities, the fund equity, is referred to as “Fund Balance.”

   Financial statements for governmental funds should be presented using the *current financial resources measurement focus* and the *modified accrual basis of accounting,* as the terms are discussed in Section 1600, “Basis of Accounting.” The governmental fund measurement focus is on determination of financial position and changes in financial position (sources, uses, and balances of financial resources).

The financial statements required for governmental funds are a balance sheet and a statement of revenues, expenditures, and changes in fund balances.

b. *Proprietary fund* reporting focuses on the determination of net income, changes in net assets (or cost recovery), financial position, and cash flows. The proprietary fund category includes enterprise and internal service funds.

Proprietary fund statements of net assets and revenues, expenses, and changes in fund net assets should be presented using the economic resources measurement focus and the accrual basis of accounting.

Required financial statements for proprietary funds are a statement of net assets or balance sheet; a statement of revenues, expenses, and changes in fund net assets or fund equity; and a statement of cash flows.

c. *Fiduciary fund* reporting focuses on net assets and changes in net assets. Fiduciary funds should be used to report assets held in a trustee or agency capacity for others and therefore cannot be used to support the government's own programs. The fiduciary fund category includes pension (and other employee benefit) trust funds, investment trust funds, private-purpose trust funds, and agency funds. The three types of trust funds should be used to report resources held and administered by the reporting government when it is acting in a fiduciary capacity for individuals, private organizations, or other governments. These funds are distinguished from agency funds generally by the existence of a trust agreement that affects the degree of management involvement and the length of time that the resources are held.

Financial statements of fiduciary funds should be reported using the economic resources measurement focus and the accrual basis of accounting, except for the recognition of certain liabilities of defined benefit pension plans and certain postemployment healthcare plans, as discussed in Sections Pe5, "Pension Plans—Defined Benefit," and Po50, "Postemployment Healthcare Plans Administered by Defined Benefit Pension Plans."

Required financial statements for fiduciary funds are the statement of fiduciary net assets and the statement of changes in fiduciary net assets.[1] Fiduciary fund financial statements should include information about all

[1] [GASBS 34, fn43] [Change *Statement* to *section* and change cross-reference.]

fiduciary funds of the primary government, as well as component units that are fiduciary in nature.

[NCGAS 1, ¶18, as amended by GASBS 6, ¶13; GASBS 34, ¶63, ¶64, ¶66, ¶69, ¶78, ¶79, ¶91, ¶92, ¶106, and ¶107]

Fund Types

.103 In fund financial statements, governments should report governmental, proprietary, and fiduciary funds to the extent that they have activities that meet the criteria for using those funds.[2]

a. Governmental funds (emphasizing major funds)
   (1) The general fund
   (2) Special revenue funds
   (3) Capital projects funds
   (4) Debt service funds
   (5) Permanent funds
b. Proprietary funds
   (6) Enterprise funds (emphasizing major funds)
   (7) Internal service funds
c. Fiduciary funds (and similar component units)
   (8) Pension (and other employee benefit) trust funds
   (9) Investment trust funds
   (10) Private-purpose trust funds
   (11) Agency funds.

[GASBS 34, ¶63]

Governmental Funds

.104 The *general fund*—to account for all financial resources except those required to be reported in another fund. [NCGAS 1, ¶26]

.105 *Special revenue funds*—to account for the proceeds of specific revenue sources (other than trusts for individuals, private organizations, or other governments or for major capital projects) that are legally restricted to expenditure

[2] [Insert current Codification footnote 4.]

for specified purposes. Resources restricted to expenditure for purposes normally financed from the general fund may be accounted for through the general fund provided that applicable legal requirements can be appropriately satisfied; and use of special revenue funds is not required unless they are legally mandated. The general fund of a blended component unit should be reported as a special revenue fund. [NCGAS 1, ¶26, as amended by GASBS 6, ¶13 and GASBS 34, ¶69; NCGAS 1, ¶30; GASBS 14, ¶54]

.106 *Capital projects funds*—to account for financial resources to be used for the acquisition or construction of major capital facilities (other than those financed by proprietary funds or in trust funds for individuals, private organizations, or other governments.) Capital outlays financed from general obligation bond proceeds should be accounted for through a capital projects fund. [NCGAS 1, ¶10 and ¶26, as amended by NCGAS 6, ¶13 and GASBS 34, ¶69]

.107 *Debt service funds*—to account for the accumulation of resources for, and the payment of, general long-term debt principal and interest. Debt service funds are required if they are legally mandated and/or if financial resources are being accumulated for principal and interest payments maturing in future years. The debt service transactions of a special assessment issue for which the government is not obligated in any manner should be reported in an agency fund (discussed below) rather than a debt service fund to reflect the fact that the government's duties are limited to acting as an agent for the assessed property owners and the bondholders, as discussed in Section S40, "Special Assessments," paragraph .119. [NCGAS 1, ¶26 and ¶30; GASBS 6, ¶19]

.108 [GASBS 34, ¶65] [Change cross-reference and footnote number.]

Proprietary Funds

.109–.110 [GASBS 34, ¶67 and ¶68] [Change cross-reference and footnote numbers.]

Fiduciary Funds

.111–.114 [GASBS 34, ¶70–¶73] [Change cross-reference.]

Statement of Principle
Number of Funds

> Governmental units should establish and maintain those funds required by law and sound financial administration. Only the minimum number of funds consistent with legal and operating requirements should be established, however, because unnecessary funds result in inflexibility, undue complexity, and inefficient financial administration. [NCGAS 1, ¶29]

Bases for Fund Establishment

.115–.116 [Insert current Codification paragraphs .105 and .106.]

Number of Other Funds

.117 [Insert current Codification paragraph .107, omitting last sentence.] [NCGAS 1, ¶30, as amended by GASBS 6, ¶13]

.118–.119 [Insert current Codification paragraphs .108 and .109.]

Interfund Receivables and Payables

.120 Interfund loans are amounts provided with a requirement for repayment, as discussed in Section 1800, "Classification and Terminology," paragraph .102. Since each fund is a fiscal and accounting entity, the amounts due to one fund from other funds, as well as the amounts owed to other funds, should be reflected in the fund accounts and in fund financial statements. Interfund loans should be reported as interfund receivables in lender funds and interfund payables in borrower funds. Where money is owed from one fund to another fund and money is also owed from the latter to the former, the amounts receivable and payable should not be offset in the accounts. But for purposes of reporting, current amounts due from and due to the same funds may be offset and the net amounts shown in the respective fund balance sheets. Liabilities arising from interfund activities do not constitute general long-term liabilities and therefore should be reported in governmental funds. [NCGAS 1, ¶22 and fn5; GASBS 34, ¶81 and ¶112]

Classifications of Funds

.121 [Insert current Codification paragraph .111.]

.122 [Insert current Codification paragraph .112, omitting last sentence.] [NCGAS 1, ¶25, as amended by GASBS 6, ¶13 and GASBS 34, ¶63]

Period versus Project Orientation of Funds

.123 [Insert current Codification paragraph .113, revising first sentence as follows:] The transactions of most of the funds are planned and evaluated annually, and may be controlled by annual appropriations. [NCGAS 1, ¶27, as amended by GASBS 6, ¶13 and GASBS 34, ¶63]

.124 [Insert current Codification paragraph .114.]

Reporting Entity Fund Presentation

.125 Section 2200 provides a detailed discussion of fund presentation in the basic financial statements.

* * *

[Rename and revise entire section as follows:]

REPORTING CAPITAL ASSETS **SECTION 1400**

Sources: NCGA Statement 1
GASB Statement 6
GASB Statement 8
GASB Statement 34

Statements of Principle
Reporting Capital Assets

A clear distinction should be made between general capital assets and capital assets of proprietary and fiduciary funds. Capital assets of proprietary funds should be reported in both the government-wide and fund financial statements. Capital assets of fiduciary funds should be reported only in the statement of fiduciary net assets. All other capital assets of the governmental unit are general capital assets. They should not be reported as assets in governmental funds but should be reported in the governmental activities column in the government-wide statement of net assets. [NCGAS 1, ¶32, as amended by GASBS 34, ¶6; GASBS 34, ¶80]

Valuation of Capital Assets

Capital assets should be reported at historical cost. The cost of a capital asset should include capitalized interest and ancillary charges necessary to place the asset into its intended location and condition for use. Donated capital assets should be reported at their estimated fair value at the time of acquisition plus ancillary charges, if any. [GASBS 34, ¶18]

Depreciation of Capital Assets

Capital assets should be depreciated over their estimated useful lives unless they are either inexhaustible or are infrastructure assets using the modified approach as set forth in this section. Inexhaustible assets such as land and land improvements should not be depreciated. Depreciation expense should be reported in the government-wide statement of activities; the proprietary fund statement of revenues, expenses, and changes in fund net assets; and the statement of changes in fiduciary net assets. [GASBS 34, ¶21, ¶22, ¶92, and ¶107]

Reporting Capital Assets—General Requirements

.101 Section 2200, "Comprehensive Annual Financial Report," requires general purpose and special-purpose governments engaged in governmental activities to provide basic financial statements that include government-wide and fund financial statements. A clear distinction should be made between general capital assets and capital assets of proprietary and fiduciary funds. Capital assets of proprietary funds should be reported in both the government-wide and fund financial statements. Capital assets of fiduciary funds should be reported only in the statement of fiduciary net assets. All other capital assets of the governmental unit are general capital assets. They should not be reported as assets in governmental funds but should be reported in the governmental activities column in the government-wide statement of net assets. [NCGAS 1, ¶32, as amended by GASBS 34, ¶6; GASBS 34, ¶80]

.102–.103 [GASBS 34, ¶18 and ¶19] [Change *Statement* to *section.*]

.104 [GASBS 34, ¶21] [Change cross-references.]

Modified Approach

.105–.108 [GASBS 34, ¶23–¶26] [Change cross-references.]

Reporting Works of Art and Historical Treasures

.109–.111 [GASBS 34, ¶27–29] [Change cross-references.]

Reporting Capital Assets in Government-wide Financial Statements

.112–.113 [GASBS 34, ¶20 and ¶22] [Change cross-references.]

Reporting General Capital Assets

.114 [GASBS 34, ¶80]

Reporting Capital Assets in Proprietary Fund Financial Statements

.115 Capital assets of proprietary funds (enterprise and internal service) should be reported in the government-wide statement of net assets and in the proprietary fund statement of net assets. Capital assets of proprietary funds should be capitalized and reported as discussed in paragraphs .102 through .111, above. [GASBS 34, ¶92 and ¶97]

Reporting Capital Assets in Fiduciary Fund Financial Statements

.116 Capital assets of fiduciary funds and component units that are fiduciary in nature should be reported in the statement of fiduciary net assets. Capital assets of fiduciary funds should be capitalized and reported as discussed in paragraphs .102 through .111, above. [GASBS 34, ¶107 and ¶108]

Required Note Disclosures about Capital Assets

.117 Required disclosures concerning capital assets are discussed in Section 2300, “Notes to Financial Statements.”

Required Supplementary Information—Modified Approach

.118–.119 [GASBS 34, ¶132 and ¶133] [Change cross-references and footnote numbers.]

Other Matters

Capital Assets Acquired through Special Assessments

.120 Capital improvements financed by special assessments that provide capital assets to a government should be reported at historical cost and depreciated, as appropriate, as discussed in paragraphs .101 through .115. Related revenues should be reported as either program revenues or general revenues in the government-wide statement of activities, in accordance with Section S40, “Special Assessments,” paragraphs .124 and .125. Capital improvements financed by special assessments that provide capital assets to a government’s proprietary funds should be reported as capital contributions after nonoperating revenues and expenses in the statement of revenues, expenses, and changes in fund net assets in accordance with Section S40, paragraph .122. [GASBS 6, ¶23, as amended by GASBS 34; GASBS 34, ¶50, ¶52, and ¶103]

Capital Assets Acquired through Grants, Contributions, or Other Nonexchange Transactions

.121 Capital assets acquired through grants, contributions, or other nonexchange transactions should be reported at historical cost or fair value and depreciated, as appropriate, as discussed in paragraphs .101 through .116. Related revenues should be reported in the government-wide statement of net assets and reported as either program revenues or general revenues in the government-wide statement of activities, in accordance with Section 2200, “Comprehensive Annual Financial Report,” paragraphs .135 through .137. When related revenues are reported in proprietary funds, the capital contributions should be reported after nonoperating revenues and expenses in the proprietary fund statement of revenues, expenses, and changes in fund net assets in accordance with Section 2200, paragraph .169. [GASBS 34, ¶50, ¶52, and ¶103]

Capital Assets Acquired through Capital Leases

.122 Section L20, "Leases," provides guidance on reporting capital assets acquired through capital leases.

Equipment and Facilities Used in Landfills

.123 Section L10, "Landfill Closure and Postclosure Care Costs," paragraphs .106 through .110, provides guidance for accounting and financial reporting for equipment and facilities used in operating municipal solid waste landfills.

Reporting by Colleges and Universities

.123 [Revise current Codification paragraph .119 as follows:] Colleges and universities that follow the AICPA College Guide model, as discussed in Section Co5, "College and Universities," should not change their accounting and reporting for depreciation of capital assets as a result of FASB Statement No. 93, *Recognition of Depreciation by Not-for-Profit Organizations.*[1] The GASB has several projects under way that may affect that reporting. [GASBS 8, ¶10 and ¶11, as amended by GASBS 15 and GASBS 34, ¶135]

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[1]The purpose of this paragraph is to maintain the status quo of applicable accounting standards (pending completion of related GASB projects) by requiring that governmental entities not change their accounting and reporting *as a result of FASB Statement 93.* Governmental colleges and universities are not precluded from depreciating their capital assets by reporting a depreciation allowance in the balance sheet and a provision for depreciation in the statement of changes in the balance of the investment-in-plant fund subsection of the plant funds group in accordance with the AICPA College Guide model. [GASBS 8, fn3, as amended by GASBS 34, ¶135]

* * *

[Rename section and revise as follows:]

REPORTING LIABILITIES **SECTION 1500**

Sources: [Add the following:] GASB Statement 34

[Revise the Statement of Principle as follows:]

Statement of Principle
Accounting for Long-term Liabilities

> A clear distinction should be made between fund long-term liabilities and general long-term liabilities. Long-term liabilities directly related to and expected to be paid from proprietary funds should be reported in the proprietary fund statement of net assets and in the government-wide statement of net assets. Long-term liabilities directly related to and expected to be paid from fiduciary funds should be reported in the statement of fiduciary net assets. All other unmatured general long-term liabilities of the governmental unit should not be reported as liabilities in governmental funds but should be reported in the governmental activities column of the government-wide statement of net assets. [NCGAS 1, ¶32 and ¶42; GASBS 34, ¶6 and ¶82]

[Revise paragraph .101 and related heading as follows:]

Reporting Long-term Liabilities

.101 Section 2200, “Comprehensive Annual Financial Report,” requires general purpose and many special-purpose governments to provide basic financial statements that include government-wide and fund financial statements. Because of the distinctive nature of fund financial statements and fund accounting requirements, some long-term liabilities should be reported in fund financial statements, while some should be reported only in the governmental activities column in the government-wide statement of net assets. [NCGAS 1, ¶33, as amended by GASBS 34, ¶6; GASBS 34, ¶82]

.102 [Revise paragraph by omitting the word *similar* from first sentence.] [NCGAS 1, ¶42, as amended by NCGAS 4, ¶14, NCGAI 8, ¶12, NCGAI 9, ¶12, GASBS 6, ¶13 and ¶23, GASBS 10, ¶53, GASBS 13, ¶7, GASBS 16, ¶6, GASBS 18, ¶7, GASBS 27, ¶17, GASBS 34, ¶69, and GASBI 1, ¶13]

General Long-term Liabilities

.103 [Revise first sentence as follows:] All other unmatured long-term indebtedness of the government, including certain special assessment debt discussed in paragraph .106 below, is *general long-term debt* and should not be reported as liabilities in governmental funds but should be reported only in the governmental activities column in the government-wide statement of net assets. [NCGAS 1, ¶43, as amended by NCGAS 4, ¶14, NCGAI 8, ¶11 and ¶12, NCGAI 9, ¶12, GASBS 6, ¶17, GASBS 13, ¶9, GASBS 16, ¶13, GASBS 17, ¶6, GASBS 18, ¶10, GASBS 27, ¶16, and GASBI 1, ¶10 and ¶12; GASBS 34, ¶82]

.104 [Revise paragraph by omitting last two sentences.] [NCGAS 1, ¶44, as amended by GASBS 34]

[Delete current Codification paragraph .105, renumbering remaining paragraphs.]

.105 [Revise current Codification paragraph .106 as follows:] Debt issued to finance capital projects that will be repaid wholly or partly from special assessments against benefited property owners should be reported as follows:

a. General obligation debt that will be repaid, in part, from special assessments should be reported as general long-term liabilities in the governmental activities column in the government-wide statement of net assets.
b. Special assessment debt for which the government is obligated in some manner as described in Section S40, paragraph .115, should be reported as general long-term liabilities in the governmental activities column in the government-wide statement of net assets, except for the portion, if any, that is directly related to and expected to be paid from proprietary funds.
   (1) The portion of the special assessment debt that will be repaid from property owner assessments should be reported as "special assessment debt with governmental commitment."
   (2) The portion of special assessment debt that will be repaid from general resources of the government (the public benefit portion, or the amount assessed against government-owned property) should be reported like other general long-term liabilities.

(3) The portion of special assessment debt that is directly related to and expected to be paid from proprietary funds should be reported as liabilities of those funds in the proprietary fund statement of net assets. Liabilities directly related to and expected to be repaid from proprietary funds also should be reported in the government-wide statement of net assets.

c. Special assessment debt for which the government is not obligated in any manner should not be displayed in the government's financial statements. However, if the government is liable for a portion of that debt (the public benefit portion, or as a property owner), that *portion* should be reported as above.

d. If a governmental entity is obligated in some manner for capital improvement special assessment debt (as discussed in Section S40, paragraph .115), capital assets constructed or acquired with capital improvement special assessment debt should be reported in the government-wide financial statements as capital assets of either governmental or business-type activities in the statement of net assets.

[GASBS 6, ¶15 and ¶17; GASBS 34, ¶15, ¶30, ¶82, and ¶92]

.106 [Revise current Codification paragraph .107 as follows:] Short-term and specific fund long-term liabilities (of proprietary funds and fiduciary funds), interfund liabilities, and, in certain circumstances, demand bonds are recorded as fund liabilities. All other long-term liabilities are general long-term liabilities and should not be reported in governmental funds but should be reported as liabilities in the governmental activities column in the government-wide statement of net assets. Proceeds of long-term debt issues not recorded as fund liabilities—for example, proceeds of bonds or notes expended through capital projects or debt service funds—normally should be reflected as "Other Financing Sources" in the operating statement of the recipient fund. Such proceeds should be reported in captions such as "Bond Issue Proceeds" or "Proceeds of Long-Term Notes." The proceeds of a special assessment debt issue for which the government is *not* obligated in any manner should be identified by a description other than "bond proceeds," such as "contribution from property owners," in accordance with Section S40, paragraph .119. The treatment of proceeds of advance refundings of general long-term debt and related payments is discussed in Section D20, "Debt Refundings." [NCGAS 1, ¶107 and ¶108; GASBS 6, ¶19; GASBS 34, ¶81, ¶82, and ¶88; GASBI 1, ¶10, ¶12, and ¶13]

Long-term Debt Issue Expenditures

.107 [Revise current Codification paragraph .108 by deleting the phrase *and the debt principal amount removed from the GLTDAG* from next-to-last sentence.] [NCGAS 1, ¶70 and ¶72, as amended by GASBS 34, ¶82; GASBS 6, ¶16]

Debt Refundings

.108 [Revise current Codification paragraph .116 as follows:] Accounting and financial reporting of advance refundings that result in legal or in-substance defeasance of debt is discussed in Section D20.

AICPA AUDIT AND ACCOUNTING GUIDES CLEARED BY THE GASB

Timing of Debt Reporting

.601 [Revise paragraph as follows:] The 1994 AICPA Industry Audit and Accounting Guide, *Audits of State and Local Governmental Units,* paragraph 10.10, provides guidance on the timing of initial reporting of debt proceeds resulting from the issuance of bonds or other debt instruments.

* * *

[Revise entire section as follows:]

Sources: NCGA Statement 1
NCGA Statement 4
NCGA Interpretation 3
AICPA *Audits of State and Local Governmental Units,* 1974
AICPA Statement of Position 75-3
GASB Statement 6
GASB Statements 16 through 17
GASB Statement 22
GASB Statement 31
GASB Statement 34

Statements of Principle
Measurement Focus and Basis of Accounting
Government-wide Financial Statements

The government-wide statement of net assets and the statement of activities should be prepared using the economic resources measurement focus and the accrual basis of accounting. Revenues, expenses, gains, losses, assets, and liabilities resulting from exchange and exchange-like transactions should be recognized when the exchange takes place. Revenues, expenses, assets, and liabilities resulting from nonexchange transactions should be recognized in accordance with Section N50, “Nonexchange Transactions.” [GASBS 34, ¶16]

Fund Financial Statements

In fund financial statements, the modified accrual or accrual basis of accounting, as appropriate, should be used in measuring financial position and operating results.

a. Financial statements for governmental funds should be presented using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues should be recognized in the accounting period in which they become available and measurable. Expenditures should be recognized in the accounting period in which the fund liability is incurred, if measurable, except for unmatured interest on general long-term liabilities, which should be recognized when due.

b. Proprietary fund statements of net assets and revenues, expenses, and changes in fund net assets should be presented using the economic resources measurement focus and the accrual basis of accounting.
c. Financial statements of fiduciary funds should be reported using the economic resources measurement focus and the accrual basis of accounting, except for the recognition of certain liabilities of defined benefit pension plans and certain postemployment healthcare plans, as discussed in Sections P20, "Pension Activities—Employer Reporting," and P50, "Postemployment Benefits Other Than Pension Benefits—Employer Reporting."
d. Transfers should be reported in the accounting period in which the interfund receivable and payable arise.

[NCGAS 1, ¶57, as amended by GASBS 6, ¶15; GASBS 34, ¶6, ¶79, ¶92, and ¶107]

.101 [Insert current Codification paragraph .101, omitting last sentence.]

Cash and Accrual Bases

.102 Under the *cash* basis of accounting, revenues and transfers in are not recognized until cash is received, and expenditures or expenses (as appropriate) and transfers out are recognized only when cash is disbursed. Under the *accrual* basis of accounting, most transactions are recognized when they occur, regardless of when cash is received or disbursed. Items not practicably measurable until cash is received or disbursed are accounted for at that time using either basis of accounting, as may be items whose measurement would be approximately the same under either basis or that are immaterial. [NCGAS 1, ¶59, as amended by GASBS 34]

Accrual-Basis Reporting in Government-wide Financial Statements

.103–.104 [GASBS 34, ¶16 and ¶17] [Change cross-references.]

Modified Accrual Basis in Governmental Fund Statements

.105 The major differences in applying the accrual concept in governmental fund accounting, as opposed to that used in government-wide financial statements and proprietary and fiduciary fund statements, relate to differences in the environment and in the accounting measurement objectives. These modifications and adaptations for the practical and appropriate implementation of the accrual concept in governmental fund accounting are best referred to as the "modified accrual basis" and should be applied in all governmental fund accounting and reporting. [NCGAS 1, ¶61, as amended by GASBS 34, ¶6]

Revenue Recognition

.106–.117 [Insert current Codification paragraphs .106–.117.]

Expenditure Recognition

.118 [Insert current Codification paragraph .118.]

.119 [Insert current Codification paragraph .119, revising next-to-last sentence as follows:] The remainder of the liability should not be reported as liabilities in governmental funds but should be reported in the governmental activities column in the government-wide statement of net assets. [NCGAS 4, ¶16 and ¶17; GASBS 16, ¶13; GASBS 17, ¶6; GASBS 34, ¶82]

.120–.122 [Insert current Codification paragraphs .120–.122.]

.123 [Insert current Codification paragraph .123, omitting the phrase *and the debt principal amount removed from the GLTDAG* from last sentence.] [NCGAS 1, ¶72, as amended by GASBS 34]

.124–.126 [Insert current Codification paragraphs .124–.126.]

Accrual Basis in Proprietary Fund Statements

.127–.130 [GASBS 34, ¶92–¶95] [Change cross-references.]

Accrual Basis in Fiduciary Fund Statements

.131 [GASBS 34, ¶107] [Change cross-references.]

Transfers

.132 [Insert current Codification paragraph .128.]

* * *

THE BUDGET AND BUDGETARY ACCOUNTING SECTION 1700

Sources: [Add the following:] GASB Statement 34

Governmental Fund Budgeting and Budgetary Control

.114 [Revise definition of *appropriated budget* as follows:]

Appropriated Budget: The expenditure authority created by the appropriation bills or ordinances that are signed into law and related estimated revenues. Appropriated budgets include both original and final budgets:

a. The *original budget* is the first complete appropriated budget. The original budget may be adjusted by reserves, transfers, allocations, supplemental appropriations, and other legally authorized legislative and executive changes *before* the beginning of the fiscal year. The original budget should also include actual appropriation amounts automatically carried over from prior years by law. For example, a legal provision may require the automatic rolling forward of appropriations to cover prior-year encumbrances.
b. The *final budget* is the original budget adjusted by all reserves, transfers, allocations, supplemental appropriations, and other legally authorized legislative and executive changes applicable to the fiscal year, whenever signed into law or otherwise legally authorized.

[NCGAI 10, ¶11; GASBS 34, ¶130]

* * *

[Revise entire section as follows:]

Sources: NCGA Statement 1
NCGA Statement 5
GASB Statements 6 through 7
GASB Statement 20
GASB Statement 34
GASB Interpretation 1

Statements of Principle
Transfer, Revenue, Expenditure, and Expense Account Classification

a. Transfers should be classified separately from revenues and expenditures or expenses in the basic financial statements.
b. Proceeds of general long-term debt issues should be classified separately from revenues and expenditures in the governmental fund financial statements.
c. Governmental fund revenues should be classified by fund and source. Expenditures should be classified by fund, function (or program), organization unit, activity, character, and principal classes of objects.
d. Proprietary fund revenues should be reported by major sources, and expenses should be classified in essentially the same manner as those of similar business organizations, functions, or activities.
e. The statement of activities should present *governmental* activities at least at the level of detail required in the governmental fund statement of revenues, expenditures, and changes in fund balances—at a minimum by *function.* Governments should present *business-type* activities at least by *segment,* as discussed in Section 2500, "Segment Information."

[NCGAS 1, ¶99; GASBS 34, ¶6, ¶39, ¶53, ¶88, ¶100, and ¶112]

Common Terminology and Classification

A common terminology and classification should be used consistently throughout the budget, the accounts, and the financial reports of each fund. [NCGAS 1, ¶123]

Introduction

.101 Use of proper terminology and appropriate classification is essential throughout the budgeting, accounting, and reporting processes. It is especially important that (a) transfers be distinguished from revenues and expenditures or expenses in the basic financial statements, (b) proceeds of general long-term debt issues be distinguished from governmental fund revenues and expenditures, and (c) the terms *revenues* and *expenses,* as used in the government-wide financial statements and in proprietary and trust fund financial statements, be distinguished from the terms *revenues* and *expenditures* as used in the governmental fund financial statements. [NCGAS 1, ¶100, as amended by GASBS 34, ¶6; GASBS 34, ¶53, ¶88, ¶100, and ¶112]

Reporting Interfund Activity in Fund Financial Statements

.102 [GASBS 34, ¶112] [Change cross-references.]

Reporting Internal Activities and Balances in Government-wide Financial Statements

.103–.105 [GASBS 34, ¶58–¶60] [Change cross-reference.]

Reporting Intra-entity Activity and Balances in Government-wide Financial Statements

.106 [GASBS 34, ¶61] [Change cross-reference.]

Reporting Internal Service Fund Balances in Government-wide Financial Statements

.107 [GASBS 34, ¶62]

Terminology and Classification Consistency in Governmental Fund Financial Statements

General Long-term Debt Issue Proceeds

.108 Proceeds of long-term debt issues not recorded as fund liabilities—for example, proceeds of bonds or notes expended through capital projects or debt service funds—normally should be reflected as "Other Financing Sources" in the operating statement of the recipient fund. Such proceeds should be reported in captions such as "Bond Issue Proceeds" or "Proceeds of Long-Term Notes." The proceeds of a special assessment issue for which the government is *not* obligated in any manner should be identified by a description other than "bond proceeds," such as "contribution from property owners," in accordance with Section S40, "Special Assessments," paragraph .119. General long-term debt issue premiums or discounts and certain payments to escrow agents for bond refundings should also be reported as other financing sources and uses. [NCGAS 1, ¶108; GASBS 6, ¶19; GASBS 34, ¶88]

.109 [Insert current Codification paragraph .111, revising first sentence as follows:] For current and advance refundings resulting in defeasance of general long-term debt, the proceeds of the new debt should be reported as an "other financing source—proceeds of refunding bonds" in the fund receiving the proceeds. [GASBS 7, ¶8, as amended by GASBS 34, ¶82 and ¶88]

Other General Long-term Debt Transactions

.110 Debt issue costs paid out of debt proceeds, such as underwriter fees, should be reported as expenditures. Issue costs, such as attorney and rating agency fees or bond insurance, paid from existing resources should be reported as expenditures when the related liability is incurred. [GASBS 34, ¶87]

Demand Bonds

.111 [Insert current Codification paragraph .112.]

Capital Lease Transactions

.112 [Insert current Codification paragraph .113.]

Capital Asset Sales

.113 Sales of capital assets (unless the sale meets the criteria for reporting as a special item, as defined in paragraph .130) should be reported as other financing sources in governmental funds. [GASBS 34, ¶88]

Revenue and Expenditure Classification

.114–.121 [Insert current Codification paragraphs .114–.121.]

Proprietary Fund Revenue and Expense Classification

.122 Proprietary fund revenues should be reported by major sources, and expenses should be classified in essentially the same manner as similar business organizations or activities, unless that classification conflicts with or contradicts GASB pronouncements, as discussed in Section P80, "Proprietary Fund Accounting and Financial Reporting." Such classification is appropriate in view of the nature of these funds, and facilitates comparison of their operating results with those of like organizations in both the public and private sectors. Further, widely accepted account classifications are available for several types of enterprise and other commercial-type activities. [NCGAS 1, ¶117; GASBS 20, ¶6; GASBS 34, ¶100]

Classification of Expenses and Revenues in the Government-wide Statement of Activities

.123–.125 [GASBS 34, ¶39–¶41] [Change cross-references.]

.126 [GASBS 34, ¶48]

.127–.128 [GASBS 34, ¶52 and ¶53] [Change cross-references.]

Reporting Extraordinary and Special Items in Government-wide Statement of Activities

.129–.130 [GASBS 34, ¶55 and ¶56] [Change cross-reference.]

Reporting Extraordinary and Special Items in Fund Financial Statements

.131 In governmental fund statements of revenues, expenditures, and changes in fund balances, special and extraordinary items (defined in paragraphs .129 and .130) should be reported separately after "other financing sources and uses." If both occur during the same period, special and extraordinary items should be reported separately within a "special and extraordinary items" classification. Significant transactions or events that are either unusual or infrequent but not within the control of management should be separately identified within the appropriate revenue or expenditure category in the statement of revenues, expenditures, and changes in fund balances or disclosed in the notes to financial statements. (Because other financing sources and uses, rather than *gains* or *losses,* are reported for debt refundings in governmental funds, debt refunding transactions should not be reported as extraordinary items in governmental funds.) Special and extraordinary items in the proprietary fund statement of revenues, expenditures, and changes in fund net assets should be reported after nonoperating revenues and expenses. [GASBS 34, ¶86, ¶89, and ¶100]

Reporting Restricted Net Assets in Government-wide Financial Statements

.132 The difference between a government's assets and its liabilities in the government-wide statement of net assets is its *net assets*. Net assets should be displayed in three broad components—*invested in capital assets, net of related debt; restricted* (distinguishing between major categories of restrictions); and *unrestricted*. [GASBS 34, ¶32]

.133–.137 [GASBS 34, ¶33–¶37] [Change cross-references.]

Reporting Restrictions in Proprietary Funds

.138 Net assets of proprietary funds should be displayed in three components—*invested in capital assets, net of related debt; restricted* (distinguishing between major categories of restrictions); and *unrestricted*. Paragraphs .133 through .137 define these terms for purposes of determining the amount to be reported in the various components of fund net assets. Designations of net assets should not be reported on the face of the financial statements. [GASBS 34, ¶98]

Reporting Reservations in Governmental Funds

.139–.142 [Insert current Codification paragraphs .123–.126.]

.143 Reserved fund balances of the combined nonmajor funds should be displayed in sufficient detail to disclose the purposes of the reservations (for example, reserved for debt service or reserved for encumbrances). Unreserved fund balances of nonmajor funds should be displayed by fund type on the face of the balance sheet. [GASBS 34, ¶84]

Terminology and Classification Consistency

.144–.147 [Insert current Codification paragraphs .128–.131, deleting the words *and Account Groups* from heading to current Codification paragraph .129.]

AICPA AUDIT AND ACCOUNTING GUIDES CLEARED BY THE GASB

Interfund Borrowings

.601 [Insert current Codification paragraph .601.]

* * *

FINANCIAL REPORTING SECTION 1900

[Eliminate entire section.]

* * *

DEFINING THE FINANCIAL REPORTING ENTITY SECTION 2100

Sources: [Add the following:] GASB Statement 34

Scope of This Section

.101 [Change *statements* to *reports* in the third sentence and add this sentence at end of paragraph:] Section 2200, "Comprehensive Annual Financial Report," provides guidance on the components of comprehensive annual financial reports, including basic financial statements. [GASBS 14, ¶1 and ¶9, as amended by GASBS 34, ¶6]

.110 [Revise paragraph as follows:] The financial statements of the reporting entity should allow users to distinguish between the primary government and its component units by communicating information about the component units and their relationships with the primary government rather than creating the perception that the primary government and all of its component units are one legal entity. To accomplish this goal, the reporting entity's government-wide financial statements should display information about the reporting government as a whole, using separate rows and columns to distinguish between the total primary government and its **discretely presented** component units. The reporting entity's fund financial statements should present the primary government's governmental, proprietary, and fiduciary funds (including its **blended** component units, which are, in substance, part of the primary government), reporting major funds individually and nonmajor funds in the aggregate. Component units that are fiduciary in nature should be reported only in the statements of fiduciary net assets and changes in fiduciary net assets with the primary government's fiduciary funds. [GASBS 14, ¶11; GASBS 34, ¶6, ¶13, ¶14, and ¶125]

Definition of the Financial Reporting Entity

.111 [Revise paragraph as follows:] As discussed in detail below, the financial reporting entity consists of (a) the primary government, (b) organizations for which the primary government is **financially accountable** (see paragraphs .120–.136), and (c) other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete (see paragraphs .138–.140). The nucleus of a financial reporting entity usually is a primary government. However, a governmental organization other than a primary government (such as a component unit, a joint venture, a jointly governed organization, or an other stand-alone government) serves as the nucleus for its own reporting entity when it issues separate financial reports. Although this section is written from the perspective of the primary government, its requirements apply to the separately issued basic financial statements of governmental component units, joint ventures, jointly governed organizations, and other stand-alone governments. These organizations should apply the provisions of this section as if they were a primary government. [GASBS 14, ¶12, as amended by GASBS 34, ¶6]

DEFINITIONS

.501 This paragraph presents terms defined within the context of this section and includes definitions of other terms used in this section. Paragraph references direct the reader to a more complete discussion of the term within this section and Sections 2600 and J50. [GASBS 14, ¶131, as amended by GASBS 34, ¶6 and ¶126]

Discrete presentation (discretely presented)

[Revise definition as follows:] The method of reporting financial data of component units in a column(s) separate from the financial data of the primary government. An integral part of this method of presentation is that major component unit supporting information is required to be provided in the reporting entity's basic financial statements by (a) presenting each major component unit in a separate column in the reporting entity's statements of net assets and activities, (b) including combining statements of major component units in the reporting entity's basic statements after the fund financial statements, or (c) presenting condensed financial statements in the notes to the reporting entity's basic financial statements. [2600.107–.111]

Financial reporting entity

[Revise definition as follows:] A primary government, organizations for which the primary government is financially accountable, and other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity's basic financial statements to be misleading or incomplete. The nucleus of a financial reporting entity usually is a primary government. However, a governmental organization other than a primary government (such as a component unit, a joint venture, a jointly governed organization, or other stand-alone government) serves as the nucleus for its own reporting entity when it issues separate financial statements. [2100.109–.111]

* * *

[Revise entire section as follows:]

Sources: NCGA Statement 1
GASB Statement 9
GASB Statement 14
GASB Statement 25
GASB Statement 34

Statement of Principle
Annual Financial Reporting

a. A comprehensive annual financial report should be prepared and published, covering all activities of the primary government (including its blended component units) and providing an overview of all discretely presented component units of the reporting entity—including introductory section, management's discussion and analysis (MD&A), basic financial statements, required supplementary information other than MD&A, combining and individual fund statements, schedules, narrative explanations, and statistical section. The reporting entity is the primary government (including its blended component units) and all discretely presented component units presented in accordance with Section 2100, "Defining the Financial Reporting Entity."
b. The minimum requirements for MD&A, basic financial statements, and required supplementary information other than MD&A are:
   (1) Management's discussion and analysis.
   (2) Basic financial statements. The basic financial statements should include:
      (a) Government-wide financial statements.
      (b) Fund financial statements.
      (c) Notes to the financial statements.
   (3) Required supplementary information other than MD&A.
c. As discussed in Section 2100, the financial reporting entity consists of (1) the primary government, (2) organizations for which the primary government is financially accountable, and (3) other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity's basic financial state-

ments to be misleading or incomplete. The reporting entity's government-wide financial statements should display information about the reporting government as a whole, distinguishing between the primary government and its discretely presented component units as well as between the primary government's governmental and business-type activities. The reporting entity's fund financial statements should present the primary government's (including its blended component units, which are, in substance, part of the primary government) major funds individually and nonmajor funds in the aggregate. Funds and component units that are fiduciary in nature should be reported only in the statements of fiduciary net assets and changes in fiduciary net assets.

d. The nucleus of a financial reporting entity usually is a primary government. However, a governmental organization other than a primary government (such as a component unit, joint venture, jointly governed organization, or other stand-alone government) serves as the nucleus for its own reporting entity when it issues separate financial statements. For all of these entities, the provisions of Section 2100 should be applied in layers "from the bottom up." At each layer, the definition and display provisions should be applied before the layer is included in the financial statements of the next level of the reporting government.

[NCGAS 1, ¶128; GASBS 14, ¶11, ¶12, ¶19, ¶43, ¶65, and ¶66; GASBS 34, ¶6, ¶13–¶15, and ¶125]

Comprehensive Annual Financial Reports—Overview

.101 Every governmental entity should prepare and publish, as a matter of public record, a comprehensive annual financial report (CAFR) that encompasses all funds of the primary government (including its blended component units). The CAFR should also encompass all discretely presented component units of the reporting entity. The financial section of the CAFR should contain:

a. Management's discussion and analysis. (See paragraphs .106–.109, below.)
b. Basic financial statements. (See paragraphs .110–.177, below.)
c. Required supplementary information other than MD&A. (See paragraphs .178–.180, below.)

d. Combining statements for nonmajor funds by fund type of the primary government (including its blended component units). Combining statements should also be presented for the nonmajor discretely presented component units. (See paragraphs .181–.183, below.)
e. Individual fund statements and schedules for the funds of the primary government (including its blended component units). (See paragraphs .181–.183, below.)

The CAFR is the governmental entity's official annual report and should also contain introductory information, schedules necessary to demonstrate compliance with finance-related legal and contractual provisions, and statistical data. The purpose of the reporting entity's financial statements is to report the financial position and results of operations of the primary government (including its blended component units) and provide an overview of the discretely presented component units. [NCGAS 1, ¶135, as amended by GASBS 14; GASBS 14, ¶19, ¶44, and ¶50; GASBS 34, ¶6, ¶126, and fn36]

Minimum Requirements for General Purpose External Financial Reporting

.102–.103 [GASBS 34, ¶6 and ¶7]

The Comprehensive Annual Financial Report

.104 The CAFR of a governmental entity should contain management's discussion and analysis (MD&A), the basic statements indicated below (including notes thereto), required supplementary information (RSI) other than MD&A, and other appropriate statements, schedules, narrative explanations, and statistical tables. It should be prepared and published promptly after the close of the fiscal year and should contain the report of the independent auditor, if an audit has been performed, together with a letter(s) of transmittal and such other information as management deems appropriate. Timely and properly presented financial reports are essential to managers, legislative officials, creditors, financial analysts, the general public, and others having need for government financial information. [NCGAS 1, ¶129 and ¶138, as amended by GASBS 14; GASBS 34, ¶6]

.105 The outline and minimum content of the CAFR of a governmental entity (with references to detailed discussion sections in this Codification) are as follows:

a. **Introductory Section**
   (Table of contents, letter(s) of transmittal, and other material deemed appropriate by management)

b. **Financial Section**
   (1) **Auditor's Report**
   (2) **Management's discussion and analysis**
   (3) **Basic financial statements**[1]
      (a) Government-wide financial statements
         (i) Statement of net assets
         (ii) Statement of activities
      (b) Fund financial statements
         (i) Governmental funds
            (a) Balance sheet
            (b) Statement of revenues, expenditures, and changes in fund balances
         (ii) Proprietary funds
            (a) Statement of net assets
            (b) Statement of revenues, expenses, and changes in fund net assets
            (c) Cash flows statement
         (iii) Fiduciary funds (and component units that are fiduciary in nature)
            (a) Statement of fiduciary net assets
            (b) Statement of changes in fiduciary net assets
      (c) Notes to the financial statements
   (4) **Required supplementary information other than MD&A**
   (5) **Combining statements and individual fund statements and schedules**
      (a) Combining statements
         (i) By fund type—when a primary government (including its blended component units) has more than one nonmajor fund.
         (ii) For discretely presented component units—when the reporting entity has more than one nonmajor component unit. Fund financial

[1]Any interfund and similar eliminations made in the basic or combining financial statements should be apparent from the headings or disclosed in the notes to the financial statements. [NCGAS 1, ¶145 and ¶156, as amended by GASBS 34, ¶6]

statements for individual component units are also required if the information is not available in separately issued financial statements of the individual component unit.

(b) Individual fund statements—When the primary government (including its blended component units) has only one nonmajor fund of a given fund type or if necessary to present prior-year and budgetary comparisons not presented in required supplementary information.

(c) Schedules

(i) Schedules necessary to demonstrate compliance with finance-related legal and contractual provisions.

(ii) Schedules to present information spread throughout the statements that can be brought together and shown in greater detail (for example, taxes receivable, including delinquent taxes; long-term debt; investments; and cash receipts, disbursements, and balances).

(iii) Schedules to present greater detail for information reported in the statements (for example, additional revenue sources detail and object of expenditure data by departments).

(Narrative explanations useful in understanding combining and individual fund and component unit statements and schedules that are not included in the notes to the financial statements should be presented on divider pages, directly on the statements and schedules, or in an accompanying section.)

c. **Statistical Section**
(See Section 2800, "Statistical Tables.")

[NCGAS 1, ¶139, as amended by GASBS 34, ¶77 and ¶79; GASBS 14, ¶19 and ¶50; GASBS 34, ¶6, ¶12, ¶78, ¶91, and ¶106 and fn35]

Management's Discussion and Analysis (MD&A)

.106–.109 [GASBS 34, ¶8–¶11] [Change *Statement* to *section* and change cross-references.]

Basic Financial Statements—Government-wide Statements

.110–.113 [GASBS 34, ¶12–¶15] [Change cross-references.]

Reporting Capital Assets

.114 Section 1400, “Reporting Capital Assets,” provides guidance on accounting and financial reporting requirements for capital assets, including infrastructure assets.

Basic Financial Statements—Government-wide Financial Statements

.115–.147 [GASBS 34, ¶30–¶62] [Change *Statement* to *section* and change cross-references.]

Basic Financial Statements—Fund Financial Statements

.148–.176 [GASBS 34, ¶74–¶78, ¶83–¶91, ¶96–¶106, and ¶108–¶111] [Change cross-references.]

Basic Financial Statements—Notes to Financial Statements

.177 Note disclosure requirements are outlined in Section 2300, “Notes to Financial Statements.”

Required Supplementary Information Other Than Management’s Discussion and Analysis

.178 Required supplementary information consists of schedules, statistical data, and other information that the GASB has determined are an essential part of financial reporting and should be presented with, but are not part of, the basic financial statements of a governmental entity. With the exception of MD&A, discussed in paragraphs .106 through .108, all other required supplementary information (as required by various Codification sections) should be presented immediately following the notes to the basic financial statements.[x] Other RSI may include budgetary comparison schedules (discussed below), information about the modified approach for reporting infrastructure assets (see Section 1500), and employee benefit related information (see Section P20, “Pension Activities—Employer Reporting”). [GASBS 25, ¶44; GASBS 34, ¶8 and ¶129]

Budgetary Comparison Schedules

.179–.180 [GASBS 34, ¶130 and ¶131] [Change cross-references.]

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[x][GASBS 34, fn5] [Change cross-reference and renumber remaining footnotes.]

Comprehensive Annual Financial Reports—Combining Statements

.181 The primary government's major governmental and enterprise funds are required to be reported on the face of the fund financial statements, as discussed in paragraphs .149 and .150. Combining and individual fund statements required in the financial section of the CAFR for the funds of the primary government include:

a. Nonmajor governmental funds
   (1) Combining balance sheets
   (2) Combining statements of revenues, expenditures, and changes in fund balances
   (3) Individual fund balance sheets and statements of revenues, expenditures, and changes in fund balances, and schedules necessary to demonstrate compliance with finance-related legal and contractual provisions of governmental funds
b. Internal service funds and nonmajor enterprise funds
   (1) Combining statements of net assets/balance sheets
   (2) Combining statements of revenues, expenses, and changes in fund net assets/equity
   (3) Combining statements of cash flows
   (4) Individual statements of revenues, expenses, and changes in fund net assets/equity and of cash flows and schedules necessary to demonstrate compliance with finance-related legal and contractual provisions
c. Fiduciary funds[24]
   (1) A combining statement of fiduciary net assets
   (2) A combining statement of changes in fiduciary net assets.

[NCGAS 1, ¶143; GASBS 9, ¶67; GASBS 34, ¶70]

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[24]For defined benefit pension plans, the statement of fiduciary net assets and statement of changes in fiduciary net assets required by this Statement are equivalent to the statement of *plan* net assets and statement of changes in *plan* net assets, respectively, required by Section Pe5, "Pension Plans—Defined Benefit." In certain circumstances, combining statements are required for pension trust funds and for postemployment healthcare plans administered by defined benefit pension plans. (See Section Pe5, paragraphs .107–.109, and Section Po50, "Postemployment Healthcare Plans Administered by Defined Benefit Pension Plans," paragraph .105.) [GASBS 25, ¶15; GASBS 26, ¶7; GASBS 34, fn43]

.182 Section 2600, paragraph .108, discusses reporting requirements for major component units. The data presented for each component unit in the combining statements generally should be its aggregated totals, taken from the total columns in the component units' statements of net assets and activities so that the details support the totals reported in the nonmajor component units column and in the reporting entity's government-wide statements.[25] Presentation of the fund financial statements of the individual component units is not required unless such information is not available in separately issued financial statements of the component unit. Combining financial statements for nonmajor discretely presented component units should be included in the reporting entity's comprehensive annual financial report (CAFR) using the same methodology as combining (and individual fund) statements of the nonmajor funds of the primary government. [GASBS 14, ¶50; GASBS 34, ¶126]

Narrative Explanations

.183 Narrative explanations of combining and individual fund statements and schedules of the primary government (including its blended component units) and of combining and individual nonmajor discretely presented component units should provide information not included in the financial statements, notes to the financial statements, and schedules that is necessary (a) to assure an understanding of those statements and schedules and (b) to demonstrate compliance with finance-related legal and contractual provisions. (In extreme cases, it may be necessary to prepare a separate legal-basis special report as discussed in Section 1200, "Generally Accepted Accounting Principles and Legal Compliance," paragraph .113.) The narrative explanations, including a description of the nature and purpose of the various funds, should be presented on divider pages, directly on the statements and schedules, or in a separate section. [NCGAS 1, ¶159, as amended by GASBS 14 and GASBS 34]

Statistical Tables

.184 [Insert current Codification paragraph .133.]

Required Major Component Unit Information

.185–.189 [GASBS 34, ¶124–¶128] [Change cross-references.]

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[25][GASBS 34, fn51]

Reporting Colleges and Universities

.190–.191 [Insert current Codification paragraphs .121 and .122.]

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NOTES TO FINANCIAL STATEMENTS SECTION 2300

Sources: [Add the following:] GASB Statement 34

.101 [Revise paragraph as follows:] Two types of disclosure are necessary in the comprehensive annual financial report (CAFR): (a) notes to the financial statements that are essential for fair presentation of the basic financial statements and (b) narrative explanations useful in providing an understanding of required supplementary information and combining, individual fund, and component unit statements and schedules. [NCGAS 1, ¶157, as amended by GASBS 14, GASBS 25, ¶40, GASBS 27, ¶22, and GASBS 34, ¶6, ¶131, and ¶133]

Notes to Financial Statements

.102 [Revise paragraph as follows:] The notes to the financial statements should communicate information essential for fair presentation of the basic financial statements that is not displayed on the face of the financial statements. As such, the notes form an integral part of the basic financial statements. Notes essential to fair presentation in the reporting entity basic financial statements encompass:

a. Governmental and business-type activities, major funds individually, and nonmajor funds in the aggregate, of the primary government including its blended component units.
b. Major discretely presented component units considering both:
   (1) The unit's significance relative to the total discretely presented component units.
   (2) The nature and significance of the unit's relationship to the primary government.

[NCGAI 6, ¶2; GASBS 14, ¶63; GASBS 34, ¶15, ¶75, and ¶113]

[Delete current Codification paragraph .103 and renumber remaining paragraphs.]

.105 [Revise current Codification paragraph .106 as follows:] Notes to the financial statements essential to fair presentation in the basic financial statements include:

a. Summary of significant accounting policies,[1] including:
   (1) A description of the government-wide financial statements, noting that neither fiduciary funds nor component units that are fiduciary in nature are included. (See Section 2200, "Comprehensive Annual Financial Report," paragraph .111.)
   (2) A brief description of the component units of the financial reporting entity and their relationships to the primary government. This should include a discussion of the criteria for including component units in the financial reporting entity and how the component units are reported. Also include information about how the separate financial statements for the individual component units may be obtained. (See Section 2600, "Reporting Entity and Component Unit Presentation and Disclosure," paragraph .120.)
   (3) The measurement focus and basis of accounting used in the government-wide statements and the revenue recognition policies used in fund financial statements. (See Section 1600, "Basis of Accounting," paragraphs .103, .104, .106–.117, .127, and .131.)
   (4) The policy for eliminating internal activity in the government-wide statement of activities. (See Section 2200, paragraph .128.)
   (5) The method of encumbrance accounting and reporting. (See Section 1700, "The Budget and Budgetary Accounting," paragraph .130.)
   (6) The policy for capitalizing assets and for estimating the useful lives of those assets (used to calculate depreciation expense). (See Section 1400, "Capital Assets," paragraphs .102 and .104.) Governments that choose to use the modified approach for reporting eligible infrastructure assets should describe that approach.
   (7) A description of the types of transactions included in program revenues and the policy for allocating indirect expenses to functions in the statement of activities. (See Section 2200, paragraphs .135–.140.)
   (8) The policy for defining operating and nonoperating revenues of proprietary funds. (See Section P80, "Proprietary Fund Accounting and Financial Reporting," paragraph .117.)

[1][Insert current Codification footnote 1.]

(9) The policy for applying FASB pronouncements issued after November 30, 1989, to business-type activities and to enterprise funds of the primary government. (See Section P80, paragraph .103.)

(10) The definition of cash and cash equivalents used in the statement of cash flows for proprietary fund types. (See Section 2450, "Cash Flows Statements," paragraphs .106–.108.)

(11) The government's policy regarding whether to first apply restricted or unrestricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available. (See Section 1800, "Classification and Terminology," paragraph .134.)

b. Cash deposits with financial institutions. (See Section C20, "Cash Deposits with Financial Institutions.")
c. Investments. (See Section I50, "Investments.")
d. Significant contingent liabilities. (See Section 1500, "Reporting Liabilities," paragraph .109, and Section C50, "Claims and Judgments," paragraph .115.)
e. Encumbrances outstanding. (See Section 1700, paragraph .129d.)
f. Significant effects of subsequent events.
g. Annual pension cost and net pension obligations (NPO). (See Section P20, "Pension Activities—Employer Reporting.")
h. Material violations of finance-related legal and contractual provisions. (See Section 1200, "Generally Accepted Accounting Principles and Legal Compliance," paragraph .112.)
i. Debt service requirements to maturity. (See Section 1500, paragraph .107.)
j. Commitments under noncapitalized (operating) leases. (See Section L20, "Leases," paragraphs .120 and .121.)
k. Construction and other significant commitments.
l. Required disclosures about capital assets. (See paragraphs .111 and .112, below.)
m. Required disclosures about long-term liabilities. (See paragraphs .113 and .114, below.)
n. Deficit fund balance or net assets of individual funds.
o. Interfund receivables and payables.
p. Significant transactions between discretely presented component units and with the primary government.
q. Disclosures about donor-restricted endowments. (See paragraph .116, below.)

(See paragraph .901 for suggested disclosure sequence.) [NCGAS 1, ¶158; NCGAI 6, ¶4, as amended]

.106 [Revise current Codification paragraph .107 by deleting subparagraph k, renumbering remaining subparagraphs, and revising current subparagraph p as follows:] Interfund eliminations in fund financial statements not apparent from headings. (See Section 2200, paragraph .105.)

.107 [Add the following at the end of the list:]

dd. The amount of interest expense included in direct expenses. (See Section 2200, paragraph .132.)

.109 [Revise current Codification paragraph .110 as follows:] While a "Summary of Significant Accounting Policies" is required disclosure, it may be a stand-alone summary or may be included as the initial note to the financial statements. If it is a stand-alone summary, each page of the basic financial statements should be referenced thereto and also to the notes to financial statements. [NCGAI 6, ¶8, as amended by GASBS 34, ¶6]

[Insert five new paragraphs as follows:]

Required Note Disclosures about Capital Assets and Long-term Liabilities

.110–.114 [GASBS 34, ¶116–¶120] [Change cross-references.]

.115 [Insert current Codification paragraph .111, omitting the term *account group* from first sentence.] [NCGAS 1, ¶159, as amended by GASBS 14 and GASBS 34]

Disclosures about Donor-Restricted Endowments

.116 [GASBS 34, ¶121]

* * *

[Revise entire section as follows:]

Sources: NCGA Statement 1
NCGA Interpretation 10
GASB Statement 14
GASB Statement 34

Statement of Principle
Budgetary Reporting

Budgetary comparison schedules should be presented as required supplementary information for the general fund and for each major special revenue fund that has a legally adopted annual budget. The budgetary comparison schedule should present both (a) the original and (b) the final appropriated budgets for the reporting period as well as (c) actual inflows, outflows, and balances, stated on the government's budgetary basis.

Scope of This Section

.101 [Insert current Codification paragraph .101.]

Required Budgetary Comparison Schedules

.102–.103 [GASBS 34, ¶130 and ¶131] [Change cross-references.]

.104 [Insert current Codification paragraph .105.]

Comprehensive Annual Financial Reports

.105 The comprehensive annual financial report (CAFR) should include budgetary comparison schedules for individual nonmajor special revenue funds and other governmental funds of the primary government (including its blended component units). [NCGAS 1, ¶139 and ¶155, as amended by GASBS 14 and GASBS 34, ¶130]

Interim Reporting

.106 [Insert current Codification paragraph .107.]

Levels of Budgets

.107 [Insert current Codification paragraph .108.]

.108 [Insert current Codification paragraph .109, adding the following to subparagraph b:]

(1) The *original budget* is the first complete appropriated budget. The original budget may be adjusted by reserves, transfers, allocations, supplemental appropriations, and other legally authorized legislative and executive changes *before* the beginning of the fiscal year. The original budget should also include actual appropriation amounts automatically carried over from prior years by law. For example, a legal provision may require the automatic rolling forward of appropriations to cover prior-year encumbrances.

(2) The *final budget* is the original budget adjusted by all reserves, transfers, allocations, supplemental appropriations, and other legally authorized legislative and executive changes applicable to the fiscal year, whenever signed into law or otherwise legally authorized.

[NCGAI 10, ¶11; GASBS 34, ¶130]

Budget–GAAP Reconciliations

.109 Budgetary comparison schedules should be accompanied by information (either in a separate schedule or in notes to RSI) that reconciles budgetary information to GAAP information. Basis, timing, perspective, and entity differences may exist between the GAAP reporting model and actual governmental budgetary practices. [NCGAI 10, ¶15; GASBS 34, ¶131]

.110–.118 [Insert current Codification paragraphs .114–.122, including their headings.]

.119 Differences between the government jurisdiction's budget practices and GAAP not otherwise reconciled on the face of the budgetary comparison schedule attributable to basis, timing, perspective, and entity differences should be reconciled in the accompanying notes to RSI. [NCGAI 10, ¶25, as amended by GASBS 34, ¶131]

Additional Reporting

.120 [Insert current Codification paragraph .111.]

.121 State and local governments often adopt multiple appropriation bills and ordinances. Further, such appropriations may have varying levels of budgetary control (for example, departments, programs, or object). Aggregation of such account classifications through the revenue "source" and expenditure "function" or "program" level, as defined in Section 1800, "Classification and Terminology," paragraphs .114 through .121, is appropriate in budgetary comparison schedules presented in RSI. However, individual fund comparisons at the level of budgetary control are required for CAFRs, except in extreme cases where preparation of a separate report may be necessary. When a separate budgetary report is prepared, the notes to RSI should make reference to that report. In addition, the CAFR must contain individual fund budgetary comparison schedules with detailed account classifications. However, aggregations of account classifications should not exceed the level presented in RSI. [NCGAI 10, ¶14, as amended by GASBS 34, ¶6 and ¶131]

* * *

CASH FLOWS STATEMENTS **SECTION 2450**

Sources: [Add the following:] GASB Statement 34

Scope of This Section

.101 [Revise paragraph as follows:] This section establishes standards for reporting cash flows of proprietary funds and governmental entities engaged in business-type activities, including public benefit corporations and authorities, governmental utilities, and governmental hospitals [and other healthcare providers]. Section 1300, "Fund Accounting," paragraphs .109 and .110, defines proprietary funds. Business-type activities are financed in whole or in part by fees charged to external users for goods or services. These activities are usually reported in enterprise funds. [GASBS 9, ¶1 and ¶5, as amended by GASBS 34, ¶106; GASBS 34, ¶15]

Applicability of This Section

.102 [Revise paragraph as follows:] The provisions of this section are applicable to proprietary funds and governmental entities engaged in business-type activities, including public benefit corporations and authorities, governmental utilities, and governmental hospitals [and other healthcare providers]. However, this section is not required to be applied to those public colleges and universities that follow the specialized industry accounting and reporting principles contained in the American Institute of Certified Public Accountants (AICPA) Industry Audit Guide, *Audits of Colleges and Universities.* Trust funds (including pension trust funds) are exempt from the requirement to present a statement of cash flows. However, trust funds are not precluded from presenting a statement of cash flows if the information provided is considered useful. [GASBS 9, ¶5, as amended by GASBS 25, ¶14; GASBS 34, ¶106 and ¶138]

.114 [Revise subparagraphs b and d as follows:]

b. Cash receipts from interfund services provided.

d. Cash receipts from interfund reimbursements.

[GASBS 9, ¶17; GASBS 34, ¶112]

.115 [Revise subparagraph f as follows:]

f. Cash payments for interfund services used, including payments in lieu of taxes that are payments for, and reasonably equivalent in value to, services provided.

[GASBS 9, ¶18; GASBS 34, ¶112]

.118 [Revise subparagraph c as follows:]

c. Cash received from other funds except (1) those amounts that are clearly attributable to acquisition, construction, or improvement of capital assets (paragraph .121c), (2) interfund services provided (paragraph .114b), and (3) reimbursement for operating transactions (paragraph .114d).

[GASBS 9, ¶21; GASBS 34, ¶112]

.119 [Revise subparagraph d as follows:]

d. Cash paid to other funds, except for interfund services used (paragraph .115f).

[GASBS 9, ¶22; GASBS 34, ¶112]

Content and Form of a Statement of Cash Flows

.128 [Revise paragraph as follows:] In reporting cash flows from operating activities, governmental enterprises should report major classes of gross cash receipts and gross cash payments and their arithmetic sum—the net cash flow from operating activities (the direct method). Governmental enterprises should, at a minimum, separately report these classes of operating cash receipts and payments:

a. Cash receipts from customers
b. Cash receipts from interfund services provided
c. Other operating cash receipts, if any
d. Cash payments to employees for services
e. Cash payments to other suppliers of goods or services
f. Cash payments for interfund services used, including payments in lieu of taxes that are payments for, and reasonably equivalent in value to, services provided
g. Other operating cash payments, if any.

Governmental enterprises are encouraged to provide further detail of operating cash receipts and payments if the detail is considered useful. [GASBS 9, ¶31; GASBS 34, ¶105 and ¶112]

[Replace current Codification paragraphs .129–.131 with the following paragraph. Renumber remaining paragraphs.]

.129 Governmental enterprises should also provide—in an accompanying schedule—a reconciliation of operating income to operating cash flows. The reconciliation should determine and report the same amount for net cash flow from operating activities indirectly by adjusting operating income to remove the effects of depreciation, amortization, and other deferrals of past operating cash receipts and payments, such as changes during the period in inventory, deferred revenue, and the like, and all accruals of expected future operating cash receipts and payments, such as changes during the period in receivables and payables. The reconciliation should separately report all major classes of reconciling items. At a minimum, changes during the period in receivables pertaining to operating activities, in inventory, and in payables pertaining to operating activities should be separately reported. Governmental enterprises are encouraged to provide further detail of those categories if the detail is considered useful. The reconciliation schedule may be presented on the same page as the statement of cash flows, if space permits. [GASBS 9, ¶32–¶34, as amended by GASBS 34, ¶105]

*   *   *

[Rename and revise entire section as follows:]

SEGMENT INFORMATION **SECTION 2500**

Source: GASB Statement 34

.101–.102 [GASBS 34, ¶122 and ¶123] [Change footnote number and cross-references as appropriate.]

*   *   *

REPORTING ENTITY AND COMPONENT UNIT PRESENTATION AND DISCLOSURE **SECTION 2600**

Sources: [Revise as follows:] NCGA Statement 1
GASB Statement 14
GASB Statement 34

[Revise as follows:]

Statement of Principle
Reporting Entity and Component Unit Presentations

a. A comprehensive annual financial report should be prepared and published, covering all activities of the primary government (including its blended component units) and providing an overview of all discretely presented component units of the reporting entity—including introductory section, management's discussion and analysis (MD&A), basic financial statements, required supplementary information other than MD&A, combining and individual fund statements, schedules, narrative explanations, and statistical section. The reporting entity is the primary government (including its blended component units) and all discretely presented component units presented in accordance with Section 2100, "Defining the Financial Reporting Entity."

b. The minimum requirements for MD&A, basic financial statements, and required supplementary information other than MD&A are:
   (1) Management's discussion and analysis.
   (2) Basic financial statements. The basic financial statements should include:
      (a) Government-wide financial statements.
      (b) Fund financial statements.
      (c) Notes to the financial statements.
   (3) Required supplementary information other than MD&A.

c. As discussed in Section 2100, the financial reporting entity consists of (1) the primary government, (2) organizations for which the primary government is financially accountable, and (3) other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity's basic financial statements to be misleading or incomplete. The reporting entity's government-wide financial statements should display information about the reporting government as a whole distinguishing between the primary government and its discretely presented component units as well as between the primary government's governmental and business-type activities. The reporting entity's fund financial statements should present the primary government's (including its blended component units, which are, in substance, part of the primary government) major funds individually and nonmajor funds in the aggregate. Funds and component units that are fiduciary in nature should be reported only in the statements of fiduciary net assets and changes in fiduciary net assets.

d. The nucleus of a financial reporting entity usually is a primary government. However, a governmental organization other than a primary government (such as a component unit, joint venture, jointly governed organization, or other stand-alone government) serves as the nucleus for its own reporting entity when it issues separate financial statements. For all of these entities, the provisions of Section 2100 should be applied in layers "from the bottom up." At each layer, the definition and display provisions should be applied before the layer is included in the financial statements of the next level of the reporting government.

[NCGAS 1, ¶128; GASBS 14, ¶11, ¶12, ¶19, ¶43, ¶65, and ¶66; GASBS 34, ¶6, ¶13–¶15, and ¶125]

Introduction

.101 [Add the following at end of paragraph:] Section 2200, "Comprehensive Annual Financial Report," requires governments to provide government-wide and fund financial statements. The reporting entity's government-wide financial statements should display information about the reporting government as a whole, distinguishing between the primary government and its discretely presented component units as well as between the primary government's governmental and business-type activities. The reporting entity's fund financial statements should present the primary government's (including its blended component units, which are, in substance, part of the primary government) major funds individually and nonmajor funds in the aggregate. Funds and component units that are fiduciary in nature should be included only in the statements of fiduciary net assets and changes in fiduciary net assets. [GASBS 14, ¶1, ¶9, and ¶11; GASBS 34, ¶6, ¶13–¶15, and ¶125]

.103 [Revise paragraph as follows:] The nucleus of a financial reporting entity usually is a primary government. However, a governmental organization other than a primary government (such as a component unit, joint venture, jointly governed organization, or other stand-alone government) serves as the nucleus for its own reporting entity when it issues separate financial statements. Although this section is written from the perspective of the primary government, its requirements apply to the separately issued financial statements of governmental component units, joint ventures, jointly governed organizations, and other stand-alone governments. These organizations should apply the provisions of this section as if they were a primary government. To accomplish this goal, the reporting entity's financial statements should present the government-wide financial statements, providing an overview of the **discretely presented** component units, and the fund financial statements, providing information about the major funds individually and nonmajor funds in the aggregate, of the primary government (including its **blended** component units, which are, in substance, part of the primary government). [GASBS 14, ¶11 and ¶12; GASBS 34, ¶6]

.104 [Delete the phrase *and account groups* from last sentence of paragraph.] [GASBS 14, ¶19, as amended by GASBS 34]

Reporting Component Units

.105 [Revise paragraph as follows:] Financial statements of the reporting entity should provide an overview of the entity based on financial accountability, yet allow users to distinguish between the primary government and its component units. Because of the closeness of their relationships with the primary government, some component units should be blended as though they are part of the primary government and therefore included in both government-wide and fund financial statements. (See paragraphs .112–.114.) However, most component units should be discretely presented and reported in the government-wide statements. (See paragraphs .107–.111.) Component units that are fiduciary in nature, however, should be included only in the fund financial statements with the primary government's fiduciary funds. [GASBS 14, ¶42; GASBS 34, ¶6 and ¶125]

Discrete Presentation of Component Units

.107 [Revise paragraph as follows:] As noted in paragraph .105, most component units should be included in the financial reporting entity by discrete presentation. Discrete presentation entails reporting component unit financial data in a column(s) separate from the financial data of the primary government. Financial data for component units that are fiduciary in nature should be reported only in the fund financial statements in the primary government's statements of fiduciary net assets and changes in fiduciary net assets. That data should be reported using the economic resources measurement focus and accrual basis of accounting. (See Section 1600, "Basis of Accounting," paragraph .103.) All other discretely presented component units should be reported only in the government-wide financial statements. The government-wide statement of net assets and statement of activities should include one or more columns to display the combined data of the discretely presented component units, prepared using the economic resources measurement focus and accrual basis of accounting. The discrete column(s) should be located to the right of the total column of the primary government, distinguishing between the financial data of the primary government (including its blended component units) and those of the discretely presented component units by providing descriptive column headings. [GASBS 14, ¶44; GASBS 34, ¶14, ¶106, ¶107, ¶125, and ¶126]

[Delete current Codification paragraphs .108–.112 and renumber remaining paragraphs and footnotes.]

Major Component Unit Disclosures

.108 [Revise current Codification paragraph .114 as follows:] Certain information should be presented about each major component unit included in the financial reporting entity, except for component units that are fiduciary in nature. In determining which component units are “major,” consideration should be given to each component unit’s significance relative to the other component units and the nature and significance of its relationship to the primary government. Major component unit reporting requirements should be satisfied by (a) presenting each major component unit in a separate column in the reporting entity’s statements of net assets and activities, (b) including combining statements of major component units in the reporting entity’s basic statements after the fund financial statements, or (c) presenting condensed financial statements in the notes to the reporting entity’s financial statements. Nonmajor component units should be aggregated in a single column. A combining statement for the nonmajor component units is not required, but may be presented as supplementary information. [GASBS 14, ¶51; GASBS 34, ¶126 and fn49]

[Insert two new paragraphs as follows and renumber remaining paragraphs.]

.109–.110 [GASBS 34, ¶127 and ¶128] [Change cross-reference.]

.111 [Revise current Codification paragraph .113 as follows:] The data presented for each component unit in the combining statements generally should be its aggregated totals, taken from the total columns in the component units’ statements of net assets and activities so that the details support the totals reported in the nonmajor component units column and in the reporting entity’s government-wide statements. (Because component units that are engaged only in business-type activities are not required to prepare a statement of activities, this disclosure should be taken from the information provided in the component unit’s statement of revenues, expenses, and changes in net assets.) Presentation of the fund financial statements of the individual component units is not required unless such information is not available in separately issued financial reports of the component unit. [GASBS 14, ¶50; GASBS 34, ¶126 and fn51]

Blending Component Units

.112 [Revise current Codification paragraph .115 as follows:] Even though it is desirable for users to be able to distinguish between the primary government and its component units, there are nevertheless some component units that, despite being legally separate from the primary government, are so intertwined with the primary government that they are, in substance, the same as the primary government. These component units should be reported as part of the primary government in both the fund financial statements and the government-wide financial statements. That is, the component unit's balances and transactions should be reported in a manner similar to the balances and transactions of the primary government itself. This method of inclusion is known as blending. [GASBS 14, ¶52; GASBS 34, ¶6 and ¶125]

.114 [Revise current Codification paragraph .117 as follows:] Some component units account for their activities in a single fund; others use all or several fund types. If a component unit is blended, the funds of the component unit should be blended with those of the primary government by including them in the appropriate fund financial statements and combining statements of the primary government. However, because the primary government's general fund is usually the main operating fund of the reporting entity and often is a focal point for report users, its general fund should be the only general fund for the reporting entity. The general fund of a blended component unit should be reported as a special revenue fund. [GASBS 14, ¶54, as amended by GASBS 34, ¶75; GASBS 34, ¶6]

[Delete current Codification paragraphs .119 and .120 and renumber remaining paragraphs.]

[Insert new paragraph and heading as follows:]

Intra-entity Transactions and Balances

.116 [GASBS 34, ¶61] [Change cross-reference.]

.122 [Revise current Codification paragraph .126 as follows:] Notes essential to fair presentation in the reporting entity basic financial statements encompass:

a. Governmental and business-type activities, major funds individually, and nonmajor funds in the aggregate of the primary government (including its blended component units).
b. Major discretely presented component units considering both:
    (1) The unit's significance relative to the total discretely presented component units.
    (2) The nature and significance of the unit's relationship to the primary government.

[GASBS 14, ¶63; GASBS 34, ¶15 and ¶75]

* * *

SUPPLEMENTAL AND SPECIAL PURPOSE REPORTING SECTION 2700

.102 [Revise second sentence as follows:] The finance officer should not assume that properly preparing a comprehensive annual financial report (CAFR) or preparing basic financial statements (and required supplementary information) and demonstrating finance-related legal and contractual compliance preclude additional reporting of fiscal data in total or other than by activities, fund types, and funds. [NCGAS 1, ¶173, as amended by GASBS 34, ¶6]

.104 [Revise last two sentences as follows:] Such research and experimentation is encouraged, but at the present time such statements should supplement, rather than supplant, the CAFR or the basic financial statements and required supplementary information. Further, the data in such highly condensed summary statements should be reconcilable with the basic financial statements, and the reader of the summary statements should be referred to the CAFR or basic financial statements of the government. [NCGAS 1, ¶175, as amended by GASBS 34, ¶6]

* * *

BOND, TAX, AND REVENUE ANTICIPATION NOTES SECTION B50

[Revise entire section as follows:]

Sources: [Add the following:] GASB Statement 34

Reporting in Fund Financial Statements—Proprietary Funds

.101 Proprietary fund bond, tax, and revenue anticipation notes should be reported as current or long-term liabilities depending on the refinancing status in accordance with the criteria in FASB Statement No. 6, *Classification of Short-Term Obligations Expected to Be Refinanced.*[1] [NCGAI 9, ¶12]

[1][Insert current Codification footnote 2.]

Reporting in Fund Financial Statements—Governmental Funds

.102 For governmental funds,[2] if all legal steps have been taken to refinance the bond anticipation notes and the intent is supported by an ability to consummate refinancing the short-term notes on a long-term basis in accordance with the criteria set forth in FASB Statement 6,[3] they should be reported only as general long-term liabilities in the governmental activities column of the government-wide statement of net assets. If the necessary legal steps and the ability to consummate refinancing criteria have not been met, then the bond anticipation notes should be reported as a liability in the governmental fund receiving proceeds as well as in the government-wide statement of net assets. Tax and revenue anticipation notes should be reported as a liability in the governmental fund receiving proceeds. [NCGAI 9, ¶12; GASBS 34, ¶82]

Reporting in the Government-wide Financial Statements

.103 In the government-wide statement of net assets, bond, tax, and revenue anticipation notes should be reported as liabilities of either governmental or business-type activities. Governments are encouraged to present assets and liabilities in order of their relative liquidity in the statement of net assets. However, liabilities whose average maturities are greater than one year should be reported in two components in that statement—the amount due within one year and the amount due in more than one year. [NCGAI 9; GASBS 34, ¶15 and ¶31]

[2][Revise current Codification footnote 1 as follows:] See Section 1500, "Reporting Liabilities," for a general discussion of treatment of long-term liabilities; that section requires different accounting treatment for long-term liabilities depending on whether they are governmental fund liabilities or general long-term liabilities.

[3]See footnote 1.

* * *

CASH DEPOSITS WITH FINANCIAL INSTITUTIONS SECTION C20

Sources: [Add the following:] GASB Statement 34

.104 [Revise paragraph as follows:] The disclosures required by this section should distinguish between the primary government and its discretely presented component units. The reporting entity's financial statements should present the governmental activities, business-type activities, major funds, and nonmajor funds in the aggregate of the primary government (including its blended component units, which are, in substance, part of the primary government) and provide an overview of the discretely presented component units. Accordingly, the reporting entity financial statements should make those discretely presented component disclosures that are essential to fair presentation of the financial reporting entity's basic financial statements.[2] The disclosures required by this section generally should be made for the primary government, including its blended component units, and, separately, for the total of those discretely presented component units for which disclosures are essential to fair presentation. Additional or separate disclosures for blended component units, pension (and other employee benefit) trust funds, or other funds should be made in certain circumstances as discussed in paragraph .107. However, additional or separate presentation by fund, fund type, or component unit is not precluded for any other disclosures required by this section. [GASBS 3, ¶64; GASBS 14, ¶11 and ¶63; GASBS 34, ¶6, ¶70, and ¶113]

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[2][Insert current Codification footnote 2.]

* * *

CLAIMS AND JUDGMENTS **SECTION C50**

Sources: [Add the following:] GASB Statement 34

.109 [Revise third- and second-to-last sentences as follows:] Paragraph .120 provides that if an entity uses a single fund in its fund financial statements to report its risk financing activities, that fund should be either the general fund or an internal service fund. The accounting in both funds is discussed in paragraphs .121 through .126. [GASBS 10, ¶52, as amended by GASBS 34, ¶6]

.110 [Revise last sentence as follows:] This section is not intended to inhibit or restrict the method of allocation of those expenditures/expenses and liabilities among funds of the primary government in the fund financial statements. [GASBS 10, ¶53, as amended by GASBS 34, ¶6]

[Revise footnote 3 to this paragraph as follows:] [3]Entities that report risk financing activities (claims and judgments) in governmental funds should recognize related expenditures and liabilities using the modified accrual basis of accounting in the fund financial statements. (See paragraph .125.) [GASBS 34, ¶79]

.118 [Revise paragraph as follows:] If an entity purchases an **annuity contract** in the claimant's name to satisfy a claim liability and the likelihood that the entity will be required to make future payments on the claim is remote, the entity is considered to have satisfied its primary liability to the claimant. Accordingly, the annuity contract should not be reported in, and the related liability should be removed from, the entity's government-wide and proprietary fund financial statements, as appropriate. However, the aggregate outstanding amount of liabilities removed from the entity's financial statements should be disclosed as long as those contingent liabilities are outstanding. If it is later determined that the primary liability will revert back to the entity, the liability should be reinstated on the entity's financial statements. (Annuity contracts used to settle claims for which the claimant has signed an agreement releasing the entity from further obligation and for which the likelihood that the entity will be required to make future payments on those claims is remote should not be included in this disclosure.) [GASBS 10, ¶61, as amended by GASBS 34, ¶6]

[Insert new paragraphs .120 through .123 and related headings after paragraph .119, renumbering remaining paragraphs, as follows:]

Reporting in Government-wide Financial Statements

.120 Governments should report an estimated loss from a claim as an expense and as a liability in the government-wide financial statements using the economic resources measurement focus and accrual basis of accounting in accordance with paragraphs .109 through .119 of this section. Claim amounts that are probable but not reasonably estimable should be disclosed in accordance with paragraph .115. That paragraph also requires disclosure about losses that are reasonably possible. Liabilities whose average maturities are greater than one year should be reported in two components—the amount due within one year and the amount due in more than one year. [GASBS 34, ¶16 and ¶31]

Classifying Claims and Judgments Expenses in the Government-wide Statement of Activities

.121 In the government-wide statement of activities, expense amounts reported for each function should, as a minimum, be direct expenses. *Direct* expenses are those expenses (including claims expenses) that are specifically associated with a service, program, or department and, thus, are clearly identifiable to a particular function, as discussed in Section 2200, "Comprehensive Annual Financial Report," paragraph .131. Claims that meet the definition of extraordinary items, defined in Section 2200, paragraph .140, should be reported separately at the bottom of the statement of activities. In addition, governments should disclose in the notes to financial statements any claims and judgments that are either unusual or infrequent. [GASBS 34, ¶41, ¶55, and ¶56]

Reporting Risk Financing Internal Service Fund Balances and Activity in the Government-wide Financial Statements

.122 Risk financing internal service fund asset and liability balances that are not eliminated in the statement of net assets should normally be reported in the *governmental* activities column. Although internal service funds are reported as proprietary funds in the fund financial statements, the activities accounted for in them are usually more governmental than business-type in nature. If enterprise funds are the predominant or only participants in a risk financing internal service fund, however, the government should report that internal service fund's residual assets and liabilities within the business-type activities column in the statement of net assets. [GASBS 34, ¶62]

.123 Eliminations should be made in the statement of activities to remove the "doubling-up" effect of risk financing internal service fund activity. [GASBS 10, ¶63; GASBS 34, ¶59]

[Replace current Codification paragraph .120 and related heading with the following:]

Reporting in Fund Financial Statements

.124 Proprietary and fiduciary funds should report an estimated loss from a claim as an expense and as a liability in the fund financial statements in accordance with paragraphs .109 through .118. Governmental fund claim expenditures and liabilities should be the amount calculated in accordance with the provisions of paragraphs .109 through .118 and recognized as expenditures and liabilities to the extent that the amounts are payable with expendable available financial resources. If a single fund is used in the fund financial statements to account for an entity's risk financing activities, that fund should be either the general fund or an internal service fund.[8] [GASBS 10, ¶63, as amended by GASBS 34, ¶6; GASBS 34, ¶79, ¶92, and ¶107]

Use of the General Fund to Account for Risk Financing Activities

.125 [Revise current Codification paragraph .121 as follows:] If an entity uses the general fund to account for its risk financing activities, that fund should recognize claim expenditures and liabilities as required by paragraph .124. The entity may use any method it chooses to allocate loss expenditures to the other funds of the entity. However, if the total amount charged to the other funds (including the general fund itself) exceeds total expenditures determined in accordance with paragraphs .110 through .118, the excess amounts should be reported as transfers. Amounts charged to other funds from the general fund should be reported as interfund reimbursements as discussed in Section 1800, "Classification and Terminology," paragraph .102. That is, claims allocated by the general fund should be reported as expenditures or expenses in the paying fund and as reductions of the expenditure/expense in the general fund. [GASBS 10, ¶64; GASBS 34, ¶79 and ¶112]

Use of an Internal Service Fund to Account for Risk Financing Activities

.126 [Revise current Codification paragraph .122 as follows:] If an entity uses an internal service fund to account for its risk financing activities in the fund financial statements, that fund should recognize claims expenses and liabilities in accordance with paragraphs .110 through .118. Claims expenses and liabilities should be reduced by amounts expected to be recovered through excess insurance. [GASBS 10, ¶65, as amended by GASBS 34, ¶6]

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[8]Participation in risk financing internal service funds is not limited to governmental funds. Entities that are reported as proprietary funds, trust funds, or discretely presented component units of a primary government may participate in a risk financing internal service fund of that primary government. However, other stand-alone entities (see Section 2600, "Reporting Entity and Component Unit Presentation and Disclosure," paragraph .124) that engage only in business-type activities or fiduciary activities and that are not considered to be a part of another financial reporting entity should not use an internal service fund (and the related provisions of paragraph .127) to report their own risk financing activities. [GASBS 10, fn12, as amended by GASBS 14, ¶66 and GASBS 34, ¶138 and ¶139]

.128 [Revise last sentence of current Codification paragraph .124 as follows:] Net assets of the internal service fund resulting from application of paragraph .123c should be disclosed in the notes to the financial statements as designations for future catastrophe losses. [GASBS 10, ¶67; GASBS 34, ¶98]

.129 [Revise current Codification paragraph .125 by changing *operating transfer* to *interfund transfer* in first sentence.] [GASBS 10, ¶68, as amended by GASBS 34, ¶112]

.130 [Revise current Codification paragraph .126 as follows:] Entities that elect to report their risk management activities in an internal service fund should report long-term claims liabilities previously reported only as general long-term liabilities as liabilities of the internal service fund. Beginning fund net assets of the internal service fund should be restated in the year of the change. [GASBS 17, ¶6, as amended by GASBS 34, ¶82 and ¶98]

Entities Participating in Public Entity Risk Pools with Transfer or Pooling of Risk

.132 [Revise first sentence of current Codification paragraph .128 as follows:] If a governmental entity participates in a pool in which there is a transfer or pooling (sharing) of risks among the participants of that pool, the entity should report its premium or required contribution in the government-wide and fund financial statements as an insurance expenditure/expense. [GASBS 10, ¶69, as amended by GASBS 34, ¶6]

Reporting Capitalization Contributions

Reporting in the Government-wide Financial Statements

[Insert new paragraph .136 and new headings after current Codification paragraph .131 and renumber remaining paragraphs, as follows:]

.136 In the government-wide financial statements, the contribution should be reported initially as prepaid insurance (an asset), and expenses should be allocated and recognized over the periods for which the pool is expected to provide coverage. The periods expected to be covered should be consistent with the periods for which the contribution is factored into the pool's determination of premiums[12] but should not exceed ten years if not readily determinable. [GASBI 4, ¶6, as amended by GASBS 34, ¶6]

.147 [Revise first three sentences of current Codification paragraph .142 as follows:] The disclosures required by this section should distinguish between the primary government and its discretely presented component units. The reporting entity's financial statements should present the governmental activities, business-type activities, major funds, and nonmajor funds in the aggregate of the primary government (including its blended component units, which are, in substance, part of the primary government) and provide an overview of the discretely presented component units. Accordingly, the reporting entity financial statements should make those discretely presented component unit disclosures that are essential to fair presentation of the financial reporting entity's basic financial statements. [GASBS 10, ¶78, as amended by GASBS 14, ¶11 and ¶63 and GASBS 34, ¶6; GASBS 34, ¶113]

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[12][Insert current Codification footnote 12.]

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COMPENSATED ABSENCES **SECTION C60**

Sources: [Revise as follows:] GASB Statement 16
GASB Statement 34

[Delete current Codification paragraphs .109 through .111. Add new paragraph .109 and related heading as follows, and renumber remaining paragraphs.]

Reporting in Government-wide Financial Statements

.109 Governments should report compensated absences expenses and liabilities in the government-wide financial statements using the recognition and measurement criteria in paragraphs .103 through .108. Compensated absences liabilities that are general long-term liabilities should be reported in the governmental activities column in the statement of net assets, as discussed in Section 2200, "Comprehensive Annual Financial Report," paragraph .120.

Liabilities whose average maturities are greater than one year should be reported in two components—the amount due within one year and the amount due in more than one year. [GASBS 34, ¶16, ¶31, and ¶92]

Reporting in Fund Financial Statements—Proprietary and Fiduciary Funds

.110 [Revise current Codification paragraph .112 as follows:] Entities that report compensated absences in proprietary and fiduciary funds (and component units that are similar in nature) should report the compensated absences liability calculated using the recognition and measurement criteria in paragraphs .103 through .108 as a fund liability. [GASBS 16, ¶6–¶11; GASBS 34, ¶92 and ¶107]

Reporting in Fund Financial Statements—Governmental Funds

.111 [Revise current Codification paragraph .113 as follows:] Entities that report compensated absences in governmental funds should recognize compensated absences expenditures each period using the modified accrual basis of accounting. That is, the amount of the compensated absences recognized as expenditures in these funds should be the net amount accrued during the year that normally would be liquidated with expendable available financial resources. [GASBS 16, ¶13, as amended by GASBS 34, ¶6 and ¶79]

* * *

DEBT REFUNDINGS **SECTION D20**

Sources: [Add the following:] GASB Statement 34

Scope of This Section

.101 [Replace first two sentences as follows:] This section provides guidance on accounting and financial reporting for advance and current refundings that result in defeasance of debt reported as general long-term debt. It also provides guidance on accounting and financial reporting for current refundings and advance refundings resulting in defeasance of debt reported by business-type activities—that is, proprietary funds and special-purpose governments that report using enterprise fund accounting and financial reporting. [GASBS 7, ¶1 and ¶7, as amended by GASBS 34, ¶82 and ¶138; GASBS 23, fn2]

Introduction

.102 [Revise last sentence as follows:] When debt is defeased, it is no longer reported as a liability on the face of the financial statements; only the new debt is reported as a liability. [GASBS 7, ¶3, as amended by GASBS 34; GASBS 23, fn1]

Accounting and Reporting

Reporting in Governmental Fund[3] Financial Statements

.106 [Revise paragraph as follows:] For current and advance refundings resulting in defeasance of general long-term debt, the proceeds of the new debt should be reported as an "other financing source—proceeds of refunding bonds" in the governmental fund receiving the proceeds. For advance refundings, payments to the escrow agent from resources provided by the new debt should be reported as an "other financing use—payment to refunded bond escrow agent." Payments to the escrow agent made from other resources of the entity should be reported as debt service expenditures. [GASBS 7, ¶8, as amended by GASBS 34; GASBS 34, ¶79 and ¶88]

[Delete current Codification paragraph .107 and renumber remaining paragraphs.]

.107 [Revise current Codification paragraph .108 as follows:] If one large refunding issue is used to refund several smaller issues, some of which are reported as general long-term liabilities in the government-wide statement of net assets and some in both the government-wide statement of net assets and proprietary or fiduciary fund financial statements, appropriate allocations should be made. [GASBS 7, ¶10, as amended by GASBS 34; GASBS 34, ¶82]

[Insert new paragraph and related heading following current Codification paragraph .110, as follows:]

Reporting in Government-wide Financial Statements

.110 In the government-wide financial statements, all current and advance refundings, including refundings of general long-term debt, should be reported in the same manner as in proprietary fund financial statements (para-

[3] See Section 1300, "Fund Accounting," for definitions of governmental and proprietary fund categories.

graphs .108–.109). Refunding transactions involving general long-term debt should be reported in the governmental activities column in the government-wide statement of assets and statement of activities, as discussed in Section 1500, "Reporting Liabilities," paragraph .101. [GASBS 34, ¶16 and ¶82]

Disclosures about Advance Refundings

.111 [Revise first sentence as follows:] Regardless of the type of debt being refunded, all governmental entities that defease debt through an advance refunding should provide a general description of the transaction in the notes to financial statements in the year of the refunding. [GASBS 7, ¶11, as amended by GASBS 34]

.113 [Revise paragraph as follows:] The disclosures required by this section should focus on the primary government (including its blended component units)—specifically, its governmental activities, business-type activities, major funds, and nonmajor funds in the aggregate. Information about the government's discretely presented component units should be presented as discussed in Section 2600, "Reporting Entity and Component Unit Presentation and Disclosure," paragraph .126. There may be circumstances when aggregate disclosures are misleading, and entities are not precluded from making additional or separate disclosures—for example, if a significant loss by one fund or blended component unit is offset by aggregate gains in other funds or blended component units of the primary government. In those circumstances, additional or separate presentation should be made by fund or blended component unit of the primary government. [GASBS 7, ¶13, as amended by GASBS 14, ¶11 and ¶63; GASBS 34, ¶113]

Disclosures about Current Refundings

.115 [Revise paragraph as follows:] All disclosures required by paragraphs .111 through .113 for advance refundings should also be made for current refundings. [GASBS 23, ¶6, as amended by GASBS 34]

* * *

DEFERRED COMPENSATION PLANS (IRC SECTION 457) SECTION D25

Sources: [Add the following:] GASB Statement 34

Reporting

.101 [Revise paragraph as follows:] An Internal Revenue Code (IRC) Section 457 deferred compensation plan that meets the criteria in Section 1300, "Fund Accounting," paragraphs .102c and .111, for a pension (and other employee benefit) trust fund should be reported in that fund type in the statements of fiduciary net assets and changes in fiduciary net assets. [GASBS 32, ¶4; GASBS 34, ¶70 and ¶106]

* * *

DEMAND BONDS SECTION D30

[Revise entire section as follows:]

Sources: GASB Statement 34
GASB Interpretation 1

Introduction and Background Information[1]

.101–.106 [Insert current Codification paragraphs .101–.106.]

Accounting and Reporting Requirements in Fund Financial Statements

.107 [Insert current Codification paragraph .107.]

.108 Demand bonds, as the term is used in this section, are bonds that by their terms have demand provisions exercisable at the statement of net assets date or within one year from the date of that statement. Such bonds should be reported by state and local governmental entities as general long-term liabilities (and reported only in the government-wide statement of net assets) or excluded from

[1][Insert current Codification footnote 1.]

current liabilities of proprietary funds if all of the following conditions are met. Unless these conditions are met, demand bonds should be reported as liabilities in governmental funds or, in the case of proprietary funds, as current liabilities.

a. Before the financial statements are issued, the issuer has entered into an arm's-length[2] financing (take out) agreement to convert bonds "put" but not resold into some other form of long-term obligation.
b. The take out agreement does not expire within one year from the date of the issuer's statement of net assets.
c. The take out agreement is not cancelable by the lender or the prospective lender during that year, and obligations incurred under the take out agreement are not callable by the lender during that year.
d. The lender or the prospective lender or investor is expected to be financially capable of honoring the take out agreement.

With regard to condition (c), if the take out agreement is cancelable or callable because of violations that can be objectively determined by both parties and no violations have occurred prior to issuance of the financial statements, the demand bonds should be classified as general long-term liabilities (and reported only in the government-wide statement of net assets) or as long-term debt of proprietary funds. If violations have occurred and a waiver has been obtained before issuance of the financial statements, the bonds should be reported in the same manner. Otherwise, the demand bonds should be reported as liabilities in governmental funds or, in the case of proprietary funds, as current liabilities. If the take out agreement is cancelable or callable because of violations that cannot be objectively determined by both parties, then the agreement does not provide sufficient assurance of long-term financing capabilities and the bonds should be

[2][Insert current Codification footnote 2.]

reported as liabilities in governmental funds or, in the case of proprietary funds, as current liabilities.[3] [GASBI 1, ¶10; GASBS 34, ¶6, ¶82, and ¶97]

.109 If the conditions of paragraph .108 are not met at the time a demand bond is issued (or prior to issuance of the financial statements for that year), the liability for demand bonds should be reported as a liability of the fund used to account for the proceeds of the bond issue, which in many instances will be the capital projects fund. If, because a take out agreement expires, it is necessary to report a liability in a governmental fund for demand bonds previously reported only in the government-wide statement of net assets, the liability should be reported as a liability of the governmental fund in which the proceeds of the issue were initially reported with a corresponding debit to "other financing uses." In both situations, debt redemptions should be reported as expenditures of the governmental fund from which debt service is normally paid; the governmental fund liability represented by the demand bonds should be reduced simultaneously by a credit to "other financing sources." [GASBI 1, ¶13, as amended by GASBS 34, ¶82]

Accounting and Reporting Requirements in the Government-wide Financial Statements

.110 Governments are encouraged to present assets and liabilities in order of their relative liquidity[4] in the government-wide statement of net assets. However, liabilities whose average maturities are greater than one year (including certain

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[3]For example, assume a take out agreement contains a provision stating that the debt is callable on default and default is defined as the failure to pay an installment of principal and interest. In this circumstance, it is likely that both the lender and the issuer will arrive at the same conclusion concerning a default. If the issuer is not in default, the demand bonds should be reported as general long-term debt or excluded from current liabilities in proprietary funds. However, if the issuer is in default, the demand bonds should be reported as a fund liability in a governmental fund or as a current liability in a proprietary fund in the fund financial statements.

On the other hand, assume an agreement contains a provision with which compliance cannot be objectively determined, such as "the agreement is not valid if there has been a material adverse change in the issuer's financial condition." In this circumstance, because it is questionable whether both the lender and the issuer would arrive at the same conclusion concerning a "material adverse change," the agreement is unilaterally cancelable and the demand bonds should be reported as a liability in a governmental fund or as a current liability in a proprietary fund in the fund financial statements. [GASBI 1, fn2, as amended by GASBS 34, ¶82 and ¶97]

[4][GASBS 34, fn23] [Change cross-references.]

demand bonds) should be reported in two components—the amount due within one year and the amount due in more than one year—giving consideration to the criteria discussed in paragraphs .108 and .109. [GASBS 34, ¶31]

Required Note Disclosures

.111–.112 [Insert current Codification paragraphs .109 and .110.]

* * *

ESCHEAT PROPERTY **SECTION E70**

Sources: [Add the following:] GASB Statement 34

.101 [Revise first sentence as follows:] This section establishes standards to be used to report escheat property transactions in the government-wide and fund financial statements. [GASBS 21, ¶3 and fn1, as amended by GASBS 34, ¶6]

[Revise paragraph .102 and related heading as follows:]

Accounting and Reporting for Escheat Property in the Fund Financial Statements

.102 Escheat property generally should be reported in the governmental or proprietary fund to which the property ultimately escheats. Escheat property held for individuals, private organizations, or another government should be reported in a private-purpose trust fund or in the governmental or proprietary fund in which escheat property is otherwise reported, offset by a liability. [GASBS 21, ¶4; GASBS 34, ¶72]

.103 [Revise first sentence as follows:] When escheat property is reported in governmental or proprietary funds, escheat revenue should be reduced and a governmental or proprietary fund liability reported to the extent that it is probable that escheat property will be reclaimed and paid to claimants. [GASBS 21, ¶5, as amended by GASBS 34]

[Replace current Codification paragraph .104 with the following:]

Accounting and Reporting for Escheat Property in the Government-wide Financial Statements

.104 In the government-wide financial statements, escheat-related assets, liabilities, and transactions generally should be measured using the economic resources measurement focus and the accrual basis of accounting. Escheat assets and liabilities reported in private-purpose trust funds in the statements of fiduciary net assets and changes in fiduciary net assets should be excluded from the government-wide financial statements. [GASBS 21, ¶4, as amended by GASBS 34, ¶6, ¶13, and ¶72]

* * *

GRANTS AND OTHER FINANCIAL ASSISTANCE SECTION G60

[Current Codification Section G60 will be superseded in its entirety. The Codification instructions of GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions,* issued in December 1998, replace this section with a new Section N50, "Nonexchange Transactions." Codification instructions for that new section, reproduced in Appendix A of the 1999 Codification, should be revised as follows:]

NONEXCHANGE TRANSACTIONS SECTION N50

Sources: [Add the following:] GASB Statement 34

.108 [Revise first two sentences as follows:] All standards in this section apply whether the accrual basis or the modified accrual basis of accounting is required, except for the revenue recognition standards. (When the modified accrual basis of accounting is used for governmental funds in the fund financial statements, the requirements of this section for the recognition of *expenses* should be interpreted as requirements for the recognition of *expenditures.*) [GASBS 33, ¶11; GASBS 34, ¶6 and ¶79]

[Replace paragraph .126 and related heading with the following:]

Revenue Recognition in Governmental Fund Statements

.126 [GASBS 34, ¶79] [Change cross-reference.]

* * *

HOSPITALS **SECTION H50**

[Eliminate entire section.]

* * *

INVESTMENTS **SECTION I50**

Sources: [Add the following:] GASB Statement 34

.105 [Revise first sentence as follows:] Except as provided in paragraphs .106, .107, and .110 of this section and in paragraph .102 of Section In5, "Investment Pools (External)," governmental entities, including governmental external investment pools, should report investments at fair value in their basic financial statements.[4] [GASBS 31, ¶7, as amended by GASBS 34, ¶6]

.112 [Revise paragraph by changing *operating transfer* to *interfund transfer* in fifth sentence and in related footnote 8.] [GASBS 31, ¶14, as amended by GASBS 34, ¶112]

External Investment Pools

.116 [Revise paragraph as follows:] In addition to the separate investment pool reports required by Section In5, paragraph .103, a governmental entity that sponsors one or more external investment pools **(sponsoring government)** should report the *external* portion of each pool as a separate investment trust fund (a fiduciary fund) that reports transactions and balances using the economic resources measurement focus and the accrual basis of accounting. (The

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[4][Insert current Codification footnote 4.] [Change *balance sheet date* to *financial report date*.]

external portion of an external investment pool is the portion that belongs to legally separate entities that are not part of the sponsoring government's financial reporting entity. The *internal* portion of each external investment pool is the portion that belongs to the primary government and its component units and should be reported as provided in paragraph .112 for the equity in internal investment pools.) In its financial statements, the sponsoring government should present for each investment trust fund statements of fiduciary net assets and changes in fiduciary net assets. The difference between the external pool assets and liabilities should be captioned *net assets held in trust for pool participants.* Section In5 provides accounting and reporting guidance for the separate annual financial reports of external investment pools. [GASBS 31, ¶18 and ¶19; GASBS 34, ¶71, ¶106, and ¶107]

.117 [Revise subparagraph c as follows:]

c. Condensed statements of fiduciary net assets and changes in fiduciary net assets. If a pool includes both internal and external investors, those condensed financial statements should include, in total, the net assets held in trust for all pool participants, and the equity of participants should distinguish between internal and external portions.

[GASBS 31, ¶19, as amended by GASBS 34, ¶106]

.121 [Revise paragraph as follows:] The disclosures required by this section should distinguish between the primary government and its discretely presented component units. The reporting entity's financial statements should present the governmental activities, business-type activities, major funds, and nonmajor funds in the aggregate of the primary government (including its blended component units, which are, in substance, part of the primary government) and provide an overview of the discretely presented component units. Accordingly, the reporting entity financial statements should make those discretely presented component unit disclosures that are essential to fair presentation of the basic financial statements.[11] The disclosures required by this section generally should be made for the primary government, including its blended component units, and, separately, for the total of those discretely presented component units for which disclosures are essential to fair presentation. Additional or separate disclosures for blended component units, pension (and other employee benefit) trust funds, external investment pools, or other funds or fund types of the primary government

[11] [Insert current Codification footnote 11.]

should be made in certain circumstances as discussed in paragraphs .119, .122, .127, and .128. Additional or separate disclosures for individual discretely presented component units also should be made in certain circumstances as discussed in paragraphs .122 and .128. However, additional or separate presentation by fund, fund type, or component unit is not precluded for any other disclosures required by this section. [GASBS 3, ¶64; GASBS 14, ¶11 and ¶63; GASBS 34, ¶6, ¶70, and ¶113]

Legal or Contractual Provisions for Deposits and Investments, including Repurchase Agreements

.122 [Revise paragraph as follows:] The entity should briefly describe in the notes to financial statements the types of investments authorized by legal or contractual provisions.[12] If the types of investments authorized for different funds, fund types, blended component units, or discretely presented component units differ significantly from those authorized for the primary government, and those funds, fund types, or component units have material investment activity compared with the reporting entity's investment activity, the differences in authorized investment types should be disclosed. [GASBS 3, ¶65, as amended by GASBS 14 and GASBS 34]

[12][Insert current Codification footnote 12.]

* * *

INVESTMENTS—REVERSE REPURCHASE AGREEMENTS SECTION I55

Sources: [Add the following:] GASB Statement 34

.107 [Revise paragraph as follows:] The disclosures required by this section should distinguish between the primary government and its discretely presented component units. The reporting entity's financial statements should present the governmental activities, business-type activities, major funds, and nonmajor funds in the aggregate of the primary government (including its blended component units, which are, in substance, part of the primary government) and provide an overview of the discretely presented component units. Accordingly, the reporting entity financial statements should make those discretely presented component disclosures that are essential to fair presentation of the basic financial statements.[4] The disclosures required by this section generally should be made for the primary government, including its blended component units, and, separately, for the total of those discretely presented component units for which disclosures are essential to fair presentation. However, additional or separate presentation by fund, fund type, or component unit is not precluded for any other disclosures required by this section. [GASBS 3, ¶64; GASBS 14, ¶11 and ¶63; GASBS 34, ¶6, ¶70, and ¶113]

[4][Insert current Codification footnote 4.]

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INVESTMENTS—SECURITIES LENDING **SECTION I60**

Sources: [Add the following:] GASB Statement 34

Level of Presentation

.102 [Revise paragraph by changing *general purpose* in first sentence to *basic*. [GASBS 28, ¶3, as amended by GASBS 34, ¶6]

Accounting for Securities Lending Transactions

.103 [Revise footnote 3 as follows:] [3]For purposes of this section, the term *balance sheet* includes the government-wide statement of net assets and the statement of fiduciary net assets required to be presented as components of the basic financial statements, as discussed in Section 2200, "Comprehensive Annual Financial Report." [GASBS 28; GASBS 34, ¶13 and ¶106]

.106 [Revise footnote 6 as follows:] [6]For purposes of this section, the term *operating statement* includes the government-wide statement of activities and statement of changes in fiduciary net assets, required to be presented as components of the basic financial statements, as discussed in Section 2200. [GASBS 28; GASBS 34, ¶13 and ¶106]

.108 [Revise paragraph as follows:] Similarly, the income and costs arising from pooled securities lending transactions should be reported in operating statements of the funds. If the income from lending pool securities that represent equity owned by one fund becomes the assets of another fund because of legal[8] or contractual provisions, the reporting treatment should be based on the specific language of those provisions.[9] If, however, the amounts become the assets of another fund for reasons other than legal or contractual provisions—for example, management decision—the income and costs should be recognized in the fund that reports the equity. Those amounts should be reported as an interfund transfer to the recipient fund. [GASBS 28, ¶10, as amended by GASBS 34, ¶112]

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[8][Insert current Codification footnote 8.]

[9][Revise footnote as follows:] That is, if the legal or contractual provision requires a transfer of the amounts to another fund, the income and costs should be reported in the fund that owns the equity, with an interfund transfer to the recipient fund. If, however, the legal or contractual provisions require that the securities lending income be that of another fund, no transfer of resources should be reported. Instead, the amounts should be reported as income and costs in the recipient fund. [GASBS 28, fn9, as amended by GASBS 34, ¶112]

* * *

ACCOUNTING FOR PARTICIPATION IN JOINT VENTURES AND JOINTLY GOVERNED ORGANIZATIONS — SECTION J50

Sources: [Add the following:] GASB Statement 34

[Revise paragraph .106 and related heading as follows:]

Reporting in Fund Financial Statements for Participation in Joint Ventures in Which There Is an Equity Interest

.106 *Proprietary Funds.* The "Investment in joint venture" account reported in a proprietary fund should report the participating government's equity interest calculated in accordance with the joint venture agreement. Initially, the investment in the joint venture should be reported at cost. If the joint venture agreement provides for the participating government to share in the operating results of the joint venture, the equity interest should be adjusted for the participant's share of the joint venture's change in net assets, regardless of whether the amount is actually remitted. In calculating the participant's share of the change in net assets of the joint venture, any profit on the operating transactions between the proprietary fund and the joint venture or capital contributions from the joint venture participants should be eliminated. Nonoperating transactions between the joint venture and the proprietary fund should be reported in the joint venture's statement of revenues, expenses, and changes in net assets. The equity interest should be reported in the proprietary fund's statement of net assets as a single amount, and the fund's share of the joint venture's change in net assets should be reported in its statement of revenues, expenses, and changes in fund net assets as a single amount. [GASBS 14, ¶73; GASBS 34, ¶91, ¶103, and ¶138]

.107 [Revise paragraph as follows:] *Governmental Funds.* Because the equity interest in a joint venture generally represents equity primarily in capital assets and otherwise does not meet the definition of a financial resource, it is inappropriate to report the entire "Net investment in joint venture" as an asset in a governmental fund. The participating government's total equity interest should be calculated in accordance with the joint venture agreement. The amount that should be reported in the governmental fund, however, should be limited to amounts appropriately reported under the modified accrual basis of accounting. Amounts reported in the governmental fund balance sheet may include, for example, an amount payable to, or receivable from, the joint venture. The governmental fund statement of revenues, expenditures, and changes in fund balances should report changes in joint venture equity interests only to the extent that the amounts received or receivable from the joint venture or the amounts paid or payable to the joint venture satisfy the revenue or expenditure recognition criteria for governmental funds. The entire equity interest in a joint venture should be reported in the government-wide statement of net assets. (See Section 2200, "Comprehensive Annual Financial Report," paragraphs .116 and .120.) [GASBS 14, ¶74, as amended by GASBS 34, ¶8; GASBS 34, ¶79, ¶80, and ¶82]

[Insert new paragraph .108 and heading following current Codification paragraph .107 and renumber remaining paragraphs:]

Reporting in the Government-wide Financial Statements for Participation in Joint Ventures in Which There Is an Equity Interest

.108 In the government-wide financial statements, equity interests in joint ventures should be reported in the same manner as in proprietary funds. (See paragraph .106.) As discussed in Section 2200, reporting should distinguish between the primary government and discretely presented component units and between governmental and business-type activities of the primary government. [GASBS 34, ¶14–¶16]

* * *

Sources: [Add the following:] GASB Statement 34

Scope of This Section

.101 [Revise paragraph as follows:] This section establishes standards of accounting and financial reporting for municipal[1] solid waste landfill (MSWLF) closure and postclosure care costs[2] that are required to be incurred by federal, state, or local laws or regulations. The provisions of this section apply to all state and local governmental entities, including public benefit corporations and authorities, governmental utilities, governmental hospitals and other healthcare providers, and governmental colleges and universities. [GASBS 18, ¶1 and ¶3, as amended by GASBS 34]

[Revise first sentence of paragraph .106 and related heading as follows:]

Reporting MSWLFs in Proprietary Fund Financial Statements

.106 For MSWLFs reported in proprietary fund financial statements, a portion of the estimated total current cost of MSWLF closure and postclosure care should be recognized as an expense and as a liability in each period that the MSWLF accepts solid waste. [GASBS 18, ¶7, as amended by GASBS 34, ¶6]

[Revise heading and combine Codification paragraphs .109 and .110 as follows:]

Reporting MSWLFs in Governmental Fund Financial Statements

.109 For MSWLFs reported in the governmental fund financial statements, the measurement of the liability for MSWLF closure and postclosure care should be consistent with paragraph .106 for proprietary funds. MSWLF expenditures and liabilities should be recognized in governmental funds using the modified accrual basis of accounting. Long-term liabilities for closure and postclosure care of MSWLFs reported in governmental funds are general long-term liabilities and should be reported in the governmental activities column in the government-wide

[1] [Insert current Codification footnote 1.]

[2] The term *costs* as used in this section is intended to encompass amounts from both an economic and a current financial resources measurement focus. [GASBS 18, fn2, as amended by GASBS 34]

statement of net assets. Facilities and equipment acquisitions included in estimated total current cost should be reported as closure and postclosure care expenditures. [GASBS 18, ¶10 and ¶11, as amended by GASBS 34, ¶119; GASBS 34, ¶82]

[Add new paragraph .110 and heading as follows:]

Reporting MSWLFs in Government-wide Financial Statements

.110 Assets, liabilities, revenues, and expenses related to MSWLFs should be reported in the government-wide financial statements using the requirements in paragraphs .106 through .108 for proprietary funds. [GASBS 34, ¶31]

Responsibility for MSWLF Closure and Postclosure Care Assumed by Another Entity

.115 [Revise last sentence as follows:] If it appears that the assuming entity will not be able to meet its obligations and it is probable that the MSWLF owner or operator will be required to pay closure and postclosure care costs, then the amount of the obligation should be reported in accordance with paragraphs .106 through .111 of this section. [GASBS 18, ¶16, as amended by GASBS 34]

* * *

LEASES **SECTION L20**

[Revise entire section as follows:]

Sources: NCGA Statement 5
GASB Statement 13
GASB Statement 14
GASB Statement 34

Background

.101 In determining the accounting and financial reporting treatment for lease agreements of state and local governments, consideration must be given to the accounting and reporting of capital assets and long-term liabilities at both the fund and the entity-wide perspectives. Section 1400, “Reporting Capital Assets,” provides that:

> A clear distinction should be made between general capital assets and capital assets of proprietary and fiduciary funds. Capital assets of proprietary funds should be reported in both the government-wide and fund financial statements. Capital assets of fiduciary funds should be reported only in the statement of fiduciary net assets. All other capital assets of the governmental unit are general capital assets. They should not be reported as assets in governmental funds but should be reported in the governmental activities column in the government-wide statement of net assets.

[NCGAS 5, ¶5, as amended by GASBS 34]

.102 Similarly, Section 1500, “Reporting Liabilities,” provides that:

> A clear distinction should be made between fund long-term liabilities and general long-term liabilities. Long-term liabilities directly related to and expected to be paid from proprietary funds should be reported in the proprietary fund statement of net assets and in the government-wide statement of net assets. Long-term liabilities directly related to and expected to be paid from fiduciary funds should be reported in the statement of fiduciary net assets. All other unmatured general long-term liabilities of the governmental unit should not be reported as liabilities in governmental funds but should be reported in the governmental activities column in the government-wide statement of net assets.

[NCGAS 5, ¶6, as amended by GASBS 34]

Accounting and Financial Reporting for Lease Agreements

.103 [Insert current Codification paragraph .107, omitting the phrase *and expendable trust funds* from first sentence.] [NCGAS 5, ¶11, as amended by GASBS 13, ¶5 and ¶6 and GASBS 34, ¶69]

Operating Leases with Scheduled Rent Increases

.104 [Insert current Codification paragraph .108, omitting the phrase *regardless of the fund type used to report the lease transactions* from first sentence.] [GASBS 13, ¶1 and ¶4, as amended by GASBS 34]

Measurement Criteria

.105–.106 [Insert current Codification paragraphs .109 and .110.]

Accrual Basis Recognition Criteria

.107 Entities that report operating leases with scheduled rent increases in the government-wide financial statements and in proprietary and trust fund financial statements should recognize rental revenue or expense each period as it accrues over the lease term using the measurement criteria provided in paragraphs .105 and .106. If the fair-value measurement of paragraph .106b is used, the interest portion should be recognized as revenue (expense) each period using the interest method. [GASBS 13, ¶7, as amended by GASBS 34, ¶82 and ¶119; GASBS 34, ¶16, ¶92, and ¶107]

Modified Accrual Basis Recognition Criteria

.108 Entities that report operating leases with scheduled rent increases in the governmental fund financial statements should recognize rental revenue or expenditures each period using the modified accrual basis of accounting. That is, the amount calculated in accordance with the measurement criteria in paragraphs .105 and .106 should be recognized as revenue to the extent it is available to finance expenditures of the fiscal period. Accrued receivables should be reported in the fund. Deferred revenue also should be reported for the portion not yet recognized as revenue. The lessee should recognize expenditures and liabilities in governmental funds to the extent that the amounts are payable with expendable, available financial resources. [GASBS 13, ¶9, as amended by GASBS 34, ¶6, ¶79, and ¶82]

Capital Leases

.109 [Insert current Codification paragraph .113.]

Accounting and Reporting in Government-wide Financial Statements

.110 Capital lease accounting in the government-wide financial statements should follow FASB Statement 13, as amended and interpreted. [NCGAS 5, ¶16; GASBS 34, ¶17]

Accounting and Reporting in Proprietary and Fiduciary Fund Financial Statements

.111 Capital lease accounting for proprietary and trust funds should follow FASB Statement 13, as amended and interpreted. All assets and liabilities of proprietary and fiduciary funds are accounted for and reported in the respective funds. Therefore, transactions for proprietary or fiduciary fund capital leases are accounted for and reported entirely within those individual funds. [NCGAS 5, ¶16 and ¶17, as amended by GASBS 13, ¶4–¶7; GASBS 34, ¶92, ¶93, and ¶107]

Accounting and Reporting in Governmental Fund Financial Statements

Lessee accounting

.112 [Insert current Codification paragraph .114.]

.113 When a capital lease represents the acquisition or construction of a general capital asset, the acquisition or construction of that asset should be reflected as an expenditure and other financing source, consistent with the accounting and financial reporting for general obligation bonded debt. (General capital assets and general long-term liabilities arising from governmental fund capital leases should be reported only in the governmental activities column in the government-wide statement of net assets. See paragraphs .101 and .102.) Subsequent governmental fund lease payments should be accounted for consistently with Section 1600, "Basis of Accounting," paragraph .123, principles for general obligation debt. A debt service or capital projects fund is not necessary unless required by Section 1300, paragraph .107. [NCGAS 5, ¶14; GASBS 34, ¶80 and ¶82]

Lessor accounting

.114 In governmental fund financial statements, lease receivables and deferred amounts should be used to account for leases receivable when a state or local government is the lessor in a lease situation. Only the portion of lease receivables that represents other financing sources that are measurable and available[4] should be recognized in governmental funds. The remainder of the receivable should be deferred. The noncurrent receivable created when a government is the lessor in a capital lease agreement is not considered a general capital asset and, therefore, should be reported in the governmental fund reporting the lease transactions. [NCGAS 5, ¶10 and ¶15, as amended by GASBS 34, ¶6, ¶79, ¶80, and ¶88]

Fiscal Funding or Cancellation Clauses

.115–.120 [Insert current Codification paragraphs .119–.124.]

.121 If under the criteria of Section 2100, the public authority is part of the primary government for financial reporting purposes, the criteria of FASB Statement 13 do not apply. Instead, the public authority's debt and assets should be reported as a form of the primary government's debt and assets. For example, the leased general fixed assets would be reported as general capital assets in the government-wide statement of net assets and related debt would be reported as a general long-term liability in the government-wide statement of net assets. The debt service activity of the public authority would be reported as a debt service activity of the primary government. [NCGAS 5, ¶24; GASBS 14, ¶58, as amended by GASBS 34, ¶67; GASBS 34, ¶80 and ¶82]

.122 [Insert current Codification paragraph .126, omitting last sentence.] [NCGAS 5, ¶25]

.123–.125 [Insert current Codification paragraphs .127–.129.]

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[4][Insert current Codification footnote 1.]

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PENSION ACTIVITIES—EMPLOYER REPORTING SECTION P20

Sources: [Add the following:] GASB Statement 34

.112 [Revise paragraph as follows:] When an employer makes ARC-related contributions to the same plan from more than one fund, the employer should determine what portion of the ARC applies to each fund. When the employer has an NPO and the related liability (asset) is allocated to more than one fund, between funds and general long-term liabilities, or between governmental and business-type activities in the government-wide statement of net assets, the employer should allocate the interest and ARC adjustment components of annual pension cost to each liability (asset), based on its proportionate share of the beginning balance of the NPO. [GASBS 27, ¶15, as amended by GASBS 34; GASBS 34, ¶6 and ¶82]

[Revise paragraph .113 and related heading as follows:]

Recognition in governmental fund financial statements

.113 Pension expenditures from governmental funds should be recognized on the modified accrual basis; that is, the amount recognized should be equal to the amount contributed to the plan or expected to be liquidated with expendable available financial resources. If the amount of pension expenditures recognized for the year in relation to the ARC is less than (greater than) annual pension cost, the difference should be added to (deducted from) the NPO. A positive year-end balance in the NPO should be reported as general long-term liabilities only in the governmental activities column in the government-wide statement of net assets as the year-end liability in relation to the ARC.[14] If the year-end balance in the NPO is negative (cumulative net over contribution of the ARC), a previously reported liability to the same plan should be reduced to zero. Any additional negative amount should be reported as an asset (prepaid expense) in the governmental activities column in the government-wide statement of net assets. The NPO balance should be disclosed in accordance with paragraph .118, whether the balance is positive or negative. [GASBS 27, ¶16, as amended by GASBS 34, ¶69; GASBS 34, ¶82]

[Revise paragraph .114 and related heading as follows:]

Recognition in proprietary fund financial statements

.114 Pension expense of proprietary funds should be recognized on the accrual basis in proprietary fund financial statements. The employer should report pension expense for the year equal to annual pension cost. The NPO should be adjusted for any difference between contributions made and pension expense.

[14]Short-term differences excluded from the NPO in accordance with paragraph .108 and not recognized in the funds should be reported as general-long term liabilities only in the governmental activities column in the government-wide statement of net assets. [GASBS 27, fn14; GASBS 34, ¶82]

A positive (negative) year-end balance in the NPO should be recognized as the year-end liability (asset) in relation to the ARC. Pension liabilities and assets to different plans should not be offset in the financial statements. [GASBS 27, ¶17, as amended by GASBS 34, ¶69]

[Insert the following paragraph and related heading after paragraph .114 and renumber remaining paragraphs as follows:]

Recognition in government-wide financial statements

.115 Pension expense reported in government-wide financial statements should be recognized on the accrual basis. The employer should report pension expense for the year equal to annual pension cost. The NPO should be adjusted for any difference between contributions made and pension expense. A positive (negative) year-end balance in the NPO should be recognized as the year-end liability (asset) in relation to the ARC. Pension liabilities and assets to different plans should not be offset in the financial statements. Separate rows and columns should be used to distinguish between assets and liabilities of the primary government and those directly related to and expected to be paid from component units. Separate rows and columns should be used to distinguish between assets and liabilities of governmental and business-type activities of the primary government. [GASBS 27, ¶17, as amended by GASBS 34, ¶6; GASBS 34, ¶14–¶16]

Cost-sharing Employers

.117 [Revise current Codification paragraph .116 as follows:] Employers that participate in **cost-sharing multiple-employer plans** (cost-sharing employers) should recognize annual pension expenditures (in governmental fund financial statements) or expense (in proprietary fund financial statements and in the government-wide statement of activities) equal to their contractually required contributions to the plan. Recognition in fund financial statements should be on the modified accrual or accrual basis, whichever applies for the fund used to report the employer's contributions. Pension liabilities and assets result from the difference between contributions required and contributions made. Pension liabilities and assets to different plans should not be offset in the financial statements. [GASBS 27, ¶19, as amended by GASBS 34, ¶6 and ¶69]

Insured Plans

.121 [Revise current Codification paragraph .120 as follows:] For purposes of this section, an **insured plan** is a pension financing arrangement whereby an employer accumulates funds with an insurance company, while employees are in active service, in return for which the insurance company unconditionally undertakes a legal obligation to pay the pension benefits of those employees or their beneficiaries, as defined in the employer's plan. If an employer's pension financing arrangement with the insurance company does not meet these criteria, the plan is not an insured plan for financial reporting purposes and the employer should comply with all requirements of this section for sole and agent employers. Employers with insured plans should recognize pension expenditures (in governmental fund financial statements) or expense (in proprietary fund financial statements and in the government-wide statement of activities) equal to the annual contributions or premiums required in accordance with their agreement with the insurance company and should disclose the following information in the notes to the financial statements:

a. A brief description of the insured plan, including the benefit provisions and the authority under which benefit provisions are established or may be amended.
b. The fact that the obligation for the payment of benefits has been effectively transferred from the employer to one or more insurance companies. Also disclose whether the employer has guaranteed benefits in the event of the insurance company's insolvency.
c. The current-year pension expenditures/expense and contributions or premiums paid.

[GASBS 27, ¶23, as amended by GASBS 34, ¶6 and ¶69]

Employers with Defined Contribution Plans

.122 [Revise current Codification paragraph .121 as follows:] Employers with defined contribution plans should recognize annual pension expenditures/expense equal to their required contributions, in accordance with the terms of the plan. Recognition in the fund financial statements should be on the modified accrual or accrual basis, whichever applies for the fund(s) used to report the employer's contributions. Pension liabilities and assets result from the difference between contributions required and contributions made. Pension liabilities and assets to different plans should not be offset in the financial statements. [GASBS 27, ¶25, as amended by GASBS 34, ¶6]

* * *

.107 [Revise paragraph as follows:] The disclosures required by this section should distinguish between the primary government and its discretely presented component units. The reporting entity's financial statements should present the governmental activities, business-type activities, major funds, and nonmajor funds in the aggregate of the primary government (including its blended component units, which are, in substance, part of the primary government) and provide an overview of the discretely presented component units. Accordingly, the reporting entity financial statements should make those discretely presented component unit disclosures that are essential to the fair presentation of the financial reporting entity's basic financial statements.[7] The disclosures required by this section generally should be made for the primary government, including its blended component units and, separately, for those discretely presented component units for which disclosures are essential to fair presentation. If the employer believes aggregate disclosures would be misleading, additional or separate disclosures should be made for one or more funds or component units. [GASBS 12, ¶12; GASBS 14, ¶11 and ¶63; GASBS 34, ¶6 and ¶113]

[7][Insert current Codification footnote 7.]

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PROPERTY TAXES — SECTION P70

[Revise paragraph .101 and related heading as follows:]

Reporting Property Taxes on the Modified Accrual Basis[1]

.101 Section 1600, "Basis of Accounting," provides that governmental fund revenues and expenditures should be recognized on the current financial resource measurement focus and the modified accrual basis of accounting.

[1]GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions,* was issued in December 1998. That Statement provides guidance on accrual-basis recognition of property tax revenue.

Paragraph .106 of that section defines modified accrual basis revenue recognition in the following manner:

> Revenues and other governmental fund financial resource increments (for example, bond issue proceeds) are recognized in the accounting period in which they become susceptible to accrual—that is, when they become both *measurable* and *available* to finance expenditures of the fiscal period.

[NCGAI 3, ¶3, as amended by GASBS 34, ¶79]

* * *

[Rename and revise entire section as follows:]

PROPRIETARY FUND ACCOUNTING AND FINANCIAL REPORTING — SECTION P80

Sources: GASB Statement 1
GASB Statement 20
GASB Statement 29
GASB Statement 34

Introduction

.101 Proprietary fund reporting focuses on the determination of operating income, changes in net assets (or cost recovery), financial position, and cash flows. The proprietary fund category includes enterprise and internal service funds. Proprietary funds—enterprise and internal service funds—are defined in Section 1300, "Fund Accounting," paragraph .103. [GASBS 34, ¶66]

Measurement Focus and Basis of Accounting

.102 Proprietary fund financial statements should be presented using the economic resources measurement focus and the accrual basis of accounting. Proprietary funds should be reported based on all applicable GASB pronouncements (including all NCGA Statements and Interpretations currently in effect) as well as the following pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements: Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins (ARBs) of the Committee on Accounting Procedure. [GASBS 1, ¶8; GASBS 20, ¶6; GASBS 34, ¶92 and ¶93]

.103 In addition to applying the FASB Statements and Interpretations, APB Opinions, and ARBs required in paragraph .102, an enterprise fund may also apply all FASB Statements and Interpretations issued after November 30, 1989, except for those that conflict with or contradict GASB pronouncements. Enterprise funds that apply the provisions of this paragraph should apply only those FASB Statements and Interpretations issued after November 30, 1989, that are developed for business enterprises. They should not apply FASB Statements and Interpretations whose provisions are limited to not-for-profit organizations, such as FASB Statement No. 117, *Financial Statements of Not-for-Profit Organizations,* or those that address issues concerning primarily such organizations, such as FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made.* [GASBS 20, ¶7; GASBS 29, ¶7; GASBS 34, ¶94]

.104 The same application of FASB pronouncements is encouraged to be used for all enterprise funds in the basic financial statements of the financial reporting entity. [GASBS 20, ¶8, as amended by GASBS 34, ¶6 and ¶94]

.105 [Insert current Codification paragraph .107 and related footnotes. Change *proprietary activities* to *enterprise funds.*] [GASBS 20, ¶9, as amended by GASBS 34, ¶92]

Required Financial Statements

.106 [GASBS 34, ¶91]

.107–.109 [GASBS 34, ¶75–77] [Change cross-references.]

.110 [GASBS 34, ¶104] [Change cross-references.]

.111 [GASBS 34, ¶96] [Change cross-reference.]

Statement of Net Assets

.112–.114 [GASBS 34, ¶97–¶99] [Change cross-references.]

Statement of Revenues, Expenses, and Changes in Fund Net Assets

.115–.118 [GASBS 34, ¶100–¶103] [Change cross-references.]

Statement of Cash Flows

.119 Governments should present a statement of cash flows for proprietary funds based on the provisions of Section 2450. [GASBS 34, ¶105]

AICPA AUDIT AND ACCOUNTING GUIDES CLEARED BY THE GASB

Reporting by Lotteries

.601 [Insert current Codification paragraph .602.]

Hospital Audit Guide

.602 Current guidance on transactions unique to healthcare activities reported using enterprise fund accounting and reporting are provided in the AICPA Audit and Accounting Guide, *Audits of Providers of Health Care Services,* issued in 1996. However, the discussion in that Guide on basic financial statements and required supplementary information, and on presentation of fund equity, have been superseded by this Codification. See Section Ho5, "Hospitals and Other Healthcare Providers."

* * *

SPECIAL ASSESSMENTS SECTION S40

[Revise entire section as follows:]

Sources: GASB Statement 6
GASB Statement 34

Scope

.101–.112 [Insert current Codification paragraphs .101–.112.]

Fund Reporting Requirements

.113 [Insert current Codification paragraph .113, replacing the terms *general purpose financial statements* and *GPFS* with *basic financial statements* in first and last sentences.] [GASBS 6, ¶13, as amended by GASBS 34, ¶6]

Reporting Service-type Special Assessments

.114 In the fund financial statements, the transactions of a service-type special assessment should be reported in the fund type that best reflects the nature of the transactions, usually the general fund, a special revenue fund, or an enterprise fund, giving consideration to the "number of funds" principle in Section 1100, "Summary Statement of Principles," paragraph .104. Service-type special assessment revenues should be treated like user fees. Both the assessment revenues and the expenditures (expenses) for which the assessments were levied should be recognized on the same basis of accounting as that normally used for that fund type. In the government-wide financial statements, service-type special assessments should be reported as either governmental or business-type activities on the accrual basis. [GASBS 6, ¶14; GASBS 34, ¶15 and ¶16]

Reporting Capital Improvement Special Assessments

General Principle—Reporting Liabilities for Capital Improvement Special Assessment Debt

.115 [Insert current Codification paragraph .116.]

.116 Debt issued to finance capital projects that will be paid wholly or partly from special assessments against benefited property owners should be reported as follows:

a. General obligation debt that will be repaid, in part, from special assessments should be reported as general long-term liabilities only in the governmental activities column in the government-wide statement of net assets.
b. Special assessment debt for which the government is obligated in some manner (as described in paragraph .115) should be reported as general long-term liabilities in the government-wide statement of net assets, except for the portion, if any, that is directly related to and expected to be paid from proprietary funds.
    (1) The portion of the special assessment debt that will be repaid from property owner assessments should be reported as "special assessment debt with governmental commitment."
    (2) The portion of special assessment debt that will be repaid from general resources of the government (the public benefit portion, or the amount assessed against government-owned property) should be reported like other general long-term liabilities.

(3) The portion of special assessment debt that is directly related to and expected to be paid from proprietary funds should be reported as liabilities of those funds in the proprietary fund statement of net assets. Liabilities directly related to and expected to be repaid from proprietary funds should also be reported in the government-wide statement of net assets.

c. Special assessment debt for which the government is not obligated in any manner should not be displayed in the government's financial statements. However, if the government is liable for a portion of that debt (the public benefit portion, or as a property owner), that *portion* should be reported as above.
d. If a governmental entity is obligated in some manner for capital improvement special assessment debt (as discussed in paragraph .115), capital assets constructed or acquired with capital improvement special assessment debt should be reported in the government-wide financial statements as capital assets of either governmental or business-type activities in the statement of net assets.

[GASBS 6, ¶15 and ¶17; GASBS 34, ¶15, ¶16, and ¶81]

.117 [Insert current Codification paragraph .118. Change cross-references.]

Capital Improvements Financed by Special Assessment Debt—Governmental Funds

.118 [Insert current Codification paragraph .115, revising last sentence as follows:] The capital assets constructed or acquired (other than those related to proprietary funds—see paragraph .121) should be reported as general capital assets only in the governmental activities column in the government-wide statement of net assets, as set forth in Section 1400, "Fixed Assets," paragraph .105. The outstanding long-term debt should be reported as general long-term liabilities only in the governmental activities column in the government-wide statement of net assets, in accordance with the provisions of paragraph .116. [GASBS 6, ¶15; GASBS 34, ¶80 and ¶82]

.119 The debt service transactions of a special assessment issue for which the government is *not* obligated in any manner should be reported in an agency fund in the statement of fiduciary net assets rather than a debt service fund, to reflect the fact that the government's duties are limited to acting as an agent for the assessed property owners and the bondholders. The construction phase should be reported like other capital improvements—in a capital projects fund, or other appropriate fund. The source of funds in the capital projects fund should be identified by a description other than "bond proceeds," such as "contribution from property owners." The capital assets constructed or acquired should be reported only as general capital assets in the governmental activities column in the government-wide statement of net assets. Displaying the transactions in this way recognizes that the construction or acquisition is a governmental activity and results in the addition of a general capital asset but is not financed by governmental debt. [GASBS 6, ¶19; GASBS 34, ¶80 and ¶106]

.120 [Insert current Codification paragraph .122.]

Capital Improvements Financed by Special Assessment Debt—Proprietary Funds

.121 If a governmental entity is obligated in some manner for capital improvement special assessment debt and that debt is directly related to and expected to be paid from proprietary funds, all transactions related to capital improvements financed by special assessments should be reported in the same manner, and on the same basis of accounting, as any other capital improvement and financing transaction reported in proprietary funds. Special assessment revenue and receivables should be recognized on the accrual basis. [GASBS 6, ¶15; GASBS 34, ¶92]

.122 If the governmental entity is not obligated in any manner for special assessment debt, capital contributions equal to the amount capitalized in the proprietary fund should be reported on the accrual basis after nonoperating revenue and identified by a description such as "contribution from property owners." [GASBS 6, ¶23; GASBS 34, ¶100]

.123 Only that portion, if any, of special assessment debt that (a) is a direct obligation of the enterprise fund or (b) is not a direct obligation but is expected to be repaid from enterprise fund revenues[1] should be reported as a liability on the enterprise fund's statement of net assets. However, a governmental entity is not precluded from reporting all of the transactions and balances of a special assessment project within an enterprise fund to properly reflect the actual administration of a project. For example, an enterprise fund may bill and collect assessments, may be required to subsidize debt service payments from enterprise fund resources, and may have unrestricted use of project surpluses. In that situation, the entire amount assessed to property owners should be reported as the enterprise fund's assessments receivable at the time of the levy; special assessment debt, if any, should be reported as a liability of the

[1][Insert current Codification footnote 1.]

enterprise fund, and so forth. Collections of assessment principal reduce the receivable, and debt service payments reduce the liability. Interest income and expense should be recognized as they accrue. [GASBS 6, ¶23]

Capital Improvements Financed by Special Assessment Debt—Government-wide Financial Statements

.124 If a governmental entity is obligated in some manner for capital improvement special assessment debt (as discussed in paragraph .115), capital assets constructed or acquired with capital improvement special assessment debt should be reported as capital assets of either governmental or business-type activities in the government-wide statement of net assets. Special assessment revenue and receivables should be recognized on the accrual basis. [GASBS 6, ¶15; GASBS 34, ¶15 and ¶16]

.125 If the governmental entity is not obligated in any manner for special assessment debt, program revenue equal to the amount capitalized should be reported along with other grants or contributions restricted for capital purposes on the accrual basis in the statement of activities. [GASBS 6, ¶19; GASBS 34, ¶16 and ¶50]

Required Disclosures

.126–.127 [Insert current Codification paragraphs .120 and .121.]

Special Assessment Districts as Component Units

.128 [Insert current Codification paragraph .124.]

Statistical Tables

.129 [Insert current Codification paragraph .125.]

Applicability

.130 [Insert current Codification paragraph .126.]

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TERMINATION BENEFITS (SPECIAL) SECTION T25

[Revise entire section as follows:]

Sources: NCGA Interpretation 8
GASB Statement 27
GASB Statement 34

.101 [Insert current Codification paragraph .101, deleting the phrase *and expendable trust funds* and deleting footnote 3.] [NCGAI 8, ¶12, as amended by GASBS 27, ¶5 and GASBS 34, ¶69]

.102 In governmental funds, the primary emphasis is on the flow of financial resources, and expenditures are recognized on the modified accrual basis. Accordingly, the amount of special termination benefits reported as expenditures in governmental funds shall be the amount accrued during the year that would normally be liquidated with expendable available financial resources. [NCGAI 8, ¶12, as amended by GASBS 34, ¶82 and ¶119]

* * *

UNEMPLOYMENT COMPENSATION BENEFIT PLANS SECTION U50

[Revise entire section as follows:]

Sources: NCGA Interpretation 9
GASB Statement 34

.101 State unemployment compensation benefit plans should be reported in an enterprise fund. Resources that are provided for administrative costs and fees of the state unemployment programs should be reported in the general fund unless legal requirements[1] exist that require the accounting and financial reporting of the resources in another fund. [NCGAI 9, ¶9; GASBS 34, fn34]

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[1][Insert current Codification footnote 2.]

* * *

[Revise entire section as follows:]

Sources: GASB Statement 14
GASB Statement 34

.101 This Codification is written from the perspective of general purpose governments—states, cities, counties, towns, and villages. However, many governments are *special-purpose* governments, including hospitals and other healthcare providers. Those governments are legally separate entities, as discussed in Section 2100, "Defining the Financial Reporting Entity," and may be component units[1] or other stand-alone governments.[2] This section describes the accounting and financial reporting requirements for hospitals and other healthcare providers that are special-purpose governments (including component units). [GASBS 34, ¶134]

Definitions

.102 Hospitals and other healthcare providers may be engaged in either governmental or business-type activities or both. Governmental activities are generally financed through taxes, intergovernmental revenues, and other nonexchange revenues. They are usually reported in governmental funds and internal service funds. Business-type activities[3] are financed in whole or in part by fees charged to external users for goods or services. They are usually reported in enterprise funds. [GASBS 34, ¶15]

.103 [GASBS 34, ¶67]

Hospitals and Other Healthcare Providers Engaged Only in Business-type Activities

.104 [GASBS 34, ¶138] [Change cross-references.]

[1][GASBS 34, fn59] [Change cross-reference.]

[2][GASBS 34, fn60] [Change cross-reference.]

[3][GASBS 34, fn10] [Change cross-reference.]

Hospitals and Other Healthcare Providers Engaged in Governmental Activities

.105–.107 [GASBS 34, ¶135–¶137] [Change cross-references.]

Component Unit Financial Statements

.108 [Insert current Codification paragraph .104.]

Other Stand-alone Government Financial Statements

.109 [Insert current Codification paragraph .105, omitting first two sentences.]

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NOT-FOR-PROFIT ACCOUNTING AND FINANCIAL REPORTING — SECTION No80

[Eliminate entire section.]

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PENSION PLANS—DEFINED BENEFIT — SECTION Pe5

Sources: [Add the following:] GASB Statement 34

.105 [Revise paragraph as follows:] The provisions of this section apply whether the plan is a **single-employer, agent multiple-employer,** or **cost-sharing multiple-employer plan** and regardless of how or when pension benefits provided by the plan are financed. The requirements apply whether (a) the plan's financial statements are included in a separate financial report issued by the plan or by the public employee retirement system that administers the plan **(stand-alone plan financial report)** or (b) the plan is included as a pension trust fund or fiduciary component unit in the statement of fiduciary net assets and statement of changes in fiduciary net assets of the plan sponsor or employer. [GASBS 25, ¶13, as amended by GASBS 34, ¶106]

.109 [Revise paragraph as follows:] The requirements of paragraph .107 also apply for the comprehensive annual financial reports of a sponsor or employer when, based on the principles described in paragraph .108, the report includes more than one defined benefit pension plan. Financial statements for individual defined benefit pension plans should be presented in the notes to the financial statements of the sponsor or employer if separate, GAAP (generally accepted accounting principles) financial reports have not been issued. If separate, GAAP financial reports have been issued, the notes should include information about how to obtain those separate reports. [GASBS 25, ¶17; GASBS 34, ¶106]

.119 [Revise paragraph by deleting footnote 10 and renumbering remaining footnotes.] [GASBS 25, fn9, as amended by GASBS 34, ¶13]

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PUBLIC ENTITY RISK POOLS **SECTION Po20**

Sources: [Add the following:] GASB Statement 34

[Insert new paragraph .114 as follows and renumber remaining paragraphs:]

.114 Public entity risk pools should present only the financial statements required for enterprise funds. Basic financial statements and required supplementary information (RSI) consist of:

a. Management's discussion and analysis (MD&A). (See Section 2200, "Comprehensive Annual Financial Report," paragraphs .106–.109, as appropriate.)
b. Enterprise fund financial statements (Section 2200, paragraphs .161–.171), consisting of:
   (1) Statement of net assets or balance sheet
   (2) Statement of revenues, expenses, and changes in net assets
   (3) Statement of cash flows
c. Notes to financial statements (See Section 2300, "Notes to Financial Statements.")
d. RSI other than MD&A, if applicable. (See paragraph .147.)

[GASBS 34, ¶138]

* * *

Sources: [Add the following:] GASB Statement 34

.102 [Revise paragraph as follows:] The provisions of this section apply whether the postemployment healthcare plan is a **single-employer, agent multiple-employer,**[2] or **cost-sharing multiple-employer plan** and regardless of whether it is funded on an actuarially determined basis or in some other manner. The requirements apply whether the defined benefit pension plan (a) issues a separate financial report or is included in the financial report of the public employee retirement system that administers the pension plan **(stand-alone plan financial report)** or (b) is included as a pension trust fund or fiduciary component unit in the statement of fiduciary net assets and statement of changes in fiduciary net assets of the plan **sponsor** or employer. [GASBS 26, ¶4; GASBS 34, ¶106]

.105

[Revise footnote 3 as follows:] [3]The disclosure requirements for employers concerning their expenditures/expense for other postemployment benefits, including postemployment healthcare benefits, are included in Section P50. When a defined benefit pension plan that administers a postemployment healthcare plan is included in the employer's financial report (pension or other employee benefit trust fund), the employer may combine the postemployment healthcare disclosures required for, respectively, the fund and the employer's expenditures/expense in a manner that avoids unnecessary duplication. [GASBS 26, fn3, as amended by GASBS 34, ¶70]

[Revise footnote 4 as follows:] [4]When the defined benefit pension plan is included in the financial reporting entity of the sponsor or employer (pension or other employee benefit trust fund), combining statements of fiduciary net assets and changes in fiduciary net assets are not required. However, the net assets in the combined statement of fiduciary net assets should be subdivided and reported as, respectively, *net assets held in trust for employees' pension benefits* and *net assets held in trust for employees' postemployment healthcare benefits.* The net increase or decrease for the year in net assets should be similarly subdivided in the statement of changes in fiduciary net assets. Financial statements for individual postemployment healthcare plans should be

[2][Insert current Codification footnote 2.]

presented in the notes to the financial statements of the primary government if separate, GAAP financial reports have not been issued. If separate, GAAP financial reports have been issued, the notes should include information about how to obtain those reports. [GASBS 26, fn4, as amended by GASBS 34, ¶70; GASBS 34, ¶106]

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PUBLIC BENEFIT CORPORATIONS AND AUTHORITIES SECTION Pu5

[Eliminate entire section.]

* * *

[Create new Codification section as follows:]

SPECIAL-PURPOSE GOVERNMENTS SECTION Sp20

Sources: GASB Statement 29
GASB Statement 34

Basic Financial Statements Required for Special-purpose Governments

.101 This Codification is written from the perspective of general purpose governments—states, cities, counties, towns, and villages. However, many governments are *special-purpose* governments. Special-purpose governments are legally separate entities, as discussed in Section 2600, "Reporting Entity and Component Unit Presentation and Disclosure," and may be component units[1] or other stand-alone governments.[2] This section describes the accounting and financial reporting requirements for special-purpose governments. [GASBS 34, ¶134]

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[1][GASBS 34, fn59] [Change cross-reference.]

[2][GASBS 34, fn60] [Change cross-reference.]

Definitions

.102 Special-purpose governments may be engaged in either governmental or business-type activities or both. Governmental activities are generally financed through taxes, intergovernmental revenues, and other nonexchange revenues. They are usually reported in governmental funds and internal service funds. Business-type activities[3] are financed in whole or in part by fees charged to external users for goods or services. They are usually reported in enterprise funds. [GASBS 34, ¶15 and ¶135]

.103 [GASBS 34, ¶67] [Change cross-references.]

Reporting by Special-purpose Governments Engaged in Governmental Activities

.104–.106 [GASBS 34, ¶135–¶137] [Change cross-references.]

Reporting by Special-purpose Governments Engaged Only in Business-type Activities

.107 [GASBS 34, ¶138] [Change cross-references.]

Reporting by Special-purpose Governments Engaged Only in Fiduciary Activities

.108–.110 [GASBS 34, ¶139–¶141] [Change cross-references.]

Reporting by Governmental Not-for-Profit Entities

.111 Governmental not-for-profit entities that reported as of June 30, 1999, using the American Institute of CPAs' Statement of Position (SOP) 78-10, *Accounting Principles and Reporting Practices for Certain Nonprofit Organizations,* or Industry Audit Guide, *Audits of Voluntary Health and Welfare Organizations,* but that do not meet the criteria in paragraph .103 may report as special-purpose governments engaged only in business-type activities (paragraph .107). [GASBS 29, ¶5; GASBS 34, ¶147]

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[3][GASBS 34, fn10] [Change cross-reference.]

* * *

[Revise entire section as follows:]

Sources: GASB Statement 14
GASB Statement 20
GASB Statement 34

.101 This Codification is written from the perspective of general purpose governments—states, cities, counties, towns, and villages. However, many governments are *special-purpose* governments. Special-purpose governments are legally separate entities, as discussed in Section 2600, "Reporting Entity and Component Unit Presentation and Disclosure," and may be component units[1] or other stand-alone governments.[2] This section describes the accounting and financial reporting requirements for utilities that are special-purpose governments (including component units). [GASBS 34, ¶134]

Definitions

.102 Utilities may be engaged in either governmental or business-type activities or both. Governmental activities are financed primarily through taxes, intergovernmental revenues, and other nonexchange revenues. They are generally reported in governmental funds and internal service funds. Business-type activities[3] are financed in whole or in part by fees charged to external users for goods or services. They are usually reported in enterprise funds. [GASBS 34, ¶15]

.103 [GASBS 34, ¶67]

Utilities Engaged Only in Business-type Activities

.104 [GASBS 34, ¶138] [Change cross-references.]

Utilities Engaged in Governmental Activities or in Both Governmental and Business-type Activities

.105–.107 [GASBS 34, ¶135–¶137] [Change cross-references.]

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[1][GASBS 34, fn59] [Change cross-reference.]

[2][GASBS 34, fn60] [Change cross-reference.]

[3][GASBS 34, fn10] [Change cross-reference.]

Component Unit Financial Statements

.108 [Insert current Codification paragraph .103.]

Other Stand-alone Government Financial Statements

.109 [Insert current Codification paragraph .104, omitting first two sentences.]

Applicability of Rate-Regulated Accounting and Reporting

.112 FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation,* does not specifically exclude state and local governmental entities from its scope,[7] nor does it preclude its application to governmental entities.[8] FASB Statement 71 and related pronouncements issued on or before November 30, 1989,[9] may be applied to utilities that use enterprise fund accounting and financial reporting and that meet the criteria of those pronouncements for reporting as regulated enterprises. Related FASB pronouncements issued after November 30, 1989, are subject to the provisions of Section P80, "Proprietary Activity Accounting and Financial Reporting," paragraph .103. [GASBS 20, ¶9; GASBS 34, ¶95]

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[7][Insert current Codification footnote 1.]

[8][Insert current Codification footnote 2.]

[9][Insert current Codification footnote 3.]