CITY of THE DALLES
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AGENDA STAFF REPORT
Addendum

AGENDA LOCATION: Item 12. A.

MEETING DATE: May 9, 2016

TO: Honorable Mayor and City Council

FROM: Kate Mast, Finance Director

ISSUE: **Review and Approval of QLife FY16/17 Budget as Approved by the QLife Budget Committee**

BACKGROUND: The Wasco County Commission, at their meeting on May 4, 2016, reviewed the QLife FY16/17 Budget as approved by the QLife Budget Committee. During their review Mr. Wayne Lease, a resident of Washington State, stated that GASB 54, which requires governmental fund balances to be designated as restricted, committed, or unrestricted, had not been correctly applied to the QLife funds.

The County then approved the QLife Budget as approved by the QLife Budget Committee, contingent upon research and resolution of the issues raised by Mr. Lease. Staff consulted Tonya Moffitt, CPA, partner at Merina & Company, LLP, Certified Public Accountants and Consultant on this question. Merina and Company, LLP, have been the auditors for the City and QLife for the past five years, with Ms. Moffitt acting as our audit manager, so she is very familiar with QLife as an Intergovernmental Agency.

Mr. Moffitt's email stating her opinion that GASB 54 does not apply to the QLife Funds because the QLife funds are not governmental in nature, but are proprietary funds, is attached below.

Also attached is a letter from QLife Attorney Keith Mobley, that describes his own research on the issue and his confidence in Ms. Moffitt's opinion.

We believe the opinions of Mr. Mobley and Ms. Moffitt are sufficient to show that the issue raised by Mr. Lease regarding the application of GASB 54 to QLife funds has no basis in fact.

The staff recommendation for the City Council to approve the QLife FY16/17 Budget as approved by the QLife Budget Committee, as stated in the previous staff report, stands as written.

Keith A. Mobley *Lawyer*

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By Appointment Only

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May 5, 2016

Tyler Stone, Administrator
Q-Life Network
511 Washington Street
The Dalles, OR 97058

Dear Tyler:

I write in response to a question posed by Mr. Wayne Lease about a provision in the proposed 2015-2017 budget for the QualityLife Intergovernmental Agency that would authorize the board of directors to transfer funds from the Agency to its founding owners, Wasco County and the City of The Dalles.

Not knowing the basis for his objection to such a transfer, I researched the question of whether there were statutory or other restrictions that would apply. I found none, and subsequently learned the authority he was relying on was Governmental Accounting Standards Board Statement 54.

After reviewing the Statement and discussing it with CPA Tonya Moffitt, a member of the firm that audits the QualityLife Intergovernmental Agency and an expert on GASB requirements, I have concluded that it does not provide authority that would support the objection.

Sincerely,

Keith A. Mobley
Legal Counsel for Q-Life Network

Kate Mast

From: Tonya Moffitt <tmoffitt@merinacpas.com>
Sent: Wednesday, May 04, 2016 3:35 PM
To: Kate Mast
Subject: GASB 54 - application to QualityLife Financial Statements
Attachments: GASBS_54__Fund_Balance_Reporting_and_Governmental_Fund_Type_Definitions.doc; GASBS_34__Basic_Financial_Statements_and_Management_s_Discussion_and_An....doc; GASBS_46 __Net_Assets_Restricted_by_Enabling_Legislation_an_amendment_of_GASB_Statement_No__34.doc

Follow Up Flag: Follow up
Flag Status: Flagged

Kate,

Government Accounting Standards Board (GASB) 54 – Fund Balance Reporting and Governmental Fund Type Definitions is not applicable to QualityLife Intergovernmental Agency because it is a Proprietary Fund. GASB 54 is applicable to Governmental Funds and not Propriety Funds. Per GASB 54 Summary:

> The objective of this Statement is to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. This Statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds.

It is our understanding that the Net Position listed as "Unrestricted" on page 1 of the QualityLife Intergovernmental Agency's June 30, 2015 Financial Statements is appropriately categorized based on the Government Accounting Standards Board's Statements definitions. Below I have referenced the GASB's that apply to Net Position (formerly referred to as Net Assets).

GASB 34 – Basic Financial Statements and Management Discussion and Analysis For State and Local Government has the following definition for Restricted Net Position paragraph 34:

> Net assets should be reported as restricted when constraints placed on net asset use are either:
> 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*, 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.

Enabling legislation was later amended in GASB 46 – Net Assets Restricted by Enabling Legislation an amendment of GASB Statement No. 34. See the attached statement.

I have attached GASB 54, 34, & 46 in their entirety for your reference.

Here are some of the classes I have taught or will be teaching in the next few months:

- GASB 51 & 54 classes
- GASB 61 & 62 – What's Coming in 2013
- Governmental Accounting and Reporting
- Governmental Accounting and Auditing Update
- GASB 68 classes at the 2016 Oregon Government Finance Officer Association Spring Conference and 2015 Oregon Society of CPA Spring Governmental Auditing Conference
- I am scheduled to:
  - Be the discussion leader for the GASB 68 panel at the 2016 OSCPA Spring Governmental Auditing Conference on May 17, 2016.
  - Teaching Applying the Uniform Guidance for Federal Awards in Your Single Audits June 1, 2016
  - Teaching Minimum Standards for Audits of Oregon Municipal Corporations and Oregon Local Budget Law on June 14, 2016
  - Teaching the Governmental Accounting and Reporting on June 28, 2016

If you have any questions please let me know.

Tonya Moffitt, CPA
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Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments

STATUS

Issued: June 1999 Effective Date: In three phases based on a government's total annual revenues, beginning with periods beginning after June 15, 2001 and continuing through periods beginning after June 15, 2003

Affects:

Amends NCGAS 1, Summary Statement of Principles Nos. 1 , 2 , 3 , 5 , 8 , 12 ; ¶2 - ¶4 , ¶16 - ¶18 , ¶22 , ¶25 - ¶27 , ¶32 , ¶42 - ¶44 , ¶46 , ¶57 , ¶59 , ¶61 , ¶72 , ¶76 , ¶99 , ¶100 , ¶107 , ¶108 , ¶114 , ¶117 , ¶123 , ¶125 , ¶128 , ¶129 , ¶131 , ¶133 , ¶135 , ¶138 , ¶139 , ¶143 , ¶145 , ¶147 , ¶155 - ¶159 , ¶161 , and ¶173 - ¶175

Supersedes NCGAS 1, Summary Statement of Principles Nos. 6 and 7 and fn4; ¶19 , ¶20 , ¶34 - ¶41 , ¶45 , ¶47 - ¶56 , ¶60 , ¶71 , ¶74 , fn16, ¶98 , ¶101 - ¶106 , ¶122 , ¶136 , ¶137 , ¶140 - ¶142 , ¶144 , ¶146 , ¶148 - ¶154 , ¶162 - ¶164 , and ¶166 - ¶171

Supersedes NCGAS 2, ¶15 , ¶16 , and ¶18

Supersedes NCGAS 4, ¶5 - ¶7

Amends NCGAS 4, ¶9 , NCGAS 4, ¶13 , ¶16 , and ¶17

Amends NCGAS 5, ¶5 , ¶6 , ¶10 , ¶11 , ¶14 - ¶17 , ¶22 , and ¶24

Supersedes NCGAS 5, ¶8 and ¶9

Supersedes NCGAI 2

Amends NCGAI 3, ¶3

Supersedes NCGAI 5

Amends NCGAI 6, ¶2 , ¶4 , ¶5 , and ¶8

Supersedes NCGAI 6, ¶3

Amends NCGAI 8, ¶12

Amends NCGAI 9, ¶9 and ¶12

Amends NCGAI 10, ¶11 , ¶13 - ¶15 , and ¶25

Supersedes NCGAI 10, ¶2 and ¶12

Supersedes AICPA SOP 77-2

Supersedes AICPA SOP 78-7

Supersedes AICPA SOP 80-2, ¶4 and ¶5

Amends GASBS 1, ¶8

Amends GASBS 3, ¶63 - ¶65 , and ¶70

Amends GASBS 6, ¶13 - 15 , ¶17 , ¶19 , and ¶23

Amends GASBS 7, ¶1 , ¶3 , ¶7 , ¶8 , ¶10 , ¶11 , ¶13 and ¶14

Supersedes GASBS 7, ¶9 and fn1

Amends GASBS 8, ¶10 , ¶11 , and fn3

Amends GASBS 9, ¶1 , ¶4 - ¶7 , ¶17 , ¶18 , ¶21 , ¶22 , ¶31 - ¶34 , ¶36 , and fn12

Supersedes GASBS 9 , fn1 and fn8

Amends GASBS 10, ¶52 , 53 , 61 , 63 - ¶65 , ¶67 - ¶69 , ¶77 , ¶78 , ¶80 , fn9, and fn12

Supersedes GASBS 11, ¶1 - ¶39 , ¶62 , ¶63 , ¶68 - ¶76 , ¶81 - ¶99 , and ¶260

Amends GASBS 12, ¶1 and ¶12

Amends GASBS 13, ¶1 , ¶4 , ¶7 , ¶9 , and ¶10

Amends GASBS 14, ¶9 , ¶11 , ¶12 , ¶19 , ¶42 , ¶44 , ¶50 - ¶52 , ¶54 , ¶58 , ¶60 , ¶63 , ¶65 , ¶73 , ¶74 , ¶78 , and ¶131

Supersedes GASBS 14, ¶45 - ¶47 , ¶49 , ¶56 , and ¶57

Amends GASBS 16, ¶1 , ¶5 , ¶10 , ¶13 , and ¶14

Supersedes GASBS 17, ¶1 - ¶3 , ¶5 - ¶7

Amends GASBS 17, ¶4 and 6

Amends GASBS 18, ¶3 , ¶5 , ¶7 , ¶10 , ¶11 , ¶16 , ¶17 , and fn2

Supersedes GASBS 20, ¶4 , fn1, and fn2

Amends GASBS 20, ¶5 - ¶9

Amends GASBS 21, ¶3 - ¶6

Amends GASBS 23, ¶1 , ¶3 , ¶4 , ¶6 , and fn5

Amends GASBS 24, ¶5 and ¶13

Supersedes GASBS 24, ¶14

Amends GASBS 25, ¶13 , ¶14 , ¶17 , ¶44 and fn2

Supersedes GASBS 25 , fn9

Amends GASBS 26, ¶4 , fn3, and fn4

Amends GASBS 27, ¶3 , ¶4 , ¶9 , ¶15 - ¶17 , ¶19 , ¶23 , ¶25 , ¶39 , and fn14

Amends GASBS 28, ¶4 , ¶10 , fn3, fn6, and fn9

Amends GASBS 29, ¶4 , ¶5 , and ¶7

Supersedes GASBS 29, ¶1 , ¶3 , ¶6 , and fn1

Amends GASBS 31, ¶7 , ¶13 , ¶14 , ¶18 , ¶19 , and fn8

Amends GASBS 32, ¶4 and ¶6

Amends GASBS 33, ¶11 , ¶29 , and fn11

Amends GASBI 1, ¶6 , ¶10 , ¶13 , and fn2

Amends GASBI 2, ¶3 and ¶4

Amends GASBI 3, ¶3 , ¶4 , and fn1- fn3

Amends GASBI 4, ¶6

Amends GASB 94-1, fn5

Affected by:

Footnote 3 superseded by GASBS 35, ¶5

Paragraph 11 amended by GASBS 37, ¶4 and ¶5 ; and GASBS 63, ¶7 and ¶8

Paragraph 12 amended by GASBS 63, ¶7 and ¶8

Paragraph 13 amended by GASBS 63, ¶8

Paragraph 16 amended by GASBS 63, ¶7 and ¶8

Paragraph 17 superseded by GASBS 62

Footnote 12 amended by GASBS 62, ¶476-¶500

Footnote 13 amended by GASBS 62, ¶77-¶82 and GASBS 63, ¶8

Paragraph 18 amended by GASBS 37, ¶6

Paragraph 19 amended by GASBS 42 , fn1 and GASBS 51, ¶5 and ¶17

Paragraph 20 amended by GASBS 63, ¶8

Paragraph 21 amended by GASBS 42, ¶9 and GASBS 51, ¶17

Paragraph 25 amended by GASBS 37, ¶8

Paragraph 30 amended by GASBS 63, ¶8

Footnote 23 amended by GASBS 63, ¶8

Paragraph 32 superseded by GASBS 63, ¶8

Paragraph 33 superseded by GASBS 63, ¶9

Paragraph 34 amended by GASBS 46, ¶2 ; and and GASBS 63, ¶10

Footnote 24 amended by GASBS 54, ¶8; and GASBS 63, ¶8

Footnote 25 amended by GASBS 62, ¶476-¶500

Paragraph 35 amended by GASBS 63, ¶8 and will be amended by GASBS 61

Paragraph 36 superseded by GASBS 63, ¶11

Paragraph 37 amended by GASBS 54, ¶10-¶16 , and GASBS 63, ¶8

Paragraph 38 amended by GASBS 37, ¶11 , and GASBS 63, ¶8

Paragraph 39 superseded by GASBS 37, ¶10

Paragraph 48 amended by GASBS 37, ¶12

Paragraph 49 superseded by GASBS 37, ¶13

Paragraph 53 amended by GASBS 63, ¶8

Paragraph 54 amended by GASBS 63, ¶8

Paragraph 55 amended by GASBS 62, ¶45-¶49

Paragraph 57 amended by GASBS 63, ¶8

Paragraph 58 amended by GASBS 48 , fn4; and GASBS 63, ¶8

Paragraph 61 amended by GASBS 48 , fn4; and GASBS 63, ¶8

Paragraph 62 amended by GASBS 63, ¶7 and ¶8

Paragraph 64 amended by GASBS 54, ¶28-¶35

Paragraph 65 amended by GASBS 54, ¶35

Paragraph 66 amended by GASBS 63, ¶8

Paragraph 67 amended by GASBS 37, ¶14

Paragraph 69 amended by GASBS 63, ¶8

Paragraph 76 amended by GASBS 37, ¶15

Paragraph 80 amended by GASBS 63, ¶8

Paragraph 81 amended by GASBS 47, ¶3

Paragraph 82 amended by GASBS 63, ¶8

Paragraph 83 amended by GASBS 63, ¶12

Paragraph 84 superseded by GASBS 54, ¶22 and ¶25

Paragraph 85 amended by GASBS 63, ¶8

Footnote 38 amended by GASBS 54, ¶22

Paragraph 88 amended by GASBS 37, ¶16

Paragraph 90 amended by GASBS 63, ¶8

Paragraph 91 amended by GASBS 63, ¶7 , ¶8 , and ¶12

Footnote 39 amended by GASBS 63, ¶8

Footnote 40 superseded by GASBS 63

Paragraph 92 amended by GASBS 63, ¶7 , ¶8 , and ¶12

Paragraphs 93 and 94 superseded by GASBS 62, ¶23-¶28

Paragraph 95 amended by GASBS 62, ¶476-¶500

Paragraph 97 amended by GASBS 62, ¶29-¶43 and GASBS 63, ¶8

Paragraph 98 amended by GASBS 63, ¶8

Paragraph 99 amended by GASBS 63, ¶8

Paragraph 100 amended by GASBS 48, ¶21 and GASBS 63, ¶8

Paragraph 101 amended by GASBS 63, ¶8

Paragraph 103 amended by GASBS 63, ¶8

Paragraph 104 amended by GASBS 63, ¶8

Paragraph 106 amended by GASBS 43, ¶15 ; and GASBS 63, ¶7 , ¶8 , and ¶12

Footnote 43 amended by GASBS 43, ¶11 ; and GASBS 63, ¶8

Footnote 44 amended by GASBS 43, ¶11

Paragraph 107 amended by GASBS 43, ¶11 and ¶24

Paragraphs 108 and 109 amended by GASBS 43, ¶11 , and GASBS 63, ¶8

Paragraph 110 amended by GASBS 63, ¶8

Paragraph 112 amended by GASBS 63, ¶8

Paragraph 115 amended by GASBS 62, ¶4 and GASBS 63, ¶8

Paragraph 116 amended by GASBS 63, ¶8

Paragraph 121 amended by GASBS 63, ¶8

Paragraph 122 amended by GASBS 37, ¶17 ; and GASBS 63, ¶7 , ¶8 , and ¶12

Paragraph 125 amended by GASBS 63, ¶8

Paragraph 126 amended by GASBS 37, ¶18 , and GASBS 63, ¶8

Footnote 51 amended by GASBS 63, ¶8

Paragraph 127 amended by GASBS 63, ¶7 , ¶8 , and ¶12

Paragraph 130 and footnote 53 amended by GASBS 41, ¶3

Paragraph 131 amended by GASBS 37, ¶19

Paragraph 136 amended by GASBS 63, ¶8

Paragraph 138 amended by GASBS 63, ¶8

Paragraph 139 amended by GASBS 63, ¶8

Paragraph 140 amended by GASBS 43, ¶11 , and GASBS 63, ¶8

Footnote 63 amended by GASBS 43, ¶12

Footnote 64 amended by GASBS 43, ¶13

Paragraph 141 amended by GASBS 43, ¶11

Paragraph 144 amended by GASBS 37, ¶9

Paragraph 146 amended by GASBS 37, ¶7

Paragraph 147 amended by GASBS 62, ¶4

Paragraph 148 amended by GASBS 63, ¶8

Other Interpretative Literature: GASBQ&A 34

GASBQ&A 34B

GASB Comprehensive Implementation Guide

Primary Codification Section Reference: Throughout

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 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.

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- \- *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 public colleges and universities. Paragraph 3 discusses the applicability of this Statement.

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]

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 , 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:

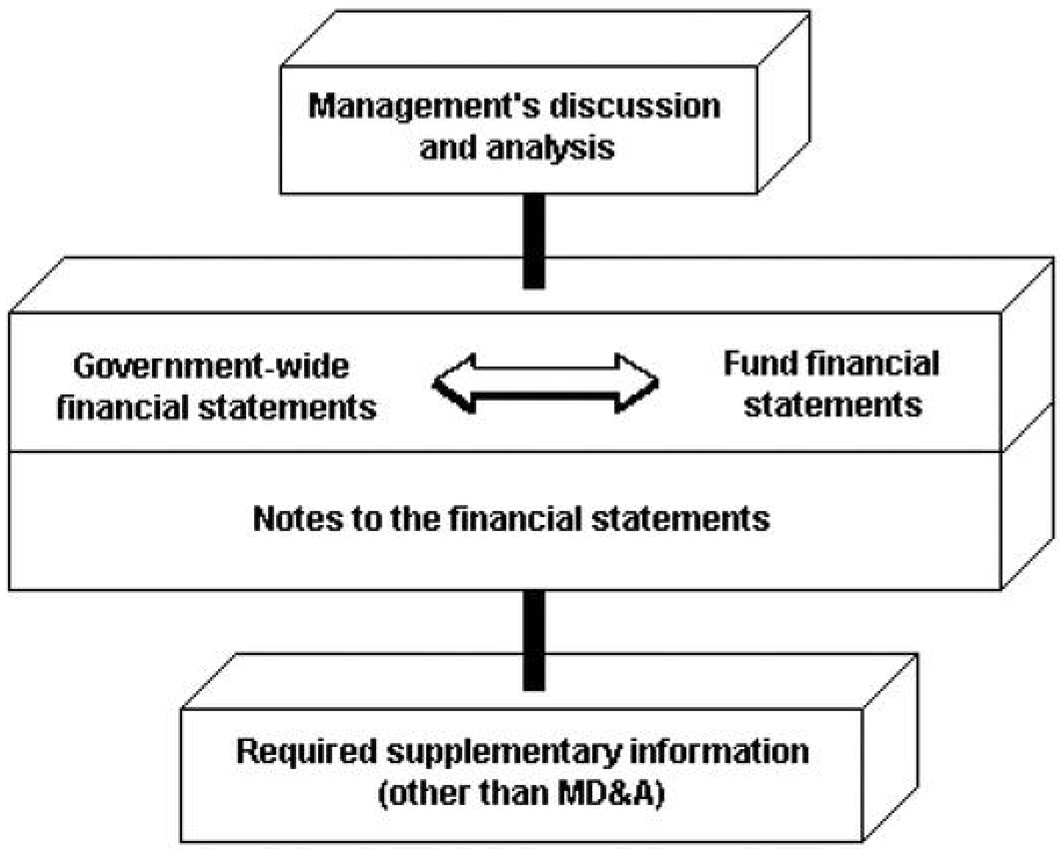
(1) *Government-wide financial statements.* The government-wide statements should display information about the reporting government as a whole, except for its fiduciary activities. The statements should include separate columns for the governmental and business-type activities of the primary government [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 .)

(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.



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 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

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 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 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.

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.

21. Capital assets should be depreciated over their estimated useful lives unless they are 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.

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.

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 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.

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*.

Restricted net assets

34.

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.

Required Financial Statements-Statement of Activities

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.

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.

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 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.

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 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 accumulatedresources* 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.

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
					XXXXX	XXXXX	XXXXXX	XXXXX

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 *withinthe 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 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]

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.

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 *currentfinancial 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 fundliabilities* 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 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.

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 also should 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

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 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 *economicresources 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.

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 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 .)

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.

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.

(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.

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).

Budgetary Comparison Schedules

130.

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, 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.

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 statements 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).

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 through 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 for periods beginning before June 15, 2000, also should 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.

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).

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.

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

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 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.

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.

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.

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 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 governmental 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 designed 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 officials 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.

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 governmental 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 revenue (expense) 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 noncurrent 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 *legallyenforceable* 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]

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.

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 reportdepreciation 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 report 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,
Debt service funds		

Permanent funds (including public-purpose funds previously classified as nonexpendable trust funds)	private organizations, or other governments)
	Agency funds (limited to net assets held for specific other persons or entities)

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 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 *proprietaryfunds* and as *governmentalactivities* 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 resource 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 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 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

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 years. 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 below is not required, but providing one may stimulate some users' interest in reading the remainder of the discussion.

The discussions 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 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 experiences 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 XXX .

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 XXX and XXX-XXX) 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 XXX. 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 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 XXX . 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 XXX . The fund financial statements begin on page XXX 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 *modifiedaccrual* 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 XXX and XXX. 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 XXX . 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

Sample City
Statement of Activities
For the Year Ended December 31, 2002

B-1

The detail presented for governmental activities represents the *minimum* requirement. Governments are encouraged to provide more details–for example, police, fire, emergency medical services, and inspections–rather than simply "public safety."

		Program Revenues			Net (Expense) Revenue and Changes in Net Assets			
					Primary Government			
Functions/Programs	**Expenses**	**Charges for Services**	**Operating Grants and Contributions**	**Capital Grants and Contributions**	**Governmental Activities**	**Business-type Activities**	**Total**	**Component Units**
Primary government:								
Governmental activities:								
General government	$ 9,571,410	$ 3,146,915	$ 843,617	$ —	$ (5,580,878)	$ —	$ (5,580,878)	$ —
Public safety	34,844,749	1,198,855	1,307,693	62,300	(32,275,901)	—	(32,275,901)	—
Public works	10,128,538	850,000	—	2,252,615	(7,025,923)	—	(7,025,923)	—
Engineering services	1,299,645	704,793	—	—	(594,852)	—	(594,852)	—
Health and sanitation	6,738,672	5,612,267	575,000	—	(551,405)	—	(551,405)	—
Cemetery	735,866	212,496	—	—	(523,370)	—	(523,370)	—
Culture and recreation	11,532,350	3,995,199	2,450,000	—	(5,087,151)	—	(5,087,151)	—
Community development	2,994,389	—	—	2,580,000	(414,389)	—	(414,389)	—
Education (payment to school district)	21,893,273	—	—	—	(21,893,273)	—	(21,893,273)	—
Interest on long-term debt	6,068,121	—	—	—	(6,068,121)	—	(6,068,121)	—
Total governmental activities	105,807,013	15,720,525	5,176,310	4,894,915	(80,015,263)	—	(80,015,263)	—
Business-type activities:								
Water	3,595,733	4,159,350	—	1,159,909	—	1,723,526	1,723,526	—
Sewer	4,912,853	7,170,533	—	486,010	—	2,743,690	2,743,690	—
Parking facilities	2,796,283	1,344,087	—	—	—	(1,452,196)	(1,452,196)	—
Total business-type activities	11,304,869	12,673,970	—	1,645,919	—	3,015,020	3,015,020	—
Total primary government	$ 117,111,882	$ 28,394,495	$ 5,176,310	$ 6,540,834	(80,015,263)	3,015,020	(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)
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					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

page XXX [*to close the table, press F6*], 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

Sample City
Balance Sheet
Governmental Funds
December 31, 2002

	General	HUD Programs	Community Redevelopment	Route 7 Construction	Other Governmental Funds (See H-1)	Total Governmental Funds
ASSETS						
Cash and cash equivalents	$ 3,418,485	$ 1,236,523	$ —	$ —	$ 5,606,792	$ 10,261,800
Investments	—	—	13,262,695	10,467,037	3,485,252	27,214,984
Receivables, net	3,644,561	2,953,438	353,340	11,000	10,221	6,972,560
Due from other funds	1,370,757	—	—	—	—	1,370,757
Receivables from other governments	—	119,059	—	—	1,596,038	1,715,097
Liens receivable	791,926	3,195,745	—	—	—	3,987,671
Inventories	182,821	—	—	—	—	182,821
Total assets	$ 9,408,550	$ 7,504,765	$ 13,616,035	$ 10,478,037	$ 10,698,303	$ 51,705,690
LIABILITIES AND FUND BALANCES						
Liabilities:						
Accounts payable	$ 3,408,680	$ 129,975	$ 190,548	$ 1,104,632	$ 1,074,831	$ 5,908,666
Due to other funds	—	25,369	—	—	—	25,369
Payable to other governments	94,074	—	—	—	—	94,074
Deferred revenue	4,250,430	6,273,045	250,000	11,000	—	10,784,475
Total liabilities (Note 2)	7,753,184	6,428,389	440,548	1,115,632	1,074,831	16,812,584
Fund balances:						
Reserved for:						
Inventories	182,821	—	—	—	—	182,821
Liens receivable	791,926	—	—	—	—	791,926
Encumbrances	40,292	41,034	119,314	5,792,587	1,814,122	7,807,349
Debt service	—				3,832,062	3,832,062
Other purposes	—				1,405,300	1,405,300
Unreserved, reported in:						
General fund	640,327	—	—	—	—	640,327
Special revenue funds	—	1,035,342	—	—	1,330,718	2,366,060
Capital projects funds	—	—	13,056,173	3,569,818	1,241,270	17,867,261
Total fund balances	1,655,366	1,076,376	13,175,487	9,362,405	9,623,472	34,893,106
Total liabilities and fund balances	$ 9,408,550	$ 7,504,765	$ 13,616,035	$ 10,478,037	$ 10,698,303	

"Designations" of unreserved fund balances may be displayed or disclosed in the notes.

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

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.)

pages XXX-XXX) 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 XXX and XXX . 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

Sample City
Balance Sheet
Governmental Funds
December 31, 2002

	General	HUD Programs	Community Redevelopment	Route 7 Construction	Other Governmental Funds (See H-1)	Total Governmental Funds
ASSETS						
Cash and cash equivalents	$ 3,418,485	$ 1,236,523	$ —	$ —	$ 5,606,792	$ 10,261,800
Investments	—	—	13,262,695	10,467,037	3,485,252	27,214,984
Receivables, net	3,644,561	2,953,438	353,340	11,000	10,221	6,972,560
Due from other funds	1,370,757	—	—	—	—	1,370,757
Receivables from other governments	—	119,059	—	—	1,596,038	1,715,097
Liens receivable	791,926	3,195,745	—	—	—	3,987,671
Inventories	182,821	—	—	—	—	182,821
Total assets	$ 9,408,550	$ 7,504,765	$ 13,616,035	$ 10,478,037	$ 10,698,303	$ 51,705,690
LIABILITIES AND FUND BALANCES						
Liabilities:						
Accounts payable	$ 3,408,680	$ 129,975	$ 190,548	$ 1,104,632	$ 1,074,831	$ 5,908,666
Due to other funds	—	25,369	—	—	—	25,369
Payable to other governments	94,074	—	—	—	—	94,074
Deferred revenue	4,250,430	6,273,045	250,000	11,000	—	10,784,475
Total liabilities (Note 2)	7,753,184	6,428,389	440,548	1,115,632	1,074,831	16,812,584
Fund balances:						
Reserved for:						
Inventories	182,821	—	—	—	—	182,821
Liens receivable	791,926	—	—	—	—	791,926
Encumbrances	40,292	41,034	119,314	5,792,587	1,814,122	7,807,349
Debt service	—				3,832,062	3,832,062
Other purposes	—				1,405,300	1,405,300
Unreserved, reported in:						
General fund	640,327	—	—	—	—	640,327
Special revenue funds	—	1,035,342	—	—	1,330,718	2,366,060
Capital projects funds	—	—	13,056,173	3,569,818	1,241,270	17,867,261
Total fund balances	1,655,366	1,076,376	13,175,487	9,362,405	9,623,472	34,893,106
Total liabilities and fund balances	$ 9,408,550	$ 7,504,765	$ 13,616,035	$ 10,478,037	$ 10,698,303	

"Designations" of unreserved fund balances may be displayed or disclosed in the notes.

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

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.)

pages XXX-XXX differs from the General Fund's *budgetary* fund balance of $1.4 million reported in the budgetary comparison schedule on

Sample City
Budgetary Comparison Schedule
General Fund
For the Year Ended December 31, 2002

The variance column is optional.

	Budgeted Amounts Original	Budgeted Amounts Final	Actual Amounts (Budgetary Basis) (See Note A)	Variance with Final Budget Positive (Negative)
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

page XXX . 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	3.2

system and treatment facilities, paid for withproceeds from a revenue note issued last year	
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 nonagricultural 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 XXX), 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

Illustration 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.

Sample City
Statement of Net Assets
December 31, 2002

A-1

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				
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.

Illustration 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).

Sample City
Statement of Net Assets
December 31, 2002

A-2

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).

Illustration A-3

Statement of net assets for a single-program government that engages in only governmental activities and has no component units.

Sample County Fire Protection District
Statement of Net Assets
June 30, 2002

A-3

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.

Illustration 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).

Sample County Fire Protection District
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) revenuesof 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

Illustration B-1

Standard statement of activities format.

B-1

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, emergency medical services, and inspections--rather than simply "public safety."

		Program Revenues			Net (Expense) Revenue and Changes in Net Assets			
					Primary Government			
Functions/Programs	**Expenses**	**Charges for Services**	**Operating Grants and Contributions**	**Capital Grants and Contributions**	**Governmental Activities**	**Business-type Activities**	**Total**	**Component Units**
Primary government:								
Governmental activities:								
General government	$ 9,571,410	$ 3,146,915	$ 843,617	$ —	$ (5,580,878)	$ —	$ (5,580,878)	$ —
Public safety	34,844,749	1,198,855	1,307,693	62,300	(32,275,901)	—	(32,275,901)	—
Public works	10,128,538	850,000	—	2,252,615	(7,025,923)	—	(7,025,923)	—
Engineering services	1,299,645	704,793	—	—	(594,852)	—	(594,852)	—
Health and sanitation	6,738,672	5,612,267	575,000	—	(551,405)	—	(551,405)	—
Cemetery	735,866	212,496	—	—	(523,370)	—	(523,370)	—
Culture and recreation	11,532,350	3,995,199	2,450,000	—	(5,087,151)	—	(5,087,151)	—
Community development	2,994,389	—	—	2,580,000	(414,389)	—	(414,389)	—
Education (payment to school district)	21,893,273	—	—	—	(21,893,273)	—	(21,893,273)	—
Interest on long-term debt	6,068,121	—	—	—	(6,068,121)	—	(6,068,121)	—
Total governmental activities	105,807,013	15,720,525	5,176,310	4,894,915	(80,015,263)	—	(80,015,263)	—
Business-type activities:								
Water	3,595,733	4,159,350	—	1,159,909	—	1,723,526	1,723,526	—
Sewer	4,912,853	7,170,533	—	486,010	—	2,743,690	2,743,690	—
Parking facilities	2,796,283	1,344,087	—	—	—	(1,452,196)	(1,452,196)	—
Total business-type activities	11,304,869	12,673,970	—	1,645,919	—	3,015,020	3,015,020	—
Total primary government	$ 117,111,882	$ 28,394,495	$ 5,176,310	$ 6,540,834	(80,015,263)	3,015,020	(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)
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					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

Illustration B-2

Statement of activities for a government that allocates indirect expenses to its functions.

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.

Functions/Programs	Expenses	Indirect Expenses Allocation	Program Revenues: Charges for Services	Program Revenues: Operating Grants and Contributions	Program Revenues: Capital Grants and Contributions	Net (Expense) Revenue and Changes in Net Assets — Primary Government: Governmental Activities	Primary Government: Business-type Activities	Primary Government: Total	Component Units
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	(36,335,774)	—	(36,335,774)	—
Public works	10,128,538	3,264,380	850,000	—	2,252,615	(10,290,303)	—	(10,290,303)	—
Engineering services	1,299,645	111,618	704,793	—	—	(706,470)	—	(706,470)	—
Health and sanitation	6,738,672	558,088	5,612,267	575,000	—	(1,109,493)	—	(1,109,493)	—
Cemetery	735,866	55,809	212,496	—	—	(579,179)	—	(579,179)	—
Culture and recreation	11,532,350	1,858,966	3,995,199	2,450,000	—	(6,946,117)	—	(6,946,117)	—
Community development	2,994,389	1,740,265	—	—	2,580,000	(2,154,654)	—	(2,154,654)	—
Education (payment to school district)	21,893,273	—	—	—	—	(21,893,273)	—	(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	(80,015,263)	—	(80,015,263)	—
Business-type activities:									
Water	3,595,733		4,159,350	—	1,159,909	—	1,723,526	1,723,526	—
Sewer	4,912,853		7,170,533	—	486,010	—	2,743,690	2,743,690	—
Parking facilities	2,796,283		1,344,087	—	—	—	(1,452,196)	(1,452,196)	—
Total business-type activities	11,304,869		12,673,970	—	1,645,919	—	3,015,020	3,015,020	—
Total primary government	$ 117,111,882		$ 28,394,495	$ 5,176,310	$ 6,540,834	(80,015,263)	3,015,020	(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)
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						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

Illustration B-3

Statement of activities with functions presented in columns, rather than rows. Governments with few functions might consider this approach more appropriate.

Sample Township
Statement of Activities
For the Year Ended December 31, 2002

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).

	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.

Illustration 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.

Sample City
Statement of Activities
For the Year Ended December 31, 2002

		Program Revenues			
Functions/Programs	Expenses	Charges for Services	Operating Grants and Contributions	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

Illustration 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).

Sample County Fire Protection District
Statement of Activities
For the Year Ended June 30, 2002

B-5

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.

Illustration 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 a line 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."

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

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	10,805,435	963,024	11,768,459	(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	$ 16,957,590	$ 1,848,957	$ 18,806,547	$ 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

B-7

	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

Illustration 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-1

Sample City
Balance Sheet
Governmental Funds
December 31, 2002

	General	HUD Programs	Community Redevelopment	Route 7 Construction	Other Governmental Funds (See H-1)	Total Governmental Funds
ASSETS						
Cash and cash equivalents	$ 3,418,485	$ 1,236,523	$ —	$ —	$ 5,606,792	$ 10,261,800
Investments	—	—	13,262,695	10,467,037	3,485,252	27,214,984
Receivables, net	3,644,561	2,953,438	353,340	11,000	10,221	6,972,560
Due from other funds	1,370,757	—	—	—	—	1,370,757
Receivables from other governments	—	119,059	—	—	1,596,038	1,715,097
Liens receivable	791,926	3,195,745	—	—	—	3,987,671
Inventories	182,821	—	—	—	—	182,821
Total assets	$ 9,408,550	$ 7,504,765	$ 13,616,035	$ 10,478,037	$ 10,698,303	$ 51,705,690
LIABILITIES AND FUND BALANCES						
Liabilities:						
Accounts payable	$ 3,408,680	$ 129,975	$ 190,548	$ 1,104,632	$ 1,074,831	$ 5,908,666
Due to other funds	—	25,369	—	—	—	25,369
Payable to other governments	94,074	—	—	—	—	94,074
Deferred revenue	4,250,430	6,273,045	250,000	11,000	—	10,784,475
Total liabilities (Note 2)	7,753,184	6,428,389	440,548	1,115,632	1,074,831	16,812,584
Fund balances:						
Reserved for:						
Inventories	182,821	—	—	—	—	182,821
Liens receivable	791,926	—	—	—	—	791,926
Encumbrances	40,292	41,034	119,314	5,792,587	1,814,122	7,807,349
Debt service	—				3,832,062	3,832,062
Other purposes	—				1,405,300	1,405,300
Unreserved, reported in:						
General fund	640,327	—	—	—	—	640,327
Special revenue funds	—	1,035,342	—	—	1,330,718	2,366,060
Capital projects funds	—	—	13,056,173	3,569,818	1,241,270	17,867,261
Total fund balances	1,655,366	1,076,376	13,175,487	9,362,405	9,623,472	34,893,106
Total liabilities and fund balances	$ 9,408,550	$ 7,504,765	$ 13,616,035	$ 10,478,037	$ 10,698,303	

"Designations" of unreserved fund balances may be displayed or disclosed in the notes.

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

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.)

Illustration 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 .

Sample City
Statement of Revenues, Expenditures, and Changes in Fund Balances
Governmental Funds
For the Year Ended December 31, 2002

C-2

	General	HUD Programs	Community Redevelopment	Route 7 Construction	Other Governmental Funds (See H-2)	Total Governmental Funds
REVENUES						
Property taxes	$ 51,173,436	$ —	$ —	$ —	$ 4,680,192	$ 55,853,628
Franchise taxes	4,055,505	—	—	—	—	4,055,505
Public service taxes	8,969,887	—	—	—	—	8,969,887
Fees and fines	606,946	—	—	—	—	606,946
Licenses and permits	2,287,794	—	—	—	—	2,287,794
Intergovernmental	6,119,938	2,578,191	—	—	2,830,916	11,529,045
Charges for services	11,374,460	—	—	—	30,708	11,405,168
Investment earnings	552,325	87,106	549,489	270,161	364,330	1,823,411
Miscellaneous	881,874	66,176	—	2,939	94	951,083
Total revenues	86,022,165	2,731,473	549,489	273,100	7,906,240	97,482,467
EXPENDITURES						
Current:						
General government	8,630,835	—	417,814	16,700	121,052	9,186,401
Public safety	33,729,623	—	—	—	—	33,729,623
Public works	4,975,775	—	—	—	3,721,542	8,697,317
Engineering services	1,299,645	—	—	—	—	1,299,645
Health and sanitation	6,070,032	—	—	—	—	6,070,032
Cemetery	706,305	—	—	—	—	706,305
Culture and recreation	11,411,685	—	—	—	—	11,411,685
Community development	—	2,954,389	—	—	—	2,954,389
Education--payment to school district	21,893,273	—	—	—	—	21,893,273
Debt service:						
Principal	—	—	—	—	3,450,000	3,450,000
Interest and other charges	—	—	—	—	5,215,151	5,215,151
Capital outlay	—	—	2,246,671	11,281,769	3,190,209	16,718,649
Total expenditures	88,717,173	2,954,389	2,664,485	11,298,469	15,697,954	121,332,470
Excess (deficiency) of revenues over expenditures	(2,695,008)	(222,916)	(2,114,996)	(11,025,369)	(7,791,714)	(23,850,003)
OTHER FINANCING SOURCES (USES)						
Proceeds of refunding bonds	—	—	—	—	38,045,000	38,045,000
Proceeds of long-term capital-related debt	—	—	17,529,560	—	1,300,000	18,829,560
Payment to bond refunding escrow agent	—	—	—	—	(37,284,144)	(37,284,144)
Transfers in	129,323	—	—	—	5,551,187	5,680,510
Transfers out	(2,163,759)	(348,046)	(2,273,187)	—	(219,076)	(5,004,068)
Total other financing sources and uses	(2,034,436)	(348,046)	15,256,373	—	7,392,967	20,266,858
SPECIAL ITEM						
Proceeds from sale of park land	3,476,488	—	—	—	—	3,476,488
Net change in fund balances (see C-3)	(1,252,956)	(570,962)	13,141,377	(11,025,369)	(398,747)	(106,657)
Fund balances—beginning	2,908,322	1,647,338	34,110	20,387,774	10,022,219	34,999,763
Fund balances—ending	$ 1,655,366	$ 1,076,376	$ 13,175,487	$ 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).

Illustration 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.

C-3

Sample City
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

Illustration D-1

Statement of net assets. Illustrates the net assets format, the balance sheet format (D-2) also may be used.

Sample City
Statement of Net Assets
Proprietary Funds
December 31, 2002

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.

	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.

Illustration D-2

Balance sheet. Illustrates the balance sheet format, the net assets format (D-1) also may be used.

Sample City
Balance Sheet
Proprietary Funds
December 31, 2002

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.

	Business-type Activities— Enterprise Funds			Governmental Activities— Internal Service Funds
	Water and Sewer	Parking Facilities	Totals	(See H-3) (Note 4)
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.

Illustration D-3

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

Sample City
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
	Water and Sewer	Parking Facilities	Totals	(See H-4) (Note 5)
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.

Illustration D-4

Statement of cash flows, using the direct method for reporting cash flows from operating activities.

Sample City
Statement of Cash Flows
Proprietary Funds
For the Year Ended December 31, 2002

D-4

	Business-type Activities—Enterprise Funds			Governmental Activities—Internal Service Funds (See H-5)
	Water and Sewer	Parking Facilities	Totals	
CASH FLOWS FROM OPERATING ACTIVITIES				
Receipts from customers	$ 11,400,200	$ 1,345,292	$ 12,745,492	$ 15,326,343
Payments to suppliers	(2,725,349)	(365,137)	(3,090,486)	(2,812,238)
Payments to employees	(3,360,055)	(750,828)	(4,110,883)	(4,209,688)
Internal activity—payments to other funds	(1,296,768)	—	(1,296,768)	—
Claims paid	—	—	—	(8,482,451)
Other receipts (payments)	(2,325,483)	—	(2,325,483)	1,061,118
Net cash provided by operating activities	1,692,545	229,327	1,921,872	883,084
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES				
Operating subsidies and transfers to other funds	(290,000)	(211,409)	(501,409)	(175,033)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES				
Proceeds from capital debt	4,041,322	8,660,778	12,702,100	—
Capital contributions	1,645,919	—	1,645,919	—
Purchases of capital assets	(4,194,035)	(144,716)	(4,338,751)	(400,086)
Principal paid on capital debt	(2,178,491)	(8,895,000)	(11,073,491)	(954,137)
Interest paid on capital debt	(1,479,708)	(1,166,546)	(2,646,254)	41,616
Other receipts (payments)	—	19,174	19,174	131,416
Net cash (used) by capital and related financing activities	(2,164,993)	(1,526,310)	(3,691,303)	(1,264,423)
CASH FLOWS FROM INVESTING ACTIVITIES				
Proceeds from sales and maturities of investments	—	—	—	15,684
Interest and dividends	454,793	143,747	598,540	129,550
Net cash provided by investing activities	454,793	143,747	598,540	145,234
Net (decrease) in cash and cash equivalents	(307,655)	(1,364,645)	(1,672,300)	(411,138)
Balances—beginning of the year	8,724,308	3,227,135	11,951,443	3,747,237
Balances—end of the year	$ 8,416,653	$ 1,862,490	$ 10,279,143	$ 3,336,099
Reconciliation of operating income (loss) to net cash provided (used) by operating activities:				
Operating income (loss)	$ 4,422,127	$ (238,804)	$ 4,183,323	$ (540,532)
Adjustments to reconcile operating income to net cash provided (used) by operating activities:				
Depreciation expense	1,163,140	542,049	1,705,189	1,707,872
Change in assets and liabilities:				
Receivables, net	653,264	1,205	654,469	31,941
Inventories	2,829	—	2,829	39,790
Accounts and other payables	(297,446)	(86,643)	(384,089)	475,212
Accrued expenses	(4,251,369)	11,520	(4,239,849)	(831,199)
Net cash provided by operating activities	$ 1,692,545	$ 229,327	$ 1,921,872	$ 883,084

Note: The required information about noncash investing, capital, and financing activities is not illustrated.

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

Illustration E-1

Statement of fiduciary net assets

Sample City
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).

Illustration E-2

Statement of changes in fiduciary net assets

Sample City
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

Illustration 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-1

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).

Illustration 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 Activities
Component Units
For the Year Ended December 31, 2002

F-2

		Program Revenues			Net (Expense) Revenue and Changes in Net Assets		
	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	School District	Landfill	Totals
Sample City School District							
Instructional	$ 16,924,321	$ 147,739	$ 2,825,109	$ —	$ (13,951,473)	$ —	$ (13,951,473)
Support services	7,972,559	300	751,711	—	(7,220,548)	—	(7,220,548)
Operation of noninstructional services	1,523,340	557,726	359,092	—	(606,522)	—	(606,522)
Facilities acquisition and construction services	48,136	—	1,171	—	(46,965)	—	(46,965)
Interest on long-term debt	546,382	—	—	—	(546,382)	—	(546,382)
Unallocated depreciation (Note F)	4,171,760	—	—	—	(4,171,760)	—	(4,171,760)
Total—Sample City School District	31,186,498	705,765	3,937,083	—	(26,543,650)	—	—
Sample City Landfill							
Landfill operations	3,382,157	3,857,858	—	11,397	—	487,098	487,098
Total component units	$ 34,568,655	$ 4,563,623	$ 3,937,083	$ 11,397			(26,056,552)
General revenues:							
Payment from Sample City					21,893,273	—	21,893,273
Grants, entitlements, and contributions not restricted to specific programs					6,461,708	—	6,461,708
Investment earnings					674,036	207,727	881,763
Miscellaneous					19,950	2,514	22,464
Total general revenues					29,048,967	210,241	29,259,208
Change in net assets					2,505,317	697,339	3,202,656
Net assets—beginning					14,645,432	1,380,539	16,025,971
Net assets—ending					$ 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 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[T]	$ 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[T]	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[T]	(15,301)	(1,020)	—	(16,321)
Total accumulated depreciation for:	(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[T]	$ 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

[T]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:

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 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[1]	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

[1]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.

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.

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			Net (Expense) Revenue and Changes in Net Assets		
	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	School District	Landfill	Totals
Sample City School District							
Instructional	$16,924,321	$ 147,739	$ 2,825,109	$ —	$(13,951,473)	$ —	$(13,951,473)
Support services	7,972,559	300	751,711	—	(7,220,548)	—	(7,220,548)
Operation of noninstructional services	1,523,340	557,726	359,092	—	(606,522)	—	(606,522)
Facilities acquisition and construction services	48,136	—	1,171	—	(46,965)	—	(46,965)
Interest on long-term debt	546,382	—	—	—	(546,382)	—	(546,382)
Unallocated depreciation (Note F)	4,171,760	—	—	—	(4,171,760)	—	(4,171,760)
Total—Sample City School District	31,186,498	705,765	3,937,083	—	(26,543,650)	—	—
Sample City Landfill							
Landfill operations	3,382,157	3,857,858	—	11,397	—	487,098	487,098
Total component units	$34,568,655	$ 4,563,623	$ 3,937,083	$ 11,397			(26,056,552)
General revenues:							
Payment from Sample City					21,893,273	—	21,893,273
Grants, entitlements and contributions not restricted to specific programs					6,461,708	—	6,461,708
Other general revenues					693,986	210,241	904,227
Total general revenues					29,048,967	210,241	29,259,208
Change in net assets					2,505,317	697,339	3,202,656
Net assets—beginning					14,645,432	1,380,539	16,025,971
Net assets—ending					$ 17,150,749	$ 2,077,878	$ 19,228,627

Note 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 .

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)

Note 5a—Explanation of Certain Differences between Governmental Fund Statements 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 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 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)	Reclassifications and Eliminations	Statement of Net Assets Totals
ASSETS					
Cash and cash equivalents	$ 10,261,800	$ —	$ 3,336,099	$ —	$ 13,597,899
Investments	27,214,984	—	150,237	—	27,365,221
Receivables, net	6,972,560	—	157,804	5,702,768	12,833,132
Due from other funds	1,370,757	—	—	(1,195,757)	175,000
Due from other governments	1,715,097	—	—	(1,715,097)	—
Liens receivable	3,987,671	—	—	(3,987,671)	—
Inventories	182,821	—	139,328	—	322,149
Capital assets	—	161,082,708	8,940,052	—	170,022,760
Total assets	$ 51,705,690	$ 161,082,708	$ 12,723,520	$ (1,195,757)	$ 224,316,161
LIABILITIES					
Accounts payable	$ 5,908,666	$ —	$ 780,570	$94,074	$ 6,783,310
Due to other funds	25,369	—	1,170,388	(1,195,757)	—
Due to other governments	94,074	—	—	(94,074)	—
Deferred revenue	10,784,475	(9,348,876)	—	—	1,435,599
Long-term liabilities	—	84,760,507	7,777,871	—	92,538,378
Total liabilities	16,812,584	75,411,631	9,728,829	(1,195,757)	100,757,287
FUND BALANCES/NET ASSETS					
Total fund balances/net assets	34,893,106	85,671,077	2,994,691	—	123,558,874
Total liabilities and fund balances/net assets	$ 51,705,690	$ 161,082,708	$ 12,723,520	$ (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.

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 Balances/Statement of Activities

	Total Governmental Funds	Long-term Revenues, Expenses (3)	Capital Related Items (4)	Internal Service Funds (5)	Long-term Debt Transactions (6)	Statement of Activities Totals
REVENUES AND OTHER SOURCES						
Taxes	$ 68,879,020	$ 566,189	$ —	$ —	$ —	$ 69,445,209
Fees and fines	606,946	—	—	—	—	606,946
Licenses and permits	2,287,794	1,354,441	—	—	—	3,642,235
Intergovernmental	11,529,045	—	—	—	—	11,529,045
Charges for services	11,405,168	—	—	—	—	11,405,168
Interest	1,823,411	—	—	134,733	—	1,958,144
Miscellaneous	951,083	—	—	—	—	951,083
Other sources:						
Bond proceeds	56,874,560	—	—	—	(56,874,560)	—
Sale of park land	3,476,488	—	(823,000)	—	—	2,653,488
Total	157,833,515	1,920,630	(823,000)	134,733	(56,874,560)	102,191,318
EXPENDITURES/EXPENSES						
Current:						
General government	9,186,401	(25,369)	275,000	135,378	—	9,571,410
Public safety	33,729,623	514,368	330,000	270,758	—	34,844,749
Public works	8,697,317	(19,201)	1,315,044	135,378	—	10,128,538
Engineering services	1,299,645	—	—	—	—	1,299,645
Health and sanitation	6,070,032	(24,049)	625,000	67,689	—	6,738,672
Cemetery	706,305	673	28,888	—	—	735,866
Culture and recreation	11,411,685	(12,024)	65,000	67,689	—	11,532,350
Community development	2,954,389	—	40,000	—	—	2,994,389
Education—payment to school district	21,893,273	—	—	—	—	21,893,273
Debt service:						
Principal	3,450,000	—	—	—	(3,450,000)	—
Interest and other charges	5,215,151	811,354	—	41,616	—	6,068,121
Capital outlay	16,718,649	—	(16,718,649)	—	—	—
Total expenditures/expenses	121,332,470	1,245,752	(14,039,717)	718,508	(3,450,000)	105,807,013
Other financing uses/changes in net assets:						
Net transfers to (from) other funds	(676,442)	—	—	175,033	—	(501,409)
Debt refunding	37,284,144	—	—	—	(37,284,144)	—
Total	157,940,172	1,245,752	(14,039,717)	893,541	(40,734,144)	105,305,604
Net change for the year	$ (106,657)	$ 674,878	$ 13,216,717	$ (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"

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 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 government 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:

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 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
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

Illustration G-1

Budget-to-actual comparison schedule for the general fund in the budget document format.

Sample City
Budgetary Comparison Schedule
General Fund
For the Year Ended December 31, 2002

G-1

The variance column is optional.

	Budgeted Amounts		Actual Amounts (Budgetary Basis)	Variance with Final Budget
	Original	Final	(See Note A)	Positive (Negative)
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

Illustration G-2

Budget-to-actual comparison schedule for a major special revenue fund, also in the budget document format.

Sample City
Budgetary Comparison Schedule
HUD Programs Fund
For the Year Ended December 31, 2002

G-2

	Budgeted Amounts		Actual Amounts (Budgetary Basis) (See Note A)	Variance with Final Budget Positive (Negative)
	Original	Final		
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

Illustration 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.

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.

Illustration 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.

G-4

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	Budgeted Amounts Final	Actual Amounts Budgetary Basis		Budget to GAAP Differences Over (Under)	Actual Amounts GAAP Basis
REVENUES						
Property taxes	$ 52,017,833	$ 51,853,018	$ 51,173,436		$ —	$ 51,173,436
Other taxes—franchise and public service	12,841,209	12,836,024	13,025,392		—	13,025,392
Fees and fines	718,800	718,800	606,946		—	606,946
Licenses and permits	2,126,600	2,126,600	2,287,794		—	2,287,794
Intergovernmental	6,905,898	6,571,360	6,119,938		—	6,119,938
Charges for services	12,392,972	11,202,150	11,374,460		—	11,374,460
Interest	1,015,945	550,000	552,325		—	552,325
Miscellaneous	3,024,292	1,220,991	881,874		—	881,874
Total revenues	91,043,549	87,078,943	86,022,165		—	86,022,165
EXPENDITURES						
Current:						
General government (including contingencies and miscellaneous)	11,837,534	9,468,155	8,621,500	(1)	(9,335)	8,630,835
Public safety	33,050,966	33,983,706	33,799,709	(1)	70,086	33,729,623
Public works	5,215,630	5,025,848	4,993,187	(1)	17,412	4,975,775
Engineering services	1,296,275	1,296,990	1,296,990	(1)	(2,655)	1,299,645
Health and sanitation	5,756,250	6,174,653	6,174,653	(1)	104,621	6,070,032
Cemetery	724,500	724,500	706,305		—	706,305
Culture and recreation	11,059,140	11,368,070	11,289,146	(1)	(122,539)	11,411,685
Education—payment to school district	22,000,000	22,000,000	21,893,273		—	21,893,273
Total expenditures	90,940,295	90,041,922	88,774,763		57,590	88,717,173
Excess (deficiency) of revenues over expenditures	103,254	(2,962,979)	(2,752,598)		57,590	(2,695,008)
OTHER FINANCING SOURCES (USES)						
Transfers in	939,525	130,000	129,323		—	129,323
Transfers out	(2,970,256)	(2,163,759)	(2,163,759)		—	(2,163,759)
Total other financing sources and uses	(2,030,731)	(2,033,759)	(2,034,436)		—	(2,034,436)
SPECIAL ITEM						
Proceeds from sale of park land	1,355,250	3,500,000	3,476,488		—	3,476,488
Net change in fund balance	(572,227)	(1,496,738)	(1,310,546)		57,590	(1,252,956)
Fund balances—beginning	3,528,750	2,742,799	2,742,799	(2)	165,523	2,908,322
Fund balances—ending	$ 2,956,523	$ 1,246,061	$ 1,432,253		$ 223,113	$ 1,655,366

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.	$ (129,100)
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.	186,690
Net Increase in fund balance—budget to GAAP	$ 57,590

(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.

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

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 Good or Better 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 (70I100), fair condition (50I69), 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.

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

Illustration 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.

Sample City
Combining Balance Sheet
Nonmajor Governmental Funds
December 31, 2002

H-1

	Special Revenue Funds				Debt Service Funds			Capital Projects Fund	Permanent Fund	Total Nonmajor Governmental Funds
	Impact Fees	Local Gas Tax	Historic District	Total	Central City Development	Community Redevelopment	Total	Bridge	Cemetery Care	(See C-1)
ASSETS										
Cash and cash equivalents	$ 371,413	$ 1,999,819	$ 189,880	$ 2,561,112	$ 677,143	$ 164,861	$ 842,004	$ 1,141,648	$ 1,062,028	$ 5,606,792
Investments	—	—	—	—	941,510	2,200,470	3,141,980	—	343,272	3,485,252
Receivables, net	—	10,221	—	10,221	—	—	—	—	—	10,221
Receivable from other governments	—	129,883	4,836	134,719	—	—	—	1,461,319	—	1,596,038
Total assets	$ 371,413	$ 2,139,923	$ 194,716	$ 2,706,052	$ 1,618,653	$ 2,365,331	$ 3,983,984	$ 2,602,967	$ 1,405,300	$ 10,698,303
LIABILITIES AND FUND BALANCES										
Liabilities:										
Accounts payable	$ 61,165	$ 170,615	$ 4,836	$ 236,616	$ 151,922	$ —	$ 151,922	$ 686,293	$ —	$ 1,074,831
Total liabilities	61,165	170,615	4,836	236,616	151,922	—	151,922	686,293	—	1,074,831
Fund balances:										
Reserved for:										
Encumbrances	176,487	962,231	—	1,138,718	—	—	—	675,404	—	1,814,122
Debt service	—	—	—	—	1,466,731	2,365,331	3,832,062	—	—	3,832,062
Other purposes	—	—	—	—	—	—	—	—	1,405,300	1,405,300
Unreserved	133,761	1,007,077	189,880	1,330,718	—	—	—	1,241,270	—	2,571,988
Total fund balances	310,248	1,969,308	189,880	2,469,436	1,466,731	2,365,331	3,832,062	1,916,674	1,405,300	9,623,472
Total liabilities and fund balances	$ 371,413	$ 2,139,923	$ 194,716	$ 2,706,052	$ 1,618,653	$ 2,365,331	$ 3,983,984	$ 2,602,967	$ 1,405,300	$ 10,698,303

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).

Sample City
Combining Statement of Revenues, Expenditures, and Changes in Fund Balances
Nonmajor Governmental Funds
For the Year Ended December 31, 2002

	Special Revenue Funds				Debt Service Funds			Capital Projects Funds			Permanent Fund	Total Nonmajor Governmental Funds
	Impact Fees	Local Gas Tax	Historic District	Total	Central City Development	Community Redevelopment	Total	Culvert Project	Bridge	Total	Cemetery Care	Funds (See C-2)
REVENUES												
Property taxes	$ —	$ —	$ —	$ —	$ 4,680,192	$ —	$ 4,680,192	$ —	$ —	$ —	$ —	$ 4,680,192
Intergovernmental	—	1,312,670	60,426	1,373,096	—	—	—	1,457,820	—	1,457,820	—	2,830,916
Charges for services	30,708	—	—	30,708	—	—	—	—	—	—	—	30,708
Investment earnings	4,543	123,329	226	128,098	103,631	42,973	146,604	13,878	3,061	16,939	72,689	364,330
Miscellaneous	—	94	—	94	—	—	—	—	—	—	—	94
Total revenues	35,251	1,436,093	60,652	1,531,996	4,783,823	42,973	4,826,796	1,471,698	3,061	1,474,759	72,689	7,906,240
EXPENDITURES												
Current:												
General government	50,000	3,622	—	53,622	8,920	2,900	11,820	13,460	42,150	55,610	—	121,052
Public works	705,487	2,968,283	47,772	3,721,542	—	—	—	—	—	—	—	3,721,542
Debt service:												
Principal	—	—	—	—	2,910,000	540,000	3,450,000	—	—	—	—	3,450,000
Interest and other charges	—	—	—	—	3,885,191	1,329,960	5,215,151	—	—	—	—	5,215,151
Capital outlay	—	—	—	—	—	—	—	1,961,440	1,228,769	3,190,209	—	3,190,209
Total expenditures	755,487	2,971,905	47,772	3,775,164	6,804,111	1,872,860	8,676,971	1,974,900	1,270,919	3,245,819	—	15,697,954
Excess (deficiency) of revenues over expenditures	(720,236)	(1,535,812)	12,880	(2,243,168)	(2,020,288)	(1,829,887)	(3,850,175)	(503,202)	(1,267,858)	(1,771,060)	72,689	(7,791,714)
OTHER FINANCING SOURCES (USES)												
Proceeds of long-term debt	—	—	—	—	38,045,000	—	38,045,000	—	1,300,000	1,300,000	—	39,345,000
Payment to bond refunding escrow agent	—	—	—	—	(37,284,144)	—	(37,284,144)	—	—	—	—	(37,284,144)
Transfers in	—	—	177,000	177,000	1,604,149	2,387,149	3,991,298	—	1,382,889	1,382,889	—	5,551,187
Transfers out	—	(42,500)	—	(42,500)	—	—	—	(113,167)	—	(113,167)	(63,409)	(219,076)
Total other financing sources and uses	—	(42,500)	177,000	134,500	2,365,005	2,387,149	4,752,154	(113,167)	2,682,889	2,569,722	(63,409)	7,392,967
Net change in fund balances	(720,236)	(1,578,312)	189,880	(2,108,668)	344,717	557,262	901,979	(616,369)	1,415,031	798,662	9,280	(398,747)
Fund balances—beginning	1,030,484	3,547,620	—	4,578,104	1,122,014	1,808,069	2,930,083	616,369	501,643	1,118,012	1,396,020	10,022,219
Fund balances—ending	$ 310,248	$ 1,969,308	$ 189,880	$ 2,469,436	$ 1,466,731	$ 2,365,331	$ 3,832,062	$ 0	$ 1,916,674	$ 1,916,674	$ 1,405,300	$ 9,623,472

Illustration 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 Statement of Net Assets
Internal Service Funds
December 31, 2002

	Casualty Insurance	Fleet Management	Health/Life Insurance	Telecom-munications	Data Processing	Total (See D-1)
ASSETS						
Current assets:						
Cash and cash equivalents	$ 632,008	$ 1,845,325	$ 428,398	$ 6,645	$ 423,723	$ 3,336,099
Investments	—	—	—	—	150,237	150,237
Receivables, net	9,837	11,363	114,930	203	21,471	157,804
Inventories	—	127,140	—	—	12,188	139,328
Total current assets	641,845	1,983,828	543,328	6,848	607,619	3,783,468
Capital assets:						
Buildings and equipment, net	21,383	2,821,024	—	5,526,642	571,003	8,940,052
Total assets	663,228	4,804,852	543,328	5,533,490	1,178,622	12,723,520
LIABILITIES						
Current liabilities:						
Accounts payable	195,988	77,931	312,622	144,840	49,189	780,570
Due to other funds	—	—	—	970,252	200,136	1,170,388
Compensated absences	11,123	69,714	—	97,449	59,404	237,690
Claims and judgments	1,687,975	—	—	—	—	1,687,975
Bonds, notes, and loans payable	—	—	—	249,306	—	249,306
Total current liabilities	1,895,086	147,645	312,622	1,461,847	308,729	4,125,929
Noncurrent liabilities:						
Claims and judgments	5,602,900	—	—	—	—	5,602,900
Total liabilities	7,497,986	147,645	312,622	1,461,847	308,729	9,728,829
NET ASSETS						
Invested in capital assets, net of related debt	21,383	2,821,024	—	5,277,336	571,003	8,690,746
Unrestricted	(6,856,141)	1,836,183	230,706	(1,205,693)	298,890	(5,696,055)
Total net assets	$ (6,834,758)	$4,657,207	$230,706	$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	Telecom-munications	Data Processing	Total (See D-3)
Operating revenues:						
Charges for services	$ 1,886,451	$ 4,096,753	$ 4,488,619	$ 3,542,116	$ 1,242,225	$ 15,256,164
Miscellaneous	18,907	—	1,047,854	—	—	1,066,761
Total operating revenues	1,905,358	4,096,753	5,536,473	3,542,116	1,242,225	16,322,925
Operating expenses:						
Personal services	169,866	1,248,271	—	1,850,222	888,797	4,157,156
Contractual services	176,486	62,449	24,402	22,843	298,216	584,396
Utilities	—	2,616	—	212,196	—	214,812
Repairs and maintenance	2,497	1,523,774	—	389,132	45,087	1,960,490
Other supplies and expenses	55,041	23,656	—	89,252	66,496	234,445
Insurance claims and expenses	2,085,306	—	5,918,980	—	—	8,004,286
Depreciation	5,541	448,944	—	938,251	315,136	1,707,872
Total operating expenses	2,494,737	3,309,710	5,943,382	3,501,896	1,613,732	16,863,457
Operating income (loss)	(589,379)	787,043	(406,909)	40,220	(371,507)	(540,532)
Nonoperating revenues (expenses):						
Interest and investment revenue	48,570	52,925	10,338	—	22,900	134,733
Miscellaneous revenue	9,544	732	—	10,579	—	20,855
Interest expense	—	—	—	(35,185)	(6,431)	(41,616)
Miscellaneous expense	(14,948)	(39,790)	—	(120,949)	(316)	(176,003)
Total nonoperating revenues (expenses)	43,166	13,867	10,338	(145,555)	16,153	(62,031)
Income (loss) before contributions and transfers	(546,213)	800,910	(396,571)	(105,335)	(355,354)	(602,563)
Capital contributions	—	3,364	—	1,222	14,202	18,788
Transfers in	10,000	—	—	9,008	—	19,008
Transfers out	—	—	(50,319)	—	(143,722)	(194,041)
Change in net assets	(536,213)	804,274	(446,890)	(95,105)	(484,874)	(758,808)
Net assets—beginning	(6,298,545)	3,852,933	677,596	4,166,748	1,354,767	3,753,499
Net assets—ending	$ (6,834,758)	$ 4,657,207	$ 230,706	$ 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

H-5

	Casualty Insurance	Fleet Management	Health/Life Insurance	Telecom-munications	Data Processing	Total (See D-4)
CASH FLOWS FROM OPERATING ACTIVITIES						
Receipts from customers	$ 1,905,870	$ 4,098,790	$ 4,549,558	$ 3,542,157	$ 1,229,968	$ 15,326,343
Payments to suppliers	(129,409)	(1,671,378)	—	(656,961)	(354,490)	(2,812,238)
Payments to employees	(166,729)	(1,236,855)	—	(1,910,948)	(895,156)	(4,209,688)
Claims paid	(2,863,973)	—	(5,618,478)	—	—	(8,482,451)
Other receipts (payments)	18,907	—	1,023,452	—	18,759	1,061,118
Net cash provided (used) by operating activities	(1,235,334)	1,190,557	(45,468)	974,248	(919)	883,084
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES						
Operating subsidies and transfers to other funds	10,000	—	(50,319)	9,008	(143,722)	(175,033)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES						
Purchases of capital assets	(13,578)	(237,054)	—	(132,596)	(16,858)	(400,086)
Principal paid on capital debt	—	—	—	(954,137)	—	(954,137)
Interest paid on capital debt	—	—	—	(35,185)	(6,431)	(41,616)
Other receipts (payments)	25,167	(39,058)	—	145,307	—	131,416
Net cash provided (used) by capital and related financing activities	11,589	(276,112)	—	(976,611)	(23,289)	(1,264,423)
CASH FLOWS FROM INVESTING ACTIVITIES						
Proceeds from sales and maturities of investments	—	—	—	—	15,684	15,684
Interest and dividends	48,570	47,742	10,338	—	22,900	129,550
Net cash provided by investing activities	48,570	47,742	10,338	—	38,584	145,234
Net increase (decrease) in cash and cash equivalents	(1,165,175)	962,187	(85,449)	6,645	(129,346)	(411,138)
Balances—beginning of the year	1,797,183	883,138	513,847	—	553,069	3,747,237
Balances—end of the year	$ 632,008	$ 1,845,325	$ 428,398	$ 6,645	$ 423,723	$ 3,336,099

Note: The required reconciliation to operating income and the required information about noncash investing, capital, and financing activities are not illustrated.

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

Illustration I-1 and I-2

I-1 and I-2 present the government-wide statements from the separately issued financial statements of the school district component unit.

Sample City School District
(A Component Unit of Sample City)
Statement of Net Assets
December 31, 2002

I-1

	Governmental Activities	Business-type Activities	Total[1]
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

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.

[1]After internal receivables and payables have been eliminated.

Sample City School District
(A Component Unit of Sample City)
Statement of Activities
For the Year Ended December 31, 2002

		Program Revenues		Net (Expense) Revenue and Changes in Net Assets		
	Expenses	**Charges for Services**	**Operating Grants**	**Governmental Activities**	**Business-type Activities**	**Total**
Instructional:						
Regular instruction	$ 12,328,240	$ 147,739	$ 1,095,297	$ (11,085,204)	$ —	$ (11,085,204)
Special instruction	3,346,325	—	1,299,004	(2,047,321)	—	(2,047,321)
Vocational education	819,435	—	54,146	(765,289)	—	(765,289)
Other instructional programs	405,732	—	376,064	(29,668)	—	(29,668)
Adult education	24,589	—	598	(23,991)	—	(23,991)
Support services:						
Pupil services	822,871	—	20,025	(802,846)	—	(802,846)
Instructional services	443,624	—	31,667	(411,957)	—	(411,957)
Administrative services	1,680,317	—	40,891	(1,639,426)	—	(1,639,426)
Health services	311,522	—	88,432	(223,090)	—	(223,090)
Business services	513,064	—	48,431	(464,633)	—	(464,633)
Plant operations and maintenance	2,905,095	300	70,697	(2,834,098)	—	(2,834,098)
Transportation	804,503	—	439,606	(364,897)	—	(364,897)
Other support services	491,563	—	11,962	(479,601)	—	(479,601)
Operation of noninstructional services:						
Athletic programs	497,304	16,343	12,102	(468,859)	—	(468,859)
Community services	117,773	—	2,866	(114,907)	—	(114,907)
Food services	908,263	541,383	344,124	—	(22,756)	(22,756)
Facilities acquisition and construction services:						
Building improvement services	48,136	—	1,171	(46,965)	—	(46,965)
Interest on long-term debt	546,382	—	—	(546,382)	—	(546,382)
Depreciation	4,171,760	—	—	(4,171,760)	—	(4,171,760)
Total	$ 31,186,498	$ 705,765	$ 3,937,083	(26,520,894)	(22,756)	(26,543,650)
General revenues:						
Payment from Sample City				21,893,273	—	21,893,273
Grants and entitlements not restricted to specific programs				6,176,108	—	6,176,108
Unrestricted contributions				285,600	—	285,600
Investment earnings				667,742	6,294	674,036
Miscellaneous				19,950	—	19,950
Total general revenues				29,042,673	6,294	29,048,967
Excess (deficiency) of revenues over expenses				2,521,779	(16,462)	2,505,317
Net assets—beginning				14,209,926	435,506	14,645,432
Net assets—ending				$ 16,731,705	$ 419,044	$ 17,150,749

The totals from these three columns are displayed separately on the reporting entity's statement of activities (B-1).

Illustration 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.

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
(A Component Unit of Sample City)
Statement of Revenue, Expenses,
and Changes in Net Assets
For the Year Ended December 31, 2002

I-4

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).

*

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

1

Concepts Statement 1, paragraphs 56 and 76 .

2

Concepts Statement 1, paragraph 32 .

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.

4

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

5

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

6

For purposes of MD&A, *currentlyknownfacts* 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.

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 .

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 .

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.

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.

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.

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.

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.)

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 .

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.

28

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

29

Paragraph 34 discusses the meaning of the term *restricted*.

30

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

31

See paragraph 136 .

32

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

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.

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.

38

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

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

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.

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.

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.

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.

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.

47

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

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.

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 combined statement of revenues, expenses, and changes in fund net assets.

52

See footnote 51 .

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."

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.

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.

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 .

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.

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.

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.

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.

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.

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."

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.

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.

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.

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 objective, elements, and characteristics of SEA reporting are discussed in GASB Concepts Statement No. 2 , *Service Efforts and Accomplishments Reporting.*

76

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

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.

78

See paragraph 143 for an explanation of the implementation phases.

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 .

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.

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."
*

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

Net Assets Restricted by Enabling Legislation an amendment of GASB Statement No. 34

STATUS

Issued: December 2004 Effective Date: For periods beginning after June 15, 2005. Earlier application is encouraged.

Affects: Amends GASBS 34, ¶ 34

Affected by: Paragraph 1 amended by GASBS 63, ¶8

Paragraph 2 amended by GASBS 63, ¶8

Paragraph 5 amended by GASBS 63, ¶8

Paragraph 6 amended by GASBS 63, ¶8

Primary Codification Section Reference: 1800 , 2200

Summary

GASB Statement No. 34 , *Basic Financial Statements-and Management's Discussion and Analysis-for*

State and Local Governments, requires that limitations on the use of net assets imposed by enabling legislation be reported as restricted net assets. In the process of applying this provision, some governments have had difficulty interpreting the requirement that those restrictions be "legally enforceable." The confusion over this phrase has resulted in a diversity of practice that has diminished comparability. This Statement clarifies that a legally enforceable enabling legislation restriction is one that a party external to a government-such as citizens, public interest groups, or the judiciary-can compel a government to honor. The Statement states that the legal enforceability of an enabling legislation restriction should be reevaluated if any of the resources raised by the enabling legislation are used for a purpose not specified by the enabling legislation or if a government has other cause for reconsideration. Although the determination that a particular restriction is not legally enforceable may cause a government to review the enforceability of other restrictions, it should not necessarily lead a government to the same conclusion for all enabling legislation restrictions.

This Statement also specifies the accounting and financial reporting requirements if new enabling legislation replaces existing enabling legislation or if legal enforceability is reevaluated. Finally, this Statement requires governments to disclose the portion of total net assets that is restricted by enabling legislation. The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2005.

How the Changes in This Statement Improve Financial Reporting

The clarifications in this Statement should improve the understandability and comparability of net asset information by making the assessment of legal enforceability more uniform across governments. For example, it should minimize the chances that a government will make an across-the-board determination that none or all of its enabling legislation restrictions are legally enforceable without considering each restriction individually. The additional accounting and financial reporting guidance should help governments determine how to respond to changes in the circumstances surrounding an enabling legislation restriction. The disclosure of the amount of net assets restricted by enabling legislation will allow users to distinguish qualifying restrictions on resource use imposed through a government's own actions from other types of net asset restrictions.

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 2 discusses the applicability of this Statement.

INTRODUCTION

1. The objective of this Statement is to enhance the usefulness and comparability of net asset information reported by state and local governments by clarifying the meaning of the phrase *legally enforceable* as it applies to restrictions imposed on net asset use by enabling legislation and by specifying the accounting and financial reporting requirements for those restricted net asset.

STANDARDS OF GOVERNMENTAL ACCOUNTING AND FINANCIAL REPORTING

Scope and Applicability

2. This Statement establishes and modifies requirements related to restrictions of net assets resulting from enabling legislation. It amends GASB Statement No. 34 , *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments*, paragraph 34 . This Statement applies to all state and local governments.

Determining Legal Enforceability

3. Legal enforceability means that a government can be compelled by an external party-such as citizens, public interest groups, or the judiciary-to use resources created by enabling legislation only for the purposes specified by the legislation. Generally, the enforceability of an enabling legislation restriction is determined by professional judgment, which may be based on actions such as analyzing the legislation to determine if it meets the qualifying criteria for enabling legislation, reviewing determinations made for similar legislation of the government or other governments, or obtaining the opinion of legal counsel. However, enforceability cannot ultimately be proven unless tested through the judicial process, which may never occur. The determination of legal enforceability should be based on the underlying facts and circumstances surrounding each individual restriction. The determination that a particular restriction is not legally enforceable may lead a government to reevaluate the legal enforceability of similar enabling legislation restrictions, but should not necessarily lead a government to conclude that all enabling legislation restrictions are unenforceable.

Changes in Circumstances Related to Enabling Legislation

4. If a government passes new enabling legislation that *replaces* the original enabling legislation by

establishing new legally enforceable restrictions on the resources raised by the original enabling legislation, then from that period forward the resources accumulated under the new enabling legislation should be reported as restricted to the purpose specified by the new enabling legislation. Professional judgment should be used to determine if remaining balances accumulated under the original enabling legislation should continue to be reported as restricted for the original purpose, restricted to the purpose specified in the new legislation, or unrestricted.

5. If resources are used for a purpose other than those stipulated in the enabling legislation or if there is other cause for reconsideration, governments should reevaluate the legal enforceability of the restrictions to determine if the resources should continue to be reported as restricted. If reevaluation results in a determination that a particular restriction is no longer legally enforceable, then from the beginning of that period forward the resources should be reported as unrestricted. If it is determined that the restrictions continue to be legally enforceable, then for the purposes of financial reporting, the restricted net asset should not reflect any reduction for resources used for purposes not stipulated by the enabling legislation.

Disclosure Requirement

6. The amount of the primary government's net asset at the end of the reporting period that are restricted by enabling legislation should be disclosed in the notes to the financial statements.

EFFECTIVE DATE AND TRANSITION

7. The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2005. Earlier application is encouraged. Accounting changes adopted to conform to the provisions of this Statement should be applied retroactively by reclassifying net asset information, if practical, in financial statements for all prior periods presented. In the period this Statement is first applied, the financial statements should disclose the nature of any reclassification and its effect. Also, the reason for not reclassifying net asset information for prior periods presented should be explained.

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

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

Robert H. Attmore *Chairman*

Cynthia B. Green

William W. Holder

Edward J. Mazur

Paul R. Reilly

Richard C. Tracy

James M. Williams

Appendix A

BACKGROUND INFORMATION

8. Following the completion of the Financial Reporting Model project, which resulted in the issuance of Statement 34 in June 1999, a committee established by the National Association of State Auditors, Comptrollers and Treasurers (NASACT) to monitor state governments' implementation of Statement 34 apprised the GASB of difficulties that some states were encountering in applying the requirement to report restrictions of net assets resulting from enabling legislation. A NASACT survey of state governments revealed substantial variation in the manner in which states were applying this requirement, as well as confusion regarding the phrase *legally enforceable* as used in Statement 34, paragraph 34 .

Advisory Council Review and Addition to the Technical Plan

9. The enabling legislation issue was included in a list of current and potential projects presented to the Governmental Accounting Standards Advisory Council (GASAC) in 2002 for its consideration and advice on the relative priority of GASB research and standards-setting activities. The GASAC expressed support for the project as part of the GASB's research agenda, pending the availability of resources to devote to the project and an opening in the GASB's current technical agenda. The Board added the project to its final-third 2002 technical plan and directed staff to conduct basic research.

Background Research

10. The GASB reviewed the financial statements of 191 general purpose local and county governments and school districts that had implemented Statement 34 . The purpose of the review was to obtain a general sense of what types of information governments report about their net assets.

11. The GASB also conducted separate surveys of financial statement users and preparers during September and October 2003. The user and preparer surveys were distributed via e-mail to 807 persons identified as users and 1,113 persons identified as preparers in the GASB's constituent database. The preparer survey also was e-mailed to the preparers from each of the fifty state governments, based on a list provided by NASACT. The availability of the surveys also was publicized with the assistance of GASAC representatives.

12. The user survey-which produced sixty-seven responses from a wide variety of user types studying a wide range of governmental entities-gathered basic information about the importance that users ascribed to net asset information and how they used the information to inform decisions and assess financial health. In addition to collecting the net asset information that preparers were reporting and information about their basic reporting practices, the preparer survey sought to obtain further insight regarding net asset restrictions from enabling legislation; 103 responses were received from preparers. The confusion and implementation difficulty regarding enabling legislation restrictions found in the NASACT survey were echoed by many respondents to the preparer survey.

Task Force

13. In December 2003, a task force was assembled comprising sixteen persons broadly representative of the GASB's constituency. The task force members advised the GASB on the project's initial work plan and reviewed and commented on papers prepared for the Board's deliberations and on preliminary versions of an Exposure Draft.

Exposure Draft

14. In June 2004, the Board issued an Exposure Draft, *Net Assets Restricted by Enabling Legislation* , and received thirty-nine responses to it. As discussed in Appendix B, "Basis for Conclusions," the comments and suggestions from the organizations and individuals who responded to the Exposure Draft contributed to the Board's deliberations and helped the Board finalize the requirements in this Statement.

Appendix B

BASIS FOR CONCLUSIONS

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

Nature of Enabling Legislation Restrictions

16. Statement 34 requires that net assets be reported in three components in the government-wide and proprietary funds statements of net assets: invested in capital assets, net of related debt; restricted; and unrestricted. Net assets are considered restricted if they are limited as to the manner in or purpose for which they may be used. Statement 34 identified three means by which restrictions are imposed on net assets: by external persons or bodies, through constitutional provision, or via enabling legislation. Enabling legislation authorizes a 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. For example, a city might pass enabling legislation to establish a special property tax levy that can be used only to finance the hiring of additional police officers, or a state might add an amount to the automobile registration fee to be used only to fund improvements to the state highway system.

17. It is common practice to pass legislation in order to raise new resources for a specified purpose. When Statement 34 was issued, the Board believed that if the resources resulting from this kind of legislation were not reported as restricted, the resulting unrestricted net assets amount would overstate the resources that were not limited in purpose. This "enabling legislation" was viewed as a compact with the resource providers that the resources would be used for the promised purpose only. The Board viewed enabling legislation to be *substantively* the same as other types of restrictions because of the nature of the promise to the resource providers inherent in enabling legislation. The Board accepted the argument that legislators, as representatives of the resource providers, would ensure that the resources were used for their promised purpose. The Board took precautions, however, such as specifying that the restrictions on resource use resulting from enabling legislation be *legally enforceable* and that preparers should consider not just the form of the restriction but also its substance.

Issues in the Determination of Legal Enforceability

18. The results of both the NASACT survey of its members and the GASB's survey of preparers (discussed in Appendix A) suggest that state and local governments are having difficulty interpreting the meaning of *legal enforceability*. Consequently, some governments are making "blanket" determinations regarding the enforceability of enabling legislation *in general*. In particular, some governments covered by constitutional, charter, or judicial prohibitions against one legislature's binding a subsequent legislature have concluded that they have no enabling legislation at all.

19. Even in circumstances in which a constitutional or charter provision or judicial decision states that one legislature cannot bind a subsequent legislature, the Board believes that one should not necessarily conclude that enabling legislation cannot be the source of restrictions. To do so may inappropriately presuppose that subsequently elected legislative bodies will undo the restrictions. Such prohibitions do not prevent a legislative body from restricting resources to a particular use. Rather, they mean that a subsequently elected legislative body cannot be prevented from changing the law and putting the resources to a different use. Furthermore, the fact that governments have the power to enact new enabling legislation that establishes different restrictions is not inconsistent with the notion of enabling legislation. This fact does not invalidate the restrictions as of the date of the financial statements.

20. The Board also recognizes that some governments may have the ability, under certain circumstances, to use restricted resources for unrestricted purposes. For example, some governments may be able to pass an appropriation that utilizes restricted resources to close a budgetary deficit. The Board believes that the *ability* to use restricted resources for unrestricted purposes, in the absence of a prior history of actually doing so, normally is not a sufficient basis on its own for determining that a government cannot have legally enforceable restrictions deriving from enabling legislation.

21. The difficulty in interpreting legal enforceability also has resulted in governments' appropriately examining enabling legislation restrictions on a case-by-case basis, but employing a variety of criteria to determine if they are enforceable. This diversity of practice may adversely affect the comparability and usefulness of net asset information.

Clarification of Legal Enforceability

22. The Board believes that these issues can be resolved by clarifying the meaning of *legal enforceability*, as well as the circumstances under which legal enforceability should be reevaluated and the reporting of net asset restrictions adjusted. Although the determination that a restriction is no longer enforceable may

prompt a government to reevaluate the legal enforceability of similar restrictions, it should not necessarily conclude that all of its enabling legislation restrictions are unenforceable as a result of that determination.

23. The Board believes that the determination of legal enforceability is a matter of professional judgment on the part of governments. Some respondents to the Exposure Draft asked that the Board establish specific criteria for determining if a restriction is legally enforceable. The Board concluded that it would not be possible to develop criteria that could be used comparably and consistently by governments and that would anticipate the variety of their individual circumstances. The Board did, however, agree that application of the standard would be aided by including examples of activities that might be involved in the use of professional judgment to this matter.

New Enabling Legislation That Establishes Different Restrictions

24. Some respondents to the Exposure Draft suggested that changing restrictions by enacting new enabling legislation resembled the "earmarking" of existing resources, which does not meet the criteria to be considered an enabling legislation restriction. The Board emphasizes that, to qualify as enabling legislation, new enabling legislation is required to provide the authorization to raise the resources, just as the original enabling legislation did. The new enabling legislation *replaces* the original enabling legislation in its entirety, and the original legislation is no longer in effect.

Reporting Requirements

25. The Exposure Draft contained a proposal that enabling legislation restrictions be displayed separately from other restricted net assets in the government-wide statement of net assets. Many respondents commented that this provision could result in a lengthy and cluttered net assets section of that statement. Some respondents requested that the requirement be eliminated, whereas others recommended changing the requirement to a note disclosure or an option of display or disclosure.

26. Other respondents commented that the requirement implied that enabling legislation restrictions were different from other restrictions of net assets, a notion contradictory to the basis of the enabling legislation standards in Statement 34 . As noted earlier, the Board affirmed that there are no significant *substantive* differences between enabling legislation restrictions and other restrictions, and agreed to eliminate the display requirement. Based on that decision, the Board also dropped the proposed requirement to present enabling legislation restrictions separately in the statistical section schedule of net asset information. However, the Board believes the differences in the manner by which restrictions are imposed, changed, or removed are important enough to financial statement users to merit disclosure of the amount of net assets

that are restricted by enabling legislation at the end of the reporting period.

Appendix C

ILLUSTRATIONS

27. This appendix illustrates the requirements of this Statement. It is presented for illustrative purposes only and is nonauthoritative. These illustrations are presented to assist the reader of this Statement in understanding its requirements. The facts assumed are illustrative only and are not intended to modify or limit the requirements of this Statement or to indicate the Board's endorsement of the situations or methods illustrated. Application of the provisions of this Statement may require assessing facts and circumstances other than those illustrated here. 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.

Illustration 1

Note Disclosure of Net Assets Restricted by Enabling Legislation

> **Net Assets.** The government-wide statement of net asset reports $10,758,421 of restricted net asset, of which $3,124,021 is restricted by enabling legislation.

Illustration 2

New Enabling Legislation Enacted to Establish Different Restrictions

Assumptions

In 1998, the State of Aslan enacted enabling legislation to create a new motor fuel tax. The legislation specified that the proceeds of the tax could be used only to finance road maintenance. The state determined, with the aid of legal counsel, that the restriction was legally enforceable. The government-wide statement of net assets prepared by the state for the year ended June 30, 200X, included the following information:

Net assets restricted for:	
Road maintenance	$10,000,000
Unrestricted net assets	$25,000,000

At the beginning of the year ended June 30, 200Y, the state replaced the original enabling legislation by enacting new enabling legislation that authorized the imposition of the motor fuel tax. The new enabling legislation established a new restriction that the resources could be used only to finance aid to school districts. The state determined that the new restriction was legally enforceable. For the year ended June 30, 200Y, revenues from the motor fuel tax were $100 million; expenses were $15 million for road maintenance and $90 million for aid to school districts. The state's policy is to lift restrictions with the first dollar spent on a program.

Reporting

If existing enabling legislation is replaced by new enabling legislation that establishes new legally enforceable restrictions, then the net assets pertaining to resources created by the enabling legislation should be reported as restricted to the new purpose from that period forward. The state would now report the net assets pertaining to motor fuel taxes as restricted for aid to school districts. The state had expenses of $15 million for road maintenance, which exceeded the $10 million in restricted net assets as of the end of the prior year, at which point the new enabling legislation replaced the old enabling legislation. Consequently, there are no remaining balances. The portion of the road maintenance expenses not financed by the $10 million of restricted net assets as of June 30, 200X ($5 million), reduces unrestricted net assets. (However, if there had been remaining balances accumulated under the prior enabling legislation, the state would have applied professional judgment to determine whether those balances should be reported as restricted and, if so, to what purpose.)

The government-wide statement of net assets prepared by the state for the year ended June 30, 200Y, should include the following information:

Net assets restricted for:	
Aid to school districts	$10,000,000
Unrestricted net assets	$20,000,000

Illustration 3

Subsequent Determination That Restrictions Are Not Legally Enforceable

Assumptions

In 1996, Aravis County enacted enabling legislation to create a 1 percent sales tax. The legislation specified that the proceeds of this tax could be used only to hire additional county police officers. With the aid of legal counsel, the county determined that the restriction was legally enforceable. The government-wide statement of net assets prepared by the county for the year ended June 30, 200B, included the following information:

Net assets restricted for:	
Police	$100,000
Unrestricted net assets	$250,000

During the year ended June 30, 200C, the county became aware of a court decision regarding a government with similar enabling legislation. In that case, the police union sued the government because the government had used a portion of the sales tax restricted to hiring police for other purposes not specified by the enabling legislation that created the sales tax. The court ruled that the government could not be compelled to use the sales tax proceeds for hiring additional police. In view of these events, the county reevaluated the legal enforceability of the restriction established by its own enabling legislation. The county determined, again with the aid of legal counsel, that the restriction to use the sales tax only for hiring additional police was not legally enforceable.

For the year ended June 30, 200C, revenues from the 1 percent sales tax were $1,000,000 and expenses for newly hired police officers were $950,000. The county's policy is to lift restrictions with the first dollar spent on a program.

Reporting

If a government has cause to reconsider the legal enforceability of an enabling legislation restriction and it is determined that the restriction is no longer legally enforceable, then the net assets pertaining to resources created by the enabling legislation should be reported as unrestricted from that period forward. The county would now report net assets pertaining to the sales tax revenues as unrestricted .

The government-wide statement of net assets prepared by the county for the year ended June 30, 200C, should not include net assets restricted for police.

Illustration 4

Resources Are Used for Purposes Not Specified by Enabling Legislation, But the Restriction Is Determined to Be Legally Enforceable

Assumptions

In 1999, the City of Caspian enacted enabling legislation to create a special property tax levy. The legislation specified that the proceeds of this tax could be used only to finance healthcare for the uninsured. The city determined that the restriction was legally enforceable. The government-wide statement of net assets prepared by the city for the year ended June 30, 200S, included the following information:

Net assets restricted for:	
Healthcare for the uninsured	$1,000,000
Unrestricted net assets	$2,500,000

During the year ended June 30, 200T, a gap developed in the city's budget. The city decided to use $2 million raised from the special property tax levy to help close the budget gap. The city reevaluated the legal enforceability of the restriction to use the special property tax levy only for healthcare for the uninsured and determined that the restriction continued to be legally enforceable.

For the year ended June 30, 200T, revenues from the special property tax levy were $10,000,000 and uninsured-care expenses were $7,500,000. The city's policy is to lift restrictions with the first dollar spent on a program.

Reporting

If resources created by enabling legislation are used for a purpose not specified in the enabling legislation, a government should reevaluate the legal enforceability of the enabling legislation restriction. If the restriction is determined not to be legally enforceable, then all of the net assets pertaining to resources raised by the enabling legislation would be reported as unrestricted . However, if it is determined that the restriction continues to be legally enforceable, then the net assets pertaining to resources should continue to be reported as restricted. In the latter case, the resources used for nonspecified purposes should be deducted from unrestricted net assets for financial reporting purposes.

The government-wide statement of net assets prepared by the city for the year ended June 30, 200T, should include the following information:

Net assets restricted for:	
Healthcare for the uninsured	$3,500,000
Unrestricted net assets	$500,000

Fund Balance Reporting and Governmental Fund Type Definitions

STATUS

Issued: February 2009

Effective Date: For periods beginning after June 15, 2010

Affects:

Supersedes NCGAS 1, Summary Statement of Principles No. 3, ¶26 , ¶118 , ¶120 , and ¶121

Amends NCGAS 1, ¶30 , ¶91 , and ¶119

Supercedes NCGAI 3, ¶10

Amends NCGAI 3, ¶11

Amends NCGAI 6, ¶4 and ¶5

Amends GASBS 14, ¶78

Supercedes GASBS 25 , fn15

Supercedes GASBS 33 , fn13

Amends GASBS 33 , fn9

Supercedes GASBS 34, ¶84

Amends GASBS 34, ¶37 , ¶64 , ¶65 , fn24, and fn38

Supercedes GASBS 43 , fn11

Amends GASBS 44, ¶12

Supercedes GASBI 4 , fn3 and fn6

Amends GASBI 4, ¶4 and ¶7

Amends GASBI 6, ¶16

Affected by: Paragraph 7 amended by GASBS 63, ¶8

Other Interpretive Literature: GASB Comprehensive Implementation Guide

Primary Codification Section Reference: 1300 and 1800

Summary

The objective of this Statement is to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and by clarifying the existing governmental fund type definitions. This Statement establishes fund balance classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds.

The initial distinction that is made in reporting fund balance information is identifying amounts that are

considered *nonspendable,* such as fund balance associated with inventories. This Statement also provides for additional classification as restricted, committed, assigned, and unassigned based on the relative strength of the constraints that control how specific amounts can be spent.

The *restricted* fund balance category includes amounts that can be spent only for the specific purposes stipulated by constitution, external resource providers, or through enabling legislation. The *committed* fund balance classification includes amounts that can be used only for the specific purposes determined by a formal action of the government's highest level of decision-making authority. Amounts in the *assigned* fund balance classification are intended to be used by the government for specific purposes but do not meet the criteria to be classified as restricted or committed. In governmental funds other than the general fund, assigned fund balance represents the remaining amount that is not restricted or committed. *Unassigned* fund balance is the residual classification for the government's general fund and includes all spendable amounts not contained in the other classifications. In other funds, the unassigned classification should be used only to report a deficit balance resulting from overspending for specific purposes for which amounts had been restricted, committed, or assigned. Governments are required to disclose information about the processes through which constraints are imposed on amounts in the committed and assigned classifications.

Governments also are required to classify and report amounts in the appropriate fund balance classifications by applying their accounting policies that determine whether restricted, committed, assigned, and unassigned amounts are considered to have been spent. Disclosure of the policies in the notes to the financial statements is required.

This Statement also provides guidance for classifying stabilization amounts on the face of the balance sheet and requires disclosure of certain information about stabilization arrangements in the notes to the financial statements.

The definitions of the general fund, special revenue fund type, capital projects fund type, debt service fund type, and permanent fund type are clarified by the provisions in this Statement. Interpretations of certain terms within the definition of the special revenue fund type have been provided and, for some governments, those interpretations may affect the activities they choose to report in those funds. The capital projects fund type definition also was clarified for better alignment with the needs of preparers and users. Definitions of other governmental fund types also have been modified for clarity and consistency.

The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2010. Early implementation is encouraged. Fund balance reclassifications made to conform to the provisions of this Statement should be applied retroactively by restating fund balance for all prior periods presented.

How the Changes in This Statement Will Improve Financial Reporting

The requirements in this Statement will improve financial reporting by providing fund balance categories and classifications that will be more easily understood. Elimination of the *reserved* component of fund balance in favor of a *restricted* classification will enhance the consistency between information reported in the government-wide statements and information in the governmental fund financial statements and avoid confusion about the relationship between reserved fund balance and restricted net assets. The fund balance classification approach in this Statement will require governments to classify amounts consistently, regardless of the fund type or column in which they are presented. As a result, an amount cannot be classified as restricted in one fund but unrestricted in another. The fund balance disclosures will give users information necessary to understand the processes under which constraints are imposed upon the use of resources and how those constraints may be modified or eliminated. The clarifications of the governmental fund type definitions will reduce uncertainty about which resources can or should be reported in the respective fund types.

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.

INTRODUCTION

1. National Council on Governmental Accounting (NCGA) Statement 1 , *Governmental Accounting and Financial Reporting Principles,* paragraphs 118 - 121 , established the fund balance classifications for governmental funds. Statement No. 34 , *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments,* retained those classification requirements. Research conducted after implementation of Statement 34, however, found considerable differences in how governments interpret and apply the standards for fund balance reporting. The differences existed, in part, because certain terms were not well defined, which affected the amounts that were reported as reserved and unreserved fund balances. Consequently, many users have been receiving inconsistent and noncomparable information which reduced its usefulness and led to confusion as to what the information

presented in fund balance reporting actually communicated. These concerns were exacerbated by two additional factors. First, different interpretations of certain aspects of the definitions of governmental fund types reduced the comparability of the governmental fund financial statements, because the funds used and the purposes for using them varied significantly from government to government. Second, the introduction of restricted net assets under Statement 34 led to confusion regarding its relationship to reserved fund balance.

2. The objective of this Statement is to improve the usefulness, including the understandability, of governmental fund balance information. This Statement provides more clearly defined categories to make the nature and extent of the constraints placed on a government's fund balance more transparent. It also clarifies the existing governmental fund type definitions to improve the comparability of governmental fund financial statements and help financial statement users to better understand the purposes for which governments have chosen to use particular funds for financial reporting.

STANDARDS OF GOVERNMENTAL ACCOUNTING AND FINANCIAL REPORTING

Scope and Applicability of This Statement

3. This Statement establishes accounting and financial reporting standards for all governments that report governmental funds. It establishes criteria for classifying fund balances into specifically defined classifications and clarifies definitions for governmental fund types.

4. This Statement supersedes NCGA Statement 1 , "Summary Statement of the Principles-Types of Funds," and paragraphs 26 , 118 , 120 , and 121 ; NCGA Interpretation 3, *Revenue Recognition-Property Taxes,* paragraph 10 ; GASB Statement No. 25 , *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans,* footnote 15; GASB Statement No. 33 , *Accounting and Financial Reporting for Nonexchange Transactions,* footnote 13; GASB Statement 34, paragraph 84 ; GASB Statement No. 43 , *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans,* footnote 11; and GASB Interpretation No. 4 , *Accounting and Financial Reporting for Capitalization Contributions to Public Entity Risk Pools,* footnotes 3 and 6. In addition, this Statement amends NCGA Statement 1, paragraphs 30 , 91 , and 119 ; NCGA Interpretation 3, paragraph 11 ; NCGA Interpretation 6, *Notes to the Financial Statements Disclosure,* paragraphs 4 and 5 ; GASB Statement 33 , footnote 9; GASB Statement 34, paragraphs 37 , 64 , and 65 and footnotes 24 and 38; GASB Statement No. 44, *Economic Condition Reporting: The Statistical Section,* paragraph 12 ; GASB Interpretation 4, paragraphs 4 and 7 ; and GASB Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements,* paragraph 16 .

Governmental Fund Reporting

Fund Balance Reporting

5. Fund balance for governmental funds should be reported in classifications that comprise a hierarchy based primarily on the extent to which the government is bound to honor constraints on the specific purposes for which amounts in those funds can be spent. Some governments may not have policies or procedures that are comparable to those policies that underlie the classifications discussed in paragraphs 10 - 16 and therefore would not report amounts in all possible fund balance classifications.

Nonspendable Fund Balance

6. The nonspendable fund balance classification includes amounts that cannot be spent because they are either (a) not in spendable form or (b) legally or contractually required to be maintained intact. The "not in spendable form" criterion includes items that are not expected to be converted to cash, for example, inventories and prepaid amounts. It also includes the long-term amount of loans and notes receivable, as well as property acquired for resale. However, if the use of the proceeds from the collection of those receivables or from the sale of those properties is restricted, committed, or assigned, then they should be included in the appropriate fund balance classification (restricted, committed, or assigned), rather than nonspendable fund balance. The corpus (or principal) of a permanent fund is an example of an amount that is legally or contractually required to be maintained intact.

7. For purposes of reporting net

assets

, Statement 34, paragraph 35 , requires amounts that are "required to be retained in perpetuity" to be classified "non-expendable" within the restricted net

assets

category. For fund balance reporting purposes, however, those amounts should be classified as nonspendable rather than restricted. ***Restricted Fund Balance***

8. Except as provided for in paragraph 7 , amounts that are restricted to specific purposes, pursuant to the definition of *restricted* in paragraph 34 of Statement 34 , as amended by Statement No. 46 , *Net Assets Restricted by Enabling Legislation,* should be reported as *restricted fund balance.* Fund balance should be reported as restricted when constraints placed on the use of resources are either:

a. Externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments; or

b. Imposed by law through constitutional provisions or enabling legislation.

9. *Enabling legislation,* 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. *Legal enforceability* means that a government can be compelled by an external party-such as citizens, public interest groups, or the judiciary-to use resources created by enabling legislation only for the purposes specified by the legislation.

Committed Fund Balance

10. Amounts that can only be used for specific purposes pursuant to constraints imposed by formal action of the government's highest level of decision-making authority should be reported as committed fund balance. Those committed amounts cannot be used for any other purpose unless the government removes or changes the specified use by taking the same type of action (for example, legislation, resolution, ordinance) it employed to previously commit those amounts. The authorization specifying the purposes for which amounts can be used should have the consent of both the legislative and executive branches of the government, if applicable. Committed fund balance also should incorporate contractual obligations to the extent that existing resources in the fund have been specifically committed for use in satisfying those contractual requirements.

11. In contrast to fund balance that is restricted by enabling legislation, as discussed in paragraph 9 , amounts in the committed fund balance classification may be redeployed for other purposes with appropriate due process, as explained in paragraph 10 . Constraints imposed on the use of *committed* amounts are imposed by the government, separate from the authorization to raise the underlying revenue. Therefore, compliance with constraints imposed by the government that *commit* amounts to specific purposes is not considered to be legally enforceable, as defined in paragraph 9 .

12. The formal action of the government's highest level of decision-making authority that commits fund balance to a specific purpose should occur prior to the end of the reporting period, but the amount, if any, which will be subject to the constraint, may be determined in the subsequent period.

Assigned Fund Balance

13. Amounts that are constrained by the government's *intent* to be used for specific purposes, but are neither restricted nor committed, should be reported as assigned fund balance, except for stabilization arrangements, as discussed in paragraph 21 . Intent should be expressed by (a) the governing body itself or (b) a body (a budget or finance committee, for example) or official to which the governing body has delegated the authority to assign amounts to be used for specific purposes.

14. Both the committed and assigned fund balance classifications include amounts that have been constrained to being used for specific purposes by actions taken by the government itself. However, the authority for making an assignment is not required to be the government's highest level of decision-making authority. Furthermore, the nature of the actions necessary to remove or modify an assignment is not as prescriptive as it is with regard to the committed fund balance classification. Constraints imposed on the use of assigned amounts are more easily removed or modified than those imposed on amounts that are classified as committed. Some governments may not have both committed and assigned fund balances, as not all governments have multiple levels of decision-making authority.

15. Assigned fund balance includes (a) all remaining amounts (except for negative balances, as discussed in paragraph 19) that are reported in governmental funds, other than the general fund, that are not classified as nonspendable and are neither restricted nor committed and (b) amounts in the general fund that are intended to be used for a specific purpose in accordance with the provisions in paragraph 13 . By reporting particular amounts that are not restricted or committed in a special revenue, capital projects, debt service, or permanent fund, the government has *assigned* those amounts to the purposes of the respective funds. Assignment within the general fund conveys that the intended use of those amounts is for a specific purpose that is narrower than the general purposes of the government itself. However, governments should not report an assignment for an amount to a specific purpose if the assignment would result in a deficit in unassigned fund balance.

16. An appropriation of existing fund balance to eliminate a projected budgetary deficit in the subsequent year's budget in an amount no greater than the projected excess of expected expenditures over expected revenues satisfies the criteria to be classified as an assignment of fund balance. As discussed in paragraph 15 , assignments should not cause a deficit in unassigned fund balance to occur.

Unassigned Fund Balance

17. Unassigned fund balance is the residual classification for the general fund. This classification represents fund balance that has not been assigned to other funds and that has not been restricted, committed, or assigned to specific purposes within the general fund. The general fund should be the only

fund that reports a positive unassigned fund balance amount. In other governmental funds, if expenditures incurred for specific purposes exceeded the amounts restricted, committed, or assigned to those purposes, it may be necessary to report a negative unassigned fund balance, as discussed in paragraph 19 .

Classifying Fund Balance Amounts

18. Fund balance classifications should depict the nature of the net resources that are *reported* in a governmental fund. An individual governmental fund could include nonspendable resources and amounts that are restricted, committed, or assigned, or any combination of those classifications. Typically, the general fund also would include an unassigned amount. A government should determine the composition of its ending fund balance by applying its accounting policies regarding whether it considers restricted or unrestricted amounts to have been spent when an expenditure is incurred for purposes for which both restricted and unrestricted (committed, assigned, or unassigned) amounts are available. Similarly, within unrestricted fund balance, the classification should be based on the government's accounting policies regarding whether it considers committed, assigned, or unassigned amounts to have been spent when an expenditure is incurred for purposes for which amounts in any of those unrestricted fund balance classifications could be used. If a government does not establish a policy for its use of unrestricted fund balance amounts, it should consider that committed amounts would be reduced first, followed by assigned amounts, and then unassigned amounts when expenditures are incurred for purposes for which amounts in any of those unrestricted fund balance classifications could be used.

19. The amount that should be reported as nonspendable fund balance, as described in paragraph 6 , should be determined before classifying amounts in the restricted, committed, and assigned fund balance classifications, as discussed in paragraph 18 . In a governmental fund other than the general fund, expenditures incurred for a specific purpose might exceed the amounts in the fund that are restricted, committed, and assigned to that purpose and a negative residual balance for that purpose may result. If that occurs, amounts assigned to other purposes in that fund should be reduced to eliminate the deficit. If the remaining deficit eliminates all other assigned amounts in the fund, or if there are no amounts assigned to other purposes, the negative residual amount should be classified as *unassigned* fund balance. In the general fund, a similar negative residual amount would have been eliminated by reducing unassigned fund balance pursuant to the policy described in paragraph 18 . A negative residual amount should not be reported for restricted, committed, or assigned fund balances in any fund.

Stabilization Arrangements

20. Some governments formally set aside amounts for use in emergency situations or when revenue

shortages or budgetary imbalances arise. Those amounts are subject to controls that dictate the circumstances under which they can be spent. Many governments have formal arrangements to maintain amounts for budget or revenue stabilization,[1] working capital needs, contingencies or emergencies, and other similarly titled purposes. The authority to set aside those amounts generally comes from statute, ordinance, resolution, charter, or constitution. Stabilization amounts may be expended only when certain specific circumstances exist. The formal action that imposes the parameters for spending should identify and describe the specific circumstances under which a need for stabilization arises. Those circumstances should be [1] such that they would not be expected to occur routinely. For example, a stabilization amount that can be accessed "in an emergency" would not qualify to be classified within the committed category because the circumstances or conditions that constitute an emergency are not sufficiently detailed, and it is not unlikely that an "emergency" of some nature would routinely occur. Similarly, a stabilization amount that can be accessed to offset an "anticipated revenue shortfall" would not qualify unless the shortfall was quantified and was of a magnitude that would distinguish it from other revenue shortfalls that occur during the normal course of governmental operations.

21. For the purposes of reporting fund balance, stabilization is considered a *specific purpose,* as discussed in paragraph 5 . Stabilization amounts should be reported in the general fund as restricted or committed if they meet the criteria set forth in paragraphs 8 - 11 , based on the source of the constraint on their use. Stabilization arrangements that do not meet the criteria to be reported within the restricted or committed fund balance classifications should be reported as *unassigned* in the general fund. A stabilization arrangement would satisfy the criteria to be reported as a separate special revenue fund only if the resources derive from a specific restricted or committed *revenue* source, as required by paragraph 30 .

Displaying Fund Balance Classifications on the Face of the Balance Sheets

22. Amounts for the two components of nonspendable fund balance-(a) not in spendable form and (b) legally or contractually required to be maintained intact-as described in paragraph 6 , may be presented separately, or non-spendable fund balance may be presented in the aggregate. Restricted fund balance may be displayed in a manner that distinguishes between the major restricted purposes, or it may be displayed in the aggregate. Similarly, specific purposes information for committed and assigned fund balances may be displayed in sufficient detail so that the major commitments and assignments are evident to the financial statement user, or each classification may be displayed in the aggregate.

Fund Balance Disclosures

Fund Balance Classification Policies and Procedures

23. Governments should disclose the following about their fund balance classification policies and procedures in the notes to the financial statements:

a. For *committed* fund balance: (1) the government's highest level of decision-making authority and (2) the formal action that is required to be taken to establish (and modify or rescind) a fund balance commitment

b. For *assigned* fund balance: (1) the body or official authorized to assign amounts to a specific purpose and (2) the policy established by the governing body pursuant to which that authorization is given

c. For the classification of fund balances in accordance with paragraph 18 :

> (1) whether the government considers restricted or unrestricted amounts to have been spent when an expenditure is incurred for purposes for which both restricted and unrestricted fund balance is available and (2) whether committed, assigned, or unassigned amounts are considered to have been spent when an expenditure is incurred for purposes for which amounts in any of those unrestricted fund balance classifications could be used.

Reporting Encumbrances

24. For governments that use encumbrance accounting, significant encumbrances should be disclosed in the notes to the financial statements by major funds and nonmajor funds in the aggregate in conjunction with required disclosures about other significant commitments. Encumbered amounts for specific purposes for which resources already have been restricted, committed, or assigned should not result in separate display of the encumbered amounts within those classifications. Encumbered amounts for specific purposes for which amounts have not been previously restricted, committed, or assigned should not be classified as unassigned but, rather, should be included within committed or assigned fund balance, as appropriate, based on the definitions and criteria in paragraphs 10 - 16 .

Details of Fund Balance Classifications Displayed in the Aggregate

25. If nonspendable fund balance is displayed in the aggregate on the face of the balance sheet, amounts for the two nonspendable components should be disclosed in the notes to the financial statements. If restricted, committed, or assigned fund balances are displayed in the aggregate, specific purposes information, as required in paragraph 22 , should be disclosed in the notes to the financial statements. Governments may display the specific purpose details for some classifications on the face of the balance

sheet, as discussed in paragraph 22, and disclose the details for other classifications in the notes to the financial statements.

Stabilization Arrangements

26. Governments that establish stabilization arrangements, even if an arrangement does not meet the criteria to be classified as restricted or committed, should disclose the following information in the notes to the financial statements:

a. The authority for establishing stabilization arrangements (for example, by statute or ordinance)

b. The requirements for additions to the stabilization amount

c. The conditions under which stabilization amounts may be spent

d. The stabilization balance, if not apparent on the face of the financial statements.

Minimum Fund Balance Policies

27. If a governing body has formally adopted a minimum fund balance policy (for example, in lieu of separately setting aside stabilization amounts), the government should describe in the notes to its financial statements the policy established by the government that sets forth the minimum amount.

Governmental Fund Type Definitions

28. Governmental fund types include the general fund, special revenue funds, capital projects funds, debt service funds, and permanent funds, as discussed in paragraphs 29 - 35 .

General Fund

29. The general fund should be used to account for and report all financial resources not accounted for and reported in another fund.

Special Revenue Funds

30. Special revenue funds are used to account for and report the proceeds of specific revenue sources that are restricted or committed to expenditure for specified purposes other than debt service or capital projects. The term *proceeds of specific revenue sources* establishes that one or more specific restricted or committed revenues should be the foundation for a special revenue fund. Those specific restricted or committed revenues may be initially received in another fund and subsequently distributed to a special

revenue fund. Those amounts should not be recognized as revenue in the fund initially receiving them; however, those infiows should be recognized as revenue in the special revenue fund in which they will be expended in accordance with specified purposes. Special revenue funds should not be used to account for resources held in trust for individuals, private organizations, or other governments.

31. The restricted or committed proceeds of specific revenue sources should be expected to continue to comprise a substantial portion of the infiows reported in the fund.[2] Other resources (investment earnings and transfers from other funds, for example) also may be reported in the fund if those resources are restricted, committed, or assigned to the specified purpose of the fund. Governments should discontinue reporting a special revenue fund, and instead report the fund's remaining resources in the general fund, if the government no longer expects that a substantial portion of the infiows will derive from restricted or committed revenue sources.

32. Governments should disclose in the notes to the financial statements the purpose for each major special revenue fund-identifying which revenues and other resources are reported in each of those funds. [2]

Capital Projects Funds

33. Capital projects funds are used to account for and report financial resources that are restricted, committed, or assigned to expenditure for capital outlays, including the acquisition or construction of capital facilities and other capital assets. Capital projects funds exclude those types of capital-related outfiows financed by proprietary funds or for assets that will be held in trust for individuals, private organizations, or other governments.

Debt Service Funds

34. Debt service funds are used to account for and report financial resources that are restricted, committed, or assigned to expenditure for principal and interest. Debt service funds should be used to report resources if legally mandated. Financial resources that are being accumulated for principal and interest maturing in future years also should be reported in debt service funds.

Permanent Funds

35. Permanent funds should be used to account for and report resources that are 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. Permanent funds do not include private-purpose trust funds, 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.

EFFECTIVE DATE AND TRANSITION

36. The requirements of this Statement are effective for financial statements for periods beginning after June 15, 2010. Early implementation is encouraged. Fund balance reclassifications made to conform to the provisions of this Statement should be applied retroactively by restating fund balance for all prior periods presented. Changes to the fund balance information presented in a statistical section may be made prospectively, although retroactive application is encouraged. If the information for previous years is not restated, governments should explain the nature of the differences from the prior information.

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

This Statement was adopted by the affirmative votes of six members of the Governmental Accounting Standards Board. Mr. Williams dissented.

Members of the Governmental Accounting Standards Board:

Robert H. Attmore, *Chairman*

Michael D. Belsky

William W. Holder

Jan I. Sylvis

Marcia L. Taylor

Richard C. Tracy

James M. Williams

Appendix A

BACKGROUND

37. A project on fund balance reporting was initiated by the GASB in August 2002. Concerns were expressed to the GASB that some users of governmental financial information were unclear about the distinctions between reserved and unreserved fund balances and the relationship between reserved fund balances and restricted net assets, the latter of which was first required to be reported by Statement No. 34, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments.*

38. At its initial stage, the project also encompassed an issue regarding the determination of net asset restrictions resulting from enabling legislation. Research on both the net asset and fund balance issues was conducted in 2003. Separate surveys of financial statement preparers and users produced a total of 170 responses. The GASB also reviewed the fund balance information in the audited financial statements of 191 governments that report governmental funds and had implemented Statement 34 at that time. Those financial statements were selected at random from the GASB's financial report repository and included 127 general purpose local governments, 35 general purpose county governments, and 29 school districts. The results of that research were complemented by the findings of two other studies-interviews with financial statement users conducted for the GASB by Dr. Gilbert Crain in 2000, and the GASB's study of the information needs of users in 2005.

39. The GASB's research indicates that fund balance is one of the most universally used pieces of governmental financial information by a very diverse community of users, including municipal analysts at rating agencies and mutual funds; taxpayer associations; legislators and legislative staff at the state, county, and local levels; and the media. In general, fund balance is examined as part of an effort to identify resources that are liquid and available to finance a particular activity, program, or project. Municipal analysts, for example, assess a government's ability to call upon ready resources if needed to repay long-term debt. However, there are considerable differences in the way that users interpret fund balance information and widespread confusion about the nature of the information and the reporting requirements within the generally accepted accounting principles (GAAP) for state and local governments.

40. The GASB's research also revealed issues that significantly affect the usefulness of fund balance information for meeting user needs. It is evident that some governments report reserved fund balance that many would have concluded should have been properly reported as unreserved. This difference of opinion

in practice could be because relevant parts of GAAP are unclear, or because the guiding pronouncement in question- National Council on Governmental Accounting (NCGA) Statement 1 , *Governmental Accounting and Financial Reporting Principles*-was 30 years old, and some of its original intentions have not been passed along to newer generations of financial statement preparers and auditors. Regardless of the reason, the uneven application of these standards can make it difficult for users to identify the amount of resources that is truly available. This situation is exacerbated by differences from government to government in the methods used to establish fund balance reservations and by a dichotomy between governments that voluntarily report designations of fund balance and those that do not. Consequently, some fund balance information may not be suitable for comparisons between governments.

41. Based on these findings, the project was moved to the GASB's current agenda in December 2003, and deliberations began in January 2004. In June 2004, the GASB decided to pursue additional research on fund balance reporting and created a separate project on the net asset issues. The net asset reporting project ultimately led to the issuance, in December 2004, of Statement No. 46, *Net Assets Restricted by Enabling Legislation.*

42. The objectives of the fund balance reporting project were to consider whether reporting requirements related to fund balance adequately met the needs of financial statement users and to contemplate potential changes that would improve the usefulness of fund balance information. Because it was apparent that the quality of fund balance information is affected by the types of funds in which resources are reported and by the circumstances under which resources fiow between funds, the project also considered clarifications to the definitions of governmental fund types.

43. Forty interviews with a mixture of types of users were conducted on fund balance issues in the latter half of 2004. The interviews sought answers to fundamental questions such as what fund balance information was used for, what parts of fund balance were most important, what the perceived problems were in using fund balance information, and what preferences exist regarding how fund balance should be reported. Although the interview subjects offered a variety of reasons why they use fund balance information, their answers may be distilled as follows: Users want to assess a government's financial fiexibility or liquidity, specifically as it relates to the availability of current financial resources. However, many expressed frustration in their efforts to make that assessment for several reasons, including differences in the funds that governments choose to report and imperfect understanding among users of fund balance terminology.

44. Following completion of this phase of research, discussions of fund balance issues resumed in July 2005. Over the ensuing 15 months, the GASB examined the information and feedback collected from its

research and developed an Invitation to Comment, *Fund Balance Reporting and Governmental Fund Type Definitions,* to solicit constituents' views and preferences on a variety of issues. Early in the GASB's discussions leading to the Invitation to Comment, the Board determined that addressing fund balance issues would require not only improving the categories in which fund balance was presented on the balance sheet but also clarifying the meaning of the fund type definitions that governed what resources are reported in the various types of governmental funds. As a result, the Invitation to Comment considered two distinct but complementary approaches to improving fund balance information. It discussed possible clarifications of the definitions of governmental fund types, and it presented alternative methods of categorizing and reporting the components of fund balance.

45. A task force was assembled comprising 13 persons broadly representative of the GASB's constituency. The task force members reviewed and commented on papers prepared for the Board's deliberations and on preliminary versions of the Invitation to Comment and the subsequent Exposure Draft, *Fund Balance Reporting and Governmental Fund Type Definitions.* In addition, at several stages of the project, input was sought from the Governmental Accounting Standards Advisory Council.

46. The Invitation to Comment was made available in October 2006. Ninety-five responses were received. The comments and suggestions from the organizations and individuals that responded to the Invitation to Comment contributed to the Board's deliberations leading to the issuance of an Exposure Draft of proposed standards in April 2008.

47. Ninety letters were received in response to the Exposure Draft and eight individuals or organizations testified at a public hearing held in Kansas City, Missouri in July 2008. Twenty-six governments, composed of 5 states, 8 counties, 10 cities, and 3 special districts volunteered to field test the proposed standard. Issues raised by the respondents and field test participants are discussed in Appendix B, Basis for Conclusions.

Appendix B

BASIS FOR CONCLUSIONS AND BOARD MEMBER DISSENT

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

factors than to others.

Basis for Conclusions

Scope and Applicability

49. Throughout the early stages of the discussions leading to the Invitation to Comment, the Board was determined to limit the scope of the project to only fund balance classification and display issues. Ultimately, however, the Board was persuaded that a path forward toward solving the fund balance reporting issues might include improving the consistency in how governmental fund types were reported. However, rather than taking a "clean sheet of paper" approach to the definitions of the special revenue fund type, capital projects fund type, and debt service fund type, the Board concluded that fund balance reporting issues could be addressed by clarifying, or interpreting, certain terms within fund type definitions at this time. Some respondents to the Invitation to Comment and to the Exposure Draft questioned whether expanding the scope to also consider fund type definitions was appropriate within the context of "fund balance reporting," while others questioned the adequacy of a limited-scope approach to modifying fund type definitions.

50. Each of the various alternative modifications to the definitions of the governmental fund types proposed in the Invitation to Comment would have resulted in some level of change in the practices followed by many governments, especially with regard to reporting special revenue funds. The Board considered the concerns expressed about the project scope together with other comments from those respondents that did not support the proposed modifications to the definitions because of the potential for significant changes in practice. With those concerns in mind, the Board continued to deliberate the possibility of amending or clarifying the existing definitions of the special revenue fund type, capital projects fund type, and debt service fund type. In the end, however, the Board declined to alter the existing fund type definitions in ways that would generally impose more restrictive interpretations regarding the resources that may be reported in those fund types beyond what was originally provided for in NCGA Statement 1 (but not always followed in practice). The Board concluded that any deliberations that could lead to more substantive changes to the fund type definitions should come only after a broader reexamination of governmental fund reporting.

Fund Balance Reporting

The Alternative Models in the Invitation to Comment

51. The Invitation to Comment presented three alternative models for reporting fund balance information. Model A preserved the existing fund balance components (reserved, unreserved, designated) but

incorporated changes to their definitions to address misconceptions and inconsistencies identified in the GASB's research. The two other models, B and C, featured alternative titles for their fund balance components and focused on different aspects of fund balance. Model B made an initial distinction between resources that are available for appropriation and those that are not. Within the *available for appropriation* category, Model B further distinguished between amounts that are committed to specific uses (narrower than the fund's purpose) and those that are available for any purpose *of the fund.* Model C distinguished between restricted and unrestricted fund balances, using the definition of restricted from paragraph 34 of Statement 34 , as amended.

52. Each of the three models received support from the respondents to the Invitation to Comment. Many respondents indicated a preference for Model A for reasons including (a) they believe the most appropriate approach would be to clarify the meanings of the existing components of fund balance and educate constituents about those newly clarified components and (b) they believe that it would be advantageous to retain familiar terminology and that the introduction of new terms would serve more to confuse than clarify. However, supporters of Model B appreciated its use of "understandable" terms, as did proponents of Model C. The Board found it informative to contrast the sentiments of the supporters of Model B or C to the views expressed by those proponents of Model A who favored that approach because it used familiar terms. Similarly, the Board compared the contention that Model B employs understandable terms with the comments by some Model A supporters that the terms in the other approaches (B and C) would be confusing to users.

53. The characteristic of the Model C approach that was most commonly embraced by the Invitation to Comment respondents was its perceived consistency; that is, they favored the consistent use of the same classification regardless of the fund or column in which it is used, as well as the consistency with the restricted/unrestricted distinction made in proprietary funds and the government-wide statement of net assets.

54. Although Invitation to Comment respondents may have expressed a preference for a particular model, many also referred to aspects of the other models that they believe may provide important information. Thus, rather than pursuing any of the three alternatives, as set forth in the Invitation to Comment, the Board concluded that the most effective approach would be to simultaneously consider (a) what information is important to users and (b) the nature or character of the resources reported in governmental funds.

55. The most frequently articulated need (primarily from credit market users) is to achieve an understanding about availability or liquidity of the net current financial resources that constitute fund balance. Those users

want to know about the character of residual amounts. They want to know the extent to which the use of amounts reported in governmental funds is constrained and how binding those constraints are. Are they enforceable by parties external to the government? Does the government itself have the ability through some specified level of due process to remove or modify the constraints? Or are they less-binding or even nonbinding constraints that are simply indications of management's intent to use resources for specific purposes, with management having the power to change their intentions through a less rigorous process? That information, the Board concluded, would probably best be depicted by using terminology that is applied consistently in each of the governmental funds.

56. The Board acknowledged that the general, special revenue, capital projects, and debt service fund types all could include amounts that are restricted to a specific use (as defined by Statement 34, as amended), committed to a specific use by the government's own actions, assigned to a specific use by the government, or any combination of the three classifications. Accordingly, the Board concluded that to respond to the need for information about *availability,* fund balance should be classified and displayed in a manner that will reveal to readers where amounts in those classifications are reported. Because those fund types have some fiexibility with regard to the amounts that can be reported in them, simply knowing that amounts are reported in a particular fund type or column may not help readers in their assessment of availability.

57. Taking into consideration the input received from the Invitation to Comment respondents and the comments and preferences expressed by interviewees and survey participants, the Board concluded that the required components of fund balance should clearly distinguish the various levels of constraints that are imposed on its use. In developing the Exposure Draft, the Board agreed that the approach should first distinguish between amounts that are nonspendable and those that are spendable, and then provide a further breakdown based on the different levels of constraints.

Fund Balance Classifications

58. Some Exposure Draft respondents commented that financial statement users understand the existing fund balance categories and that sharpening those definitions and re-educating users would be a preferable approach to the changes proposed in the Exposure Draft. The GASB's substantial body of research, the results of which were summarized in both the Invitation to Comment and the Exposure Draft, characterized the status of user comprehension of fund balance information under the existing standards to be such that change would be advantageous. The argument from respondents that users understand the existing fund balance categories may be accurate in their specific cases; however, that generalization is not

borne out by the Board's research results.

59. Other respondents argued that restructuring the presentation of fund balance is inconsistent with stated users' needs in other GASB standards. They referred to discussions in paragraphs 417 and 418 of the Basis for Conclusions section of Statement 34 to illustrate their point. Those paragraphs state that the Board believes that the distinction between reserved and unreserved fund balance "provides information that users have consistently deemed important and useful" and that "information about amounts that are 'available for appropriation' has always been regarded as very useful by governmental financial statement users." During the development of Statement 34 , the Board did not have the benefit of the fund balance user needs research that was subsequently conducted in connection with this Statement. Therefore, the references to user needs and to the importance and usefulness of the existing fund balance display methods in Statement 34 were based on long-standing impressions and general research discussions with financial statement users that were held during the development of Statement 34. The Board's more recent research found that the information that users "consistently deemed important and useful" was not what was actually being delivered to them in many instances. The research results highlighted in paragraph 39 in the Background section of this Statement reaffirms the notion that fund balance information is very important but concludes that "there are considerable differences in the way that users interpret fund balance information and widespread confusion about the nature of the information and the reporting requirements within the generally accepted accounting principles for state and local governments."

60. In discussions leading to the Exposure Draft, the Board considered the significance of the statement from paragraph 417 of Statement 34 that "information about amounts 'available for appropriation' has always been regarded as very useful by governmental financial statement users." It was determined that to regard unreserved fund balance as equivalent to available for appropriation was potentially misleading because reserved amounts are also "available for appropriation" to the extent that they can be appropriated for the purposes for which they have been reserved. When Statement 34 was issued, the Board did not have a sufficient basis for proposing changes to fund balance reporting *at that time,* but since that time, research has provided compelling reasons for the need to change.

Confiicts with Legal or Oversight Agency Requirements and the Budgetary Process

61. Some respondents to the Exposure Draft pointed out that some governments are subject to requirements to establish *reserves* or to submit reports that include information based on existing fund balance classifications. They are concerned that reporting new classifications of fund balance would confiict with the statutory and regulatory requirements they follow. The Board is sensitive to these concerns but

believes that if specific aspects of GAAP, as may be incorporated in statutory or regulatory reporting, could not be changed, it would significantly undermine efforts to improve financial reporting. Furthermore, the Board does not agree that the new fund balance classifications cannot meet most current statutory and regulatory reporting needs. For example, a statute that regulates the establishment, funding, and use of *reserves* by local governments would, under the classification approach in this Statement, likely have resulted in the reporting of *restricted* fund balance. Thus, information regarding those reserves would only be labeled differently but would be equally transparent. Oversight agencies that currently require information to be submitted using previous fund balance terminology would have the opportunity to change their requirements for consistency with the classifications in this Statement. If such a change were not considered feasible, a crosswalk to the regulatory presentation could be provided for the oversight body. The Board recognizes that such changes initially may be inconvenient to government, but it is confident that the continuing value of the revised fund balance classifications exceeds the effort required to incorporate the changes.

62. Some respondents to the Exposure Draft expressed similar concerns about the potential difficulties that new fund balance terms would introduce into their budgetary processes. The Board understands and respects the concerns of those who consider the budget and the existing fund balance classifications inextricably linked, but it believes that the classifications in this Statement can be equally, if not more, pertinent to the budgetary process. For example, it would be very useful to know the amount of resources that are restricted, committed, or assigned to (and thus, available to finance) a program or activity when contemplating how the budget of that program or activity is to be funded. Differences between budgetary accounting and GAAP financial reporting have always existed for many governments; budgetary terminology and fund structure for many governments differ from what is reported in their financial statements. The Board accepts that the fund balance classifications in this Statement may not bring financial reporting *closer* to budgetary concepts, but it does not believe that the gap will invariably widen as a result of this standard.

Number of Classifications

63. Some respondents to the Exposure Draft stated that it proposed too many classifications of fund balance and would therefore be too complex. A common suggestion was to combine the proposed classifications of *limited* (*committed,* in this Statement) and *assigned* fund balance. The Board considered that suggestion and other approaches to reducing the classifications, such as requiring a distinction only between restricted and unrestricted fund balances. However, the Board concluded that classifications such as unrestricted fund balance or a combined committed/assigned fund balance were too broad to sufficiently

meet users' needs to identify differences in the relative strengths of the constraints placed on how resources can be used. Consequently, the Board decided to retain the five proposed classifications; however, greater clarity was provided regarding the nature of each classification and how they differ from each other.

Nonspendable Fund Balance

64. The budgetary connotations of the term *appropriation,* and concerns expressed by several of the Invitation to Comment respondents about its inapplicability in certain circumstances, led the Board to base fund balance classifications on a notion of *spendable* amounts, rather than amounts that are *available for appropriation.* The Board believes this approach is consistent with the fact that governmental funds historically have been characterized as having a *spending* focus. The nonspendable category comprises the net current financial resources that cannot be spent because they are either not in spendable form or legally or contractually required to be maintained intact.

65. Respondents generally reacted favorably to the proposed nonspendable fund balance category, but there were some who suggested that certain clarifications would improve the final standard. Some respondents urged the Board to explain more clearly what *spendable form* means and to offer more examples of items that could possibly be included within the nonspendable fund balance classification. The Board responded by clarifying that, generally, *not in spendable form* means that an item is not expected to be converted to cash (for example, inventory). Also, paragraph 6 was expanded to discuss how the long-term amount of loans and notes receivable, and property acquired for resale should be classified. That paragraph further explains that if the proceeds from their collection or sale, respectively, are restricted, committed, or assigned, those constraints take precedence over the nonspendable nature of the resources when classifying the amounts.

Spendable Fund Balance

66. The Exposure Draft proposed that the remaining classifications of fund balance be reported under the general heading of *spendable fund balance.*The label was primarily intended to communicate that all fund balance not classified as *nonspendable* would, by default, be *spendable,* and further to convey that the resources are spendable for the purposes to which they have been restricted, committed, or assigned. Nevertheless, many Exposure Draft respondents believed that the term would be misunderstood. A concern shared by several of the respondents is that because the term *spendable* is commonly used in other contexts, it may carry a connotation that the resources in such a category may be spent for any purpose, when in fact they may be subject to significant external or internal constraints controlling the

purposes for which those resources may be used. In response to those concerns, the Board decided that, because the Exposure Draft only used the term as a title for a category of other fund balance classifications, eliminating references to it in the final Statement would have no substantive effect on the specific fund balance amounts that are required to be reported.

Restricted Fund Balance

67. Research shows that one of the difficulties that users have encountered since the implementation of Statement 34 is understanding the relationship between reserved fund balance and restricted net assets. The similarity in terminology has caused many users to infer a more direct connection than would normally exist pursuant to a strict application of the two definitions. The Board agreed that the advantages of using a consistent term throughout the financial statements would outweigh the disadvantages that come with replacing a familiar term. Therefore, the Board concluded that the term used to identify the most binding level of constraint on the use of fund balance in the fund financial statements should be the same term used to describe the equivalent level of constraint on the use of net assets in proprietary funds and the government-wide statements. The Board believes that there is a distinct advantage to using the same term to characterize the status of these balances regardless of the context in which they are reported. By doing so, the Board believes that the confusion that arises when an amount can be reported as reserved in one particular fund but unreserved in another will be eliminated.

68. Exposure Draft respondents also pointed out a potential inconsistency between restricted net assets and restricted fund balances. Paragraph 35 of Statement 34 indicates that permanent fund principal should be included in the restricted net assets classification. However, in the Exposure Draft, permanent fund principal would have been regarded as nonspendable rather than restricted fund balance, resulting in a discontinuity between restricted fund balance and restricted net assets. The Board's general intention was that the definition of restricted fund balance be identical to that of restricted net assets. In deliberating Statement 34, the Board concluded that permanent fund principal should be classified as restricted because it could not be spent and would be miscast as unrestricted, and a net asset classification analogous to nonspendable was not under consideration. The Board believes that the nonspendable classification more closely defines permanent fund principal and should be used to report permanent fund corpus in governmental funds. Further, that classification inconsistency will not be the sole source of differences between restricted *fund balance* and restricted *net assets;* in many instances, differences will arise from the different measurement focuses and bases of accounting employed in reporting net assets and fund balance.

Committed Fund Balance

69. The Invitation to Comment included a definition of the term *legally limited,* as it might have been used in the definition of *special revenue funds,* as "resources that are legally limited to a particular purpose by a government that cannot be used for any other purpose unless the government removes or changes the limitation by taking the same action it employed to impose the limitation or by taking a higher authority action." Many of the Invitation to Comment respondents supported the proposed definition. For the Exposure Draft, the Board used a modified version of that definition to describe the limited fund balance classification. The definition was modified by eliminating the word *legally* because it implies a restriction that is enforceable by law and may overstate the strength of the constraints that can be imposed by a government upon itself.

70. Numerous respondents to the Exposure Draft expressed concern about the use of the term *limited* for this portion of fund balance. Among the alternative titles suggested, the Board selected the term *committed fund balance.* The Board had previously considered titling this portion of fund balance *committed,* but it had opted for *limited* because the notion of commitments has other meanings in GAAP. Ultimately, the Board concluded that *committed* had fewer objectionable connotations than other possible titles. This change, however, should not be construed as a substantive change to this classification of fund balance as it was proposed in the Exposure Draft.

71. Some respondents to the Exposure Draft suggested that the definition of committed, and how it is distinguished from restricted and assigned, should be clarified for the final Statement. In response, the Board added an explanation of how the actions taken by a government to commit resources differ from those taken to restrict resources through enabling legislation, even though both kinds of actions are taken by the government itself. In response to another concern by respondents, the Board also clarified the meaning of *commitment* as it applies to fund balance classification by providing that contractual obligations that will be satisfied with existing fund resources should be reported as committed fund balance.

Authority to Commit Resources

72. The Board considered whether this Statement should specify which formal actions of a government's highest level of decision-making authority are required to commit fund balance to a specific purpose, but it determined that it would not be practical to do so because of differences in the powers accorded to governments. For example, some governments may establish statutes or ordinances and resolutions, whereas some may only be able to pass resolutions, and other governments-such as some special-purpose governments- may have no legislative authority at all. Furthermore, the legal standing of

the actions available to a government may differ. For some governments, a resolution may carry the force of law, but for others, a resolution may be only ceremonial in nature. In response to concerns about lack of consistency, this Statement requires disclosures that should give users a clear understanding of the authority behind the commitments of fund balance and the specific actions taken to impose them.

73. Because the overall classification approach includes two categories of self-imposed constraints (committed and assigned), the Board agreed that it would be appropriate to start with the assumption that the level of authority required to establish constraints sufficient to invoke display in the *committed* fund balance category should be high enough to represent the consensus objective of the governing body as a whole. In other words, the purpose constraints imposed on amounts in that category should come from the source that possesses the highest level of decision-making authority.

74. The level of authority necessary to establish fund balance commitments is similar to that required in the restricted (through enabling legislation) category. Enabling legislation exclusively involves revenues *authorized* by the restricting legislation. It is not uncommon for governments to pass legislation to raise new revenues for a specific purpose. For fund balance classification, *enabling legislation* is considered a compact with the resource providers that the revenues raised pursuant to that legislation would be used *only* for the promised purpose. In contrast, the committed fund balance classification includes amounts generated from existing revenue sources that are formally constrained to be used for a specific purpose, but there is no comparable compact with the providers of those resources about how they can be used. Thus, the substantive difference between amounts that are restricted by enabling legislation and amounts that are in the committed fund balance category is the relative inability of the government to redeploy restricted amounts for other purposes.

75. This Statement requires, for financial reporting purposes, that the formal action that establishes committed fund balance occur before the end of the reporting period. The Board recognizes, however, that even if the specific purpose of the commitment is established before year-end, a mechanism or formula for determining the amount subject to the commitment is sometimes based on events, conditions, or results that are not known or finalized at that time. As a result, this Statement allows that the amount subject to the commitment may be determined in the subsequent period before financial statements are issued.

Assigned Fund Balance

76. Throughout its deliberations about defining the fund balance classifications, the Board generally supported the notion that there was a need for a classification representing a level of constraint that was less binding than that associated with the limited (committed) fund balance classification but not so

available as to be considered unassigned. The Board also considered, and ultimately rejected, alternatives that would have reported those amounts in the committed or unassigned classifications. The decision to establish the assigned classification essentially depended on whether amounts classified as assigned would be sufficiently distinguishable from those other two classifications. The Board believes that the definition of assigned fund balance in this Statement appropriately provides for that distinction.

77. The Board views an assignment as an expression of a government's *intent,* comparable to designations in the previous fund balance classification and display model. By accepting the validity of that analogy, the Board had the benefit of the input obtained from its past research efforts and from the responses to the Invitation to Comment relative to questions asked about designations of fund balances. Those sources clearly indicated that information about management's plans or intentions is considered important. There was considerable interest in information about the designations themselves: three-quarters of the survey respondents said that they consider information about the purposes of designations "important" or "very important." Furthermore, over 70 percent of the respondents to the 2003 user survey rated information about *unreserved-undesignated* fund balance to be "very important" to the decisions they make or to their assessments of a government's financial health.

78. Both the committed and assigned fund balance classifications include amounts that have been constrained to being used for specific purposes by actions taken by the government itself. As noted earlier in paragraph 72 , this Statement does not specify which actions of a government would be required to establish committed fund balance, largely because of the differences in abilities and structures from government to government. Those differences led the Board to reach the same conclusion with regard to identifying particular actions that should be required to assign amounts. Several respondents to the Exposure Draft commented that it would be difficult to distinguish between the actions taken to *commit* fund balance amounts and actions taken to *assign* fund balance amounts. Other respondents indicated concern that some governments may not have decision-making processes in place to commit or assign resources, as described in the Exposure Draft. Those respondents urged the Board to provide clarification of the requirements. In response, the Board added paragraph 15 to highlight the differences between the committed and assigned fund balance classifications emphasizing (a) the level of authority required, (b) the nature of the actions necessary to nullify a commitment or assignment of fund balance, and (c) the degree of difficulty with which they may be reversed. The Board also clarified in other places in this Statement that some governments may not report both committed and assigned fund balances because not all governments have multiple levels of decision-making authority.

79. The assigned category should include amounts that have been set aside for a specific purpose by an

authorized government body or official, but the constraint imposed does not satisfy the criteria to be classified as restricted or committed. *How* the government's intent should be expressed and communicated is not specifically prescribed; however, the Statement does clarify that an authorized government body or official should be characterized as "the governing body itself or a body (a budget or finance committee, for example) or official to which the governing body has delegated the authority to assign amounts to be used for specific purposes." The Board believes that the disclosures required in paragraph 23(b) should provide users with a clear understanding of who is empowered to make assignments and by what authority.

80. Paragraph 12 in this Statement provides that the specific purpose for a fund balance commitment should be established prior to the end of the reporting period but that the specific amount of that commitment can be determined in the following period. The basis for that conclusion is discussed in paragraph 75 . Some Exposure Draft respondents asked why such a provision was not also made for fund balance assignments. The Board does not believe that a similar timing requirement is necessary or appropriate for fund balance assignments largely for two reasons. First, the process of assigning amounts to specific purposes is less binding than the procedures for fund balance commitments, and second, assignments are often not considered until after the amount of unrestricted and uncommitted fund balance is quantified. That is, it is common for governments to express an intent to use accumulated resources for specified purposes only after the amount that is available for assignment has been determined. Paragraph 15 clarifies that governments cannot assign an amount to a specific purpose if that assignment would cause a deficit to occur in unassigned fund balance.

Unassigned Fund Balance

81. In the Exposure Draft, the Board proposed that, based on the definitions of the restricted, committed, and assigned fund balance classifications, unassigned amounts could exist only in the general fund. Even though some contend that amounts in other governmental funds could, in actuality, be just as accessible as unassigned amounts in the general fund, the Board believes that governments, through the formal process of reporting amounts in other funds, have assigned those amounts to the purposes of the respective funds. This Statement provides that unassigned fund balance is the residual classification in the general fund and includes amounts that have not been assigned to other funds. Accordingly, assigned fund balance should be the least constraining classification in governmental funds other than the general fund.

Reporting Negative Balances

82. Respondents to the Exposure Draft and participants in the field test raised questions about the appropriate fund balance classification for reporting *negative* fund balances. A negative balance

communicates that more resources were spent for a specific purpose than had been restricted, committed, or assigned to that purpose. A prohibition against reporting negative restricted fund balances already exists by extension of the requirements for reporting restricted net assets. Item 7.24.13 in the *Comprehensive Implementation Guide* states that restricted net assets is intended to portray, at the date of the statement of net assets, the extent to which the government has assets that can only be used for a specific purpose. If the related liabilities exceed the assets on hand, then the "shortfall," by default, is covered by unrestricted net assets. Extending that logic to the unrestricted fund balance classifications, the Board believes that shortfalls in any of the classifications would be covered by the next classification for that specific purpose in the government's spending prioritization policy (stopping at zero in each classification). Thus, if fund balance (exclusive of nonspendable amounts) in total is negative, then the negative amount can only be attributed to the unassigned fund balance classification. Similar to the net asset conclusion discussed above, shortfalls ultimately are covered by unassigned resources. The Board believes that the use of unassigned resources "in substance" should be recognized in the fund balance classifications. Consequently, the Board concluded that negative balances should be reported only in the unassigned classification. Although the general fund is the only fund in which a positive unassigned fund balance may be reported, other governmental funds may be required to use the unassigned fund balance classification to report negative amounts.

83. Paragraph 19 states that if expenditures incurred for a specific purpose exceed the amounts that have been restricted, committed, and assigned to that purpose and a negative balance for that purpose results, then amounts assigned to other purposes in that fund should be reduced before reporting a negative unassigned fund balance amount. This provision does not require the reduction of restricted or committed fund balance amounts. The Board believes that in funds other than the general fund, the expenditure of resources assigned to one specific purpose has been, in substance, *reassigned* to the other purpose for which they actually have been spent. In the general fund, on the other hand, the Board believes that an overexpenditure for a specific purpose is first covered by unassigned resources, to the extent adequate unassigned resources exist. That is, the government has, in effect, assigned the amounts to the purpose for which they were spent, thereby reducing unassigned fund balance rather than attributing the overexpenditure to amounts assigned to other purposes. The fund balance classification policy for the general fund, discussed in paragraph 18 , would describe that resource fiow assumption.

Classifying Fund Balance Amounts

84. This Statement does not require the presentation of a detailed statement of changes in fund balances; rather, it provides that an analysis of ending fund balance can be made to determine how residual balances

should be classified. In developing the Exposure Draft, the Board discussed approaches that would have established a required spending prioritization scheme, but it rejected them because they would necessarily be arbitrary and would not be sensitive to the differences in resource management philosophies that exist from one government to another. Some respondents to the Exposure Draft indicated that they believe the standard *should* require a specific spending prioritization. They believe that the final standard should state that resources are used in the same descending order as the fund balance classifications appear in the hierarchy, and one Board member agrees with that position (see paragraphs 135 and 136). The Board redeliberated the issue and reaffirmed the Exposure Draft's approach that fund balance at the end of a reporting period should reflect the government's accounting policy that determines which amounts in the various classifications are considered to have been spent. The Board recognizes that a final determination of whether specific resources are *restricted* may ultimately be subject to legal interpretation. The government's policy should therefore be consistent with such legal determinations. For example, if a government's policy is to spend unrestricted resources before certain restricted resources, the reported restricted amounts are required to be legally constrained for a specified purpose at the end of the reporting period to be included in the restricted fund balance classification. Disclosure of the government's policies should provide context within which readers can better understand the fund balance information being reported.

85. Several respondents commented that some governments do not have formal spending prioritization policies and that establishing those policies may be difficult. However, governments already are required by Statement 34 to have a policy for determining whether restricted or unrestricted amounts are spent. Furthermore, establishing an additional policy to determine whether committed, assigned, or unassigned amounts have been spent is expected to be a one-time effort at the time of implementation. Nevertheless, in response those concerns, the Board decided that this Statement should provide a "default" policy for governments that do not establish a policy, stipulating that, committed amounts would be reduced first, followed by assigned amounts, and then unassigned, when expenditures are incurred for purposes for which amounts in any of those unrestricted fund balance classifications could be used. Some respondents also contended that the spending prioritization policy disclosures required in the Exposure Draft would become "boilerplate" and thus should not be required. The Board is sensitive to concerns about excessive disclosure but continues to believe that those disclosures are essential for a reader's understanding of the fund balance classifications required by this Statement. Because the procedures for committing and assigning resources to specific purposes may differ from government-to-government, users need to understand the process through which the constraints have been imposed by a particular government to help assess the availability of amounts reported in governmental funds.

86. Some commentators pointed out that governments may have different policies for different programs or functions and that a single fiow assumption would not be representative of that management approach. In response to those comments, the Board modified that provision from the Exposure Draft to eliminate the unintended implication that a government would be required to apply a single classification policy to all of its programs or functions.

87. The Exposure Draft included a provision that in other than the general fund, unspent amounts that were assigned to a specific purpose that is no longer applicable should not be reported as assigned fund balance but, rather, should be included in the unassigned fund balance of the general fund by reporting those amounts as due to the general fund. Many respondents objected to that proposal, indicating that they believe that amounts transferred to other funds remain committed or assigned to a specific purpose until the government takes action to eliminate or modify those commitments or assignments. After redeliberating the Exposure Draft's requirement, the Board agreed with that notion. Although the Board believes that preparers have a responsibility to periodically review the status of commitments and assignments, the Board does not believe that a cautionary provision in the standard is necessary to inform them that it would be inappropriate to continue to report an amount as committed or assigned if the purpose for which the commitment or assignment was imposed has expired. In addition, the Board understands that, in many cases, the reason that a fund is in a deficit position is because it has a large balance "due to the general fund" representing a loan that was needed to cover current expenditures in anticipation of other resources. The provision in the Exposure Draft would have caused an amount due *from* the general fund to be reported, offsetting the amount due *to* the general fund and, in effect, reclassifying the loan as a transfer. After considering the comments to the Exposure Draft made by respondents, the Board agreed that, in this instance, reporting a fiow of funds that likely will not take place should not be required.

Level of Detail of Fund Balance Classifications

88. The Exposure Draft proposed that the two components of nonspendable fund balance-resources that are not in spendable form and those that are legally or contractually required to be maintained intact-be presented separately. Restricted fund balance would be reported at the same level of detail as required for restricted net assets in paragraph 32 of Statement 34 . Committed and assigned fund balances would be reported in sufficient detail so that the major purposes for which amounts are committed and assigned can be identified readily.

89. Several Exposure Draft respondents urged the Board to clarify those requirements in the final Statement. Some concluded that the disclosures suggested by the Exposure Draft would be too detailed

and too time-consuming to compile. Others recommended that the Board express a preference for either display or disclosure. Still others preferred a requirement that called for display in the aggregate with supporting details disclosed in the notes. Many users have traditionally been ambivalent about whether this type of information is disclosed in the notes or displayed on the face of financial statements. Users that express a preference are divided-some prefer more detail on the face of the statement, provided it is not so voluminous as to be distracting, whereas others prefer note disclosure, as they believe it can be more informative and easier to read. Consequently, the Board does not believe that there is any single approach that offers such an advantage over others that its use should be required or encouraged. Thus, the nonprescriptive approach in the Exposure Draft was retained for the final Statement, and governments are provided with options for meeting these requirements-through display, disclosure, or a combination of both.

Stabilization Arrangements

90. Stabilization (rainy-day) arrangements were discussed in the Invitation to Comment in connection with the alternatives proposed for the special revenue fund definition. Respondents were asked their preferences for reporting stabilization amounts (a) as a component of fund balance in the general fund, (b) in a note disclosure or separate schedule that disaggregates the general fund, (c) as a new fund type, or (d) by another approach. The Board considered the advantages and disadvantages of each of those alternatives and the comments from respondents to the Invitation to Comment before reaching the conclusion proposed in the Exposure Draft.

91. Initially, the Board considered including stabilization amounts as a classification within the nonspendable fund balance classification based on the concept that stabilization amounts are spendable only when certain specific circumstances or conditions exist-if those circumstances or conditions do not exist at the end of the financial reporting period, then the resources cannot be spent. The Board eventually rejected that approach primarily because the nonspendable caption implies a level of constraint that overstates most stabilization arrangements.

92. The Board concluded that, generally, the most appropriate presentation of stabilization amounts would be as a component of fund balance in the general fund. The Board agreed that *economic stabilization* (or a similar intention by a different name) constituted a *specific purpose* and, therefore, amounts constrained to stabilization would usually meet that criterion for inclusion in the committed or restricted fund balance classifications of the general fund. In some instances, for example, if setting aside stabilization resources is a constitutional requirement, those amounts may meet one or more of the criteria of the restricted fund balance classification. The Board believes that it is unlikely that a stabilization arrangement would satisfy

the criteria to be reported as a separate special revenue fund because the resources usually do not derive from a specific restricted or committed *revenue* source, as required by that fund type definition. Paragraph 21 of this Statement was amended to clarify that point.

93. This Statement requires that stabilization arrangements be classified within the committed or restricted fund balance classifications if they satisfy the respective criteria of those classifications. However, the Board concluded that, for financial reporting purposes, stabilization should be regarded as a specific purpose only if the circumstances or conditions that signal the need for stabilization are identified in sufficient detail. The guidance provided in paragraph 20 of this Statement was expanded to clarify the meaning of *specific purpose,* in the context of stabilization.

94. The Board considered and rejected the notion that stabilization amounts might also meet the assigned fund balance criteria and could therefore be reported within the assigned classification. The Board believes that *stabilization* is a purpose that, relative to specific activity or program purposes, has inherent financial reporting significance. That is, awareness of the existence and conditions of stabilization arrangements and amounts can help users assess a government's financial health. Consequently, for financial reporting purposes, the Board believes that a government's ability to establish and spend stabilization amounts should be the province, at a minimum, of its highest level of decision-making authority, which is consistent with the criteria for the committed fund balance classification.

95. The GASB's research found that users often consider stabilization arrangements to be a positive indicator of a government's fiscal management philosophy; that is, governments that establish stabilization arrangements are perceived by many to be responsibly setting aside resources to withstand unexpected revenue shortfalls or expenditure needs. However, some financial statement users interviewed by the GASB expressed concern about their inability to find stabilization amounts in the financial statements of certain governments. Thus, the Board concluded that information about stabilization arrangements should be disclosed in the notes to financial statements, even if those arrangements do not meet the criteria for display as committed or restricted fund balance.

Minimum fund balance policy disclosures

96. Many governments create *de facto* stabilization arrangements by establishing formal minimum fund balance requirements. The Board believes that users are similarly interested in information about those minimum fund balance requirements and how they are complied with by the respective governments. Therefore, this Statement also requires that governments disclose their minimum fund balance policies. Some Exposure Draft respondents and field test participants asked that the final Statement more clearly

identify the minimum balance arrangements that are intended to be the focus of the disclosure requirement. They pointed out that governments are often required to maintain minimum balances by ordinance, statute, indenture, contract, and other sources and asked whether the disclosures would be required for all minimum balances, regardless of the source of the requirement or its objective. To clarify the focus of the minimum balance disclosures, paragraph 27 refers to policies rather than requirements and emphasizes that those policies are *adopted* or *established* by the government to distinguish them from other minimum balance requirements that are *imposed* upon the government from other sources and authority.

Reporting Encumbrances

97. In developing the Exposure Draft, the Board discussed the question of whether encumbrances meet the criteria to be included in the restricted, committed, or assigned fund balance classifications. In the previous model, encumbrances were included in the *reserved* fund balance category. However, within the classification approach in this Statement, the Board concluded that an encumbrance does not represent any further constraint on the use of amounts than is already communicated by classification as restricted, committed, or assigned. The restricted, committed, and assigned classifications of fund balance are distinguished by the extent to which purpose limitations have been established regarding the use of those amounts. None of those classifications are based on a budgetary availability notion in the way encumbrances are. In fact, amounts in any of those three classifications also could be encumbered from a budgetary perspective. Based on those considerations, the Board determined that reporting encumbrances as a separate classification is incompatible with the focus on purpose limitations established in the restricted/committed/assigned fund balance hierarchy. Given that difference in focus, the Board concluded that, for governments that use encumbrances in their budgetary accounting system, information about significant encumbrances should be disclosed in the notes to the financial statements in conjunction with other commitments, rather than displayed on the face of the fund financial statements.

98. The comments of respondents to the Exposure Draft and participants in the field test made it evident that many disagreed with or did not fully understand that encumbrances should not be displayed on the face of the balance sheet but may be disclosed. Some respondents argued that encumbrances represent legal commitments or contractual obligations and should be reported as restricted. Others expressed their belief that encumbrances are nonspendable and should be included in that fund balance classification. Some contended that encumbrances should be explicitly displayed on the face of the statement. Many argued that encumbrances should be classified as committed or assigned, and others rejected the possibility that they could be classified as unassigned. The Exposure Draft's contention that encumbrances are a budgetary consideration, rather than a financial reporting matter, also was disputed by some respondents.

99. The Board recognized that the Exposure Draft did not sufficiently communicate that encumbered resources are included within the relevant classifications based on the purposes to which the encumbrances relate. For example, an amount could be classified as restricted to a specific purpose, some or all of which also may be encumbered. That further delineation of the encumbered portion of restricted fund balance is not required to be displayed because the encumbrance does not further restrict the purpose for which the resources may be used. Displaying the encumbered portion separately on the face of the financial statements would result in a level of detail that does not add to the decision-usefulness of the information. The Board therefore decided to add clarifying language in the Statement to explicitly state that encumbrances should not be reported separately from the classifications of fund balance- restricted, committed, and assigned-on the face of the balance sheet.

100. In response to the contention that an encumbrance (through the issuance of a purchase order) represents a legal commitment with an outside party and thus should be regarded as restricted fund balance, the Board points out that such an interpretation is not consistent with the definition of *restricted* in Statement 34 and in this Statement. *Restricted,* as defined, applies to resources that have been provided by creditors (bond sales), grantors, or donors or have been raised pursuant to enabling legislation. In the case of encumbrances, vendors have not provided resources-they have not provided goods or services and have no infiuence over how a government uses its existing resources. If and when a purchase order is filled, a vendor is entitled to payment and a liability would be recognized, but at no point does that vendor have any legally enforceable authority, as outlined in Statement 34 and amended by Statement 46, over how the government uses its resources.

101. The Board also determined that the Statement should clarify whether unassigned amounts that are encumbered for a specific purpose that is not already included within the restricted, committed, or assigned classifications should continue to be regarded as unassigned. That is, does the process of encumbering amounts equate to the process that leads to commitments or assignments? To address this issue, the Board clarified that encumbrances of otherwise unassigned amounts should be reported in the fund balance classification that equates to the process that the government uses in encumbering amounts. Thus, encumbrances of unassigned amounts could be classified as committed or assigned depending on the process by which amounts are encumbered.

Appropriations of Existing Fund Balance

102. In developing the Exposure Draft, the Board considered the common situation in which the subsequent year's budget includes a specific provision to use *existing resources* (ending fund balance from the prior

year) for a specific purpose. The Board discussed whether that action would meet the criteria to be reported as an assignment and concluded that in some circumstances, appropriations of existing fund balance would constitute an assignment, and in other situations, it would not. That distinction should be based on whether the appropriation possesses the characteristics of an assignment; that is, whether both the *amount* and the *purpose* of the appropriation are specified. For example, a general fund budget could include an appropriation of a specific amount from the prior year's fund balance to finance the renovation of an athletic field.

103. In the Exposure Draft, the application of the fund balance classification provisions to an appropriation of existing fund balance was discussed only in the Basis for Conclusions. Respondents to the Exposure Draft sought clarification of that application guidance and suggested that it appear in the standards section of the final Statement. In addition, several respondents argued that "balancing the budget" by appropriating a portion of existing fund balance constitutes the setting aside of resources for a specific purpose and that that intent should be communicated through the fund balance classifications. Some of those respondents argued that the Exposure Draft's requirement to identify a specific purpose (that is, more specific than balancing the budget) was too restrictive and arbitrary-they suggested that a government could simply choose any item from its budget and assert that the existing resources were intended to finance that purpose. The Board generally agreed and responded to those concerns by adding paragraph 16 to this Statement. That paragraph clarifies the circumstances under which such an appropriation of existing fund balance constitutes an assignment. Specifically, the Board agreed that an appropriation of fund balance in an amount no greater than the projected excess of expected expenditures over expected revenues satisfies the criteria to be classified as an assignment of fund balance.

104. The Board considered whether an appropriation of existing fund balance could be classified as a commitment rather than an assignment. Some assert that an appropriation of existing fund balance necessary to balance the next year's budget is tantamount to a temporary stabilization arrangement. That is, that portion of existing fund balance constitutes an amount that the government *intends* to use for budgetary stabilization in the subsequent year. However, appropriation of existing fund balance lacks the constraints and ongoing nature of the formal stabilization arrangements addressed in this Statement. Therefore, even though the specified use-stabilization-is similar in those two situations, the fact that in one instance stabilization is an *intent,* while in the otheritisa *committed purpose,* the Board believes, leads to the appropriate classification distinction. The Board also believes that an appropriation of existing fund balance does not meet the criteria for a commitment because the government does not have to take action to remove the constraint-it expires at the end of the budgetary period. Formal stabilization arrangements

would generally result in committed fund balance classification, as provided for in paragraph 21 , whereas the appropriation of existing fund balance for temporary budgetary stabilization would result in an assignment, provided that the amount is specified as a budgetary resource in the budget document and the purpose of the appropriation is specified.

Governmental Fund Type Definitions

105. The definitions of the individual governmental fund types presented in this Statement provide that funds of a particular type either *should be used* (that is, required) or *are used* (that is, discretionary) for all activities that meet its criteria. If use of a fund type is generally discretionary, specific situations under which a fund of that type should be used are identified either in the definitions in this Statement (debt service funds) or by requirements established in other authoritative pronouncements (special revenue and capital projects funds).

General Fund

106. For consistency with clarifications made to the terminology in the definitions of the other governmental fund types and to acknowledge that other governmental funds are required only in prescribed situations, the Board concluded that the definition of *general fund* in paragraph 26 of NCGA Statement 1 needed a conforming alteration. That definition stated that the general fund "is used to account for all financial resources except those required to be accounted for in another fund." To recognize that the establishment of other funds can be discretionary in certain circumstances, the Board concluded that the definition should be revised to state that the general fund should be used "to account for and report all financial resources not accounted for and reported in another fund." Thus, the unintended notion that no other governmental funds should be reported unless they are *required* is eliminated.

Special Revenue Fund Type

107. In the deliberations for the Exposure Draft, regarding the definition of the special revenue fund type, the Board acknowledged that the diversity in the reporting of those funds in practice could largely be attributed to confusion that derived from several provisions in the previous definition. Those provisions determined the nature of the revenue source for which a special revenue fund may be created to report in external financial statements, as well as the nature of other resources that also may be reported in those funds. The provisions in the definition that appeared to cause the confusion were *proceeds of specific revenue sources, legally restricted,* and *specified purposes.* The Invitation to Comment included alternative interpretations of those parts of the definition, each of which would have, to different degrees, limited the

reporting of special revenue funds by many governments.

108. As discussed earlier, the fund balance information needs of users vary- from information about compliance with restrictions on the use of revenues, to the relative availability of resources, to the revenues and expenditures of specific programs and activities. The comments received from the Invitation to Comment respondents about the use of special revenue funds validated that notion and are indicative of the differences in the way in which those funds have been reported in practice. On one side are those that believe that special revenue funds should be used only to report the use and availability of specific revenues (a motor fuel tax fund, for example), while on the other side are those that believe that special revenue funds also may be used to report the revenues and expenditures of specific programs or activities (a public library fund, for example).

109. In connection with the intent of the proceeds of specific revenue sources provision, a question in the Invitation to Comment asked what resources should be accounted for in a special revenue fund included in external financial reports. The alternatives were (a) only a specific revenue source, (b) a specific revenue source and transferred matching amounts, or (c) a specific revenue source, transferred matching amounts, and other legally limited transferred amounts. The comments received from the respondents to the Invitation to Comment reflected the differences in practice. Because different user groups have different needs, supporters of either a revenue-focused approach or an activity-focused approach could declare that consideration of user needs indicates support for their preferred definition. On the one hand, many users from the investor/creditor group generally contend that the focus of special revenue funds should be on revenues so they can easily identify resources that are available. On the other hand, several preparer and attestor respondents believe that users other than credit market participants also want information about programs or activities and that special revenue funds have been an effective medium in reporting that information.

110. Financial reporting standards do not *require* separate fund usage for either specific revenues or specific activities. That is, GAAP does not require all restricted road and bridge taxes, for example, to be reported in separate special revenue funds. Therefore, some governments report those revenues in their general fund and others use one or more funds. Similarly, GAAP does not require governments to report their public parks activities (or any other specific function, program, or activity) in a separate fund. Consequently, some governments account for all public parks revenues and expenditures in the general fund, while others use a separate fund, and still others use both. As a result, some have asserted that an activity-based approach is not in accord with the intended use of special revenue funds and does little, if anything, to enhance consistency. Because an activity could be reported in a variety of ways (in the general

fund, in a special revenue fund, or in both), those that are interested in activity reporting may not find the information they need unless the special revenue fund definition *requires* reporting of activities in separate special revenue funds.

111. Proponents of an activity focus suggest that if it is essential for readers to be able to isolate the proceeds and uses of a restricted revenue, then a separate fund should be required for all restricted revenues. That is, if governments can report a specific restricted revenue in the general fund commingled with other restricted and unrestricted revenues, why should a similar mix be prohibited in a less comprehensive separate special revenue fund? Those who prefer a revenue focus would respond that if all unrestricted amounts were required to be reported in the general fund, a user's search for available amounts is simplified as long as restricted amounts in that fund are clearly identified. After weighing the arguments from both perspectives, the Board concluded that the need for information regarding available amounts is an important consideration, but it is not the only user need that should be addressed, and it should not be met at the expense of others.

112. A popular argument from those that support limiting the use of special revenue funds to reporting the uses of restricted revenues is that it demonstrates compliance with spending restrictions. Yet, the Board is aware that governments can report compliance selectively with whatever restricted revenues they choose to report in a separate special revenue fund. Restricted revenues for which they choose not to demonstrate compliance can be reported in the general fund with other revenues, both restricted and unrestricted. That level of fiexibility led the Board to conclude for the Exposure Draft that general purpose external financial statements are not the most appropriate medium for demonstrating this form of compliance.

113. Many users that favor limiting special revenue fund usage do not assert that they want to judge compliance but rather that they want to know about availability of resources. Government compliance with spending limitations is not a driving factor for those users; rather, they want to know where the available amounts are. The Board believes that such information can be provided through display and classification techniques and based the Exposure Draft classification approach on that notion.

114. Some Invitation to Comment respondents pointed out that Statement 34 provides for an activity or program focus in the government-wide statement of activities and, therefore, reporting similar information in governmental funds would be redundant. While that assertion, on its face, may seem valid, many financial statement users contend that the minimum requirement for level of detail (total direct expenses, for example) at the government-wide level is inadequate for assessing the operations of a particular activity or program. In other words, without additional details of program expenses (personnel and related

expenditures, supplies, maintenance, and so on, by program), activity reporting in special revenue funds is the only way for users to get the level of information they need to assess a particular program without piecing it together from a variety of locations.

115. In arriving at the approach proposed in the Exposure Draft, the Board was faced with the question of whether a revenue focus or an activity focus provides better information. Users interested in locating available resources, or in determining how restricted revenues were used, could easily obtain that information from revenue-based funds, while needing additional information to assess the uses and availability of resources if single activity-based funds were reported. The Board believes that those user needs are better served by revenue-based reporting. Conversely, users interested in program or activity information would generally need to look only to the single activity-based funds to obtain it, while under a revenue-based approach, they would have to gather the information from a variety of funds including the general fund. The Board believes that those users' needs are best met by activity-based reporting. Because the Board believes those competing user needs are of equal importance, the Board agreed that a solution to satisfy one need at the expense of the other should be avoided.

116. After carefully evaluating the strengths and weaknesses of the alternatives, the Board concluded for the Exposure Draft that the special revenue fund type definition should not be interpreted in a way that would prohibit governments from pursuing an activity-based reporting objective in certain cases. The Board believes that it is easier to understand information about specific revenues in an activity-based special revenue fund than it is to understand information about specific activities in a revenue-based fund framework. In addition, the Board believes that more effort will be required, and more confusion will result, in informing readers about activities if the special revenue fund type is defined so narrowly as to include only specific committed or restricted *revenues.* Nevertheless, the Board believes that it is important to stress that the definition requires that a specific restricted or committed revenue source be the *foundation* of a special revenue fund. This is one aspect of the clarification of the definition of the special revenue fund type for which the Board believes there appears to be little controversy.

117. Governments that currently report special revenue funds consistent with a narrow revenue-based approach are not required to convert those funds to incorporate more of an activity focus. In contrast, those governments that report special revenue funds in a manner consistent with the approach provided for in this Statement would have been required to make significant changes to comply with a narrower revenue-based definition.

118. The question posed in the Invitation to Comment regarding the meaning of *legally restricted* was

intended to solicit views on how *binding* the limitations on the use of a specific revenue should be for it to form the foundation of a separate special revenue fund. That is, should it be necessary for the constraints to be imposed only through the legally restricting channels defined in paragraph 34 of Statement 34 , as amended (Option 1)? Or can the constraints also be imposed by the reporting government itself even though the government has the ability, through some specified level of due process, to remove or modify them (Option 2)?

119. Respondents that expressed a preference for Option 1 alluded to consistency and comparability as reasons for their support. Some suggested that the Option 1 approach paralleled their belief that all unrestricted resources should be reported in the general fund and that the basis for a separate fund should be a legal restriction. Others stated that Option 1 would help to keep the number of funds at a minimum, and they believe that it would eliminate, or at least significantly reduce, the reporting of available resources in special revenue funds. The Board acknowledges that the consistency and comparability argument has some merit, but it also realizes that the argument is significantly diluted by the fact that governments can choose to report restricted revenues in a separate fund or commingle those revenues with other restricted and unrestricted resources in the general fund. Thus, the Board believes that under Option 1, consistency or comparability would be fully achieved only to the extent that all special revenue funds presented would include only restricted revenues, but it would not be fully achieved in the sense that all governments would report the same restricted revenues in identical ways. The Board also agreed with the suggestion that Option 1 would impede a government's ability to report unrestricted resources in special revenue funds to make those resources appear less available than they actually are but concluded that the concern could be easily mitigated by clearly stated and well-defined classifications of fund balance.

120. A common argument made by those that preferred Option 2 is that it gives governments the fiexibility to report in a manner that portrays how they actually manage their resources and activities. They contend that some decision makers (the legislative and oversight users) would find financial statements that do not provide this fiexibility to be less useful. Another popular observation from the respondents that supported Option 2 was that the substance of the constraints arising from restrictions and commitments is so comparable that allowing separate fund reporting of one but not the other was not warranted. Finally, many that preferred Option 2 pointed out that it more closely resembles current practice and that adopting the definition in Option 1 would cause significant changes and loss of useful information. After considering the two alternatives, the Board determined for the Exposure Draft that intent of the *legally restricted* provision in the definition should not be the equivalent of *restricted* in Statement 34 but, rather, should encompass committed resources as well. Accordingly, the Board eliminated *legally* from the special revenue fund type

definition because it implies a restriction that is enforceable by law and overstates the strength of the constraints that can be imposed by a government on itself.

121. The responses discussed above to the questions in the Invitation to Comment about possible alternative interpretations of the terminology in the special revenue fund type definition were very informative to the Board and aided the deliberations that led to the special revenue fund type definition in the Exposure Draft. The Board decided not to propose substantive modifications to the definition but, instead, to propose that governments disclose in the notes to financial statements the kinds of revenues that are reported in special revenue funds. That is, the disclosure would reveal the nature and extent of the constraints imposed on the use of those revenues. In addition, the Board concluded that rather than requiring which revenues or amounts can be reported in special revenue funds, this Statement would provide for a fund balance classification and display methodology that would inform readers about the levels of constraint placed on the use of the amounts accumulated in special revenue funds.

122. Many respondents to the Exposure Draft expressed concern about the change from current practice that would result if the proposed clarifications were implemented. There appeared to be much uncertainty about whether governments can assign amounts to the purposes of an individual special revenue fund. One question that arose was whether a special revenue fund can include *any* amounts that are not restricted or committed. A second question was whether the foundation of a special revenue fund can be a specific revenue that has been assigned (rather than restricted or committed) to the purpose of the fund. The reason for the uncertainty was the reference in paragraph 26 of the Exposure Draft to "specific revenues that are restricted or limited," while paragraph 27 of the Exposure Draft referred to resources that have been assigned to the purpose of a special revenue fund. Many respondents also had questions about the inclusion of assigned amounts in the discussion in one paragraph but not the other. The Board's intent was to use the first paragraph to emphasize that assigned resources should not be considered an appropriate foundation for a separate special revenue fund. The following paragraph made the point that specific revenues also could be assigned to a special revenue fund (or existing resources from other funds could be transferred in) provided that a substantial portion of the resources in the fund are attributable to restricted or committed revenues.

123. The Board addressed the question of whether assigned amounts can be reported in special revenue funds to supplement restricted or committed resources by clarifying that discussion in the standard. The other issue was whether a government can establish and maintain a separate fund with assigned resources as the foundation. The Board evaluated the pros and cons of such an approach and ultimately rejected it, concluding that it would be tantamount to having no parameters at all for using special revenue funds, and

because such a permissive definition could ultimately undermine the significance of the general fund.

124. Respondents also voiced concerns about situations in which resources are received in one fund and distributed to other funds for expenditure in accordance with specified purposes. Some referred to those funds as "clearing funds," and they surmised that the Exposure Draft would allow for a clearing fund to be reported as a special revenue fund but not an ultimate expenditure fund because those "transferred" resources would not be considered *revenues* of that fund. The Board concluded that perception is a misinterpretation of the Exposure Draft's intent. In those instances, the foundation *is* a specific revenue and if those resources are either restricted or committed, separate special revenue funds may be reported, regardless of the fact that the resource was initially received in another fund. The Board agreed that the final standard should clarify that, in those situations, the inflows should not be recognized as revenues in the fund that initially receives them.

125. Another recurring concern from the respondents was that additional clarification is needed to understand what is meant by *significant portion* in the Exposure Draft's definition of special revenue funds, which stated that "restricted or limited proceeds of specific revenue sources should comprise a *significant portion* of the resources reported." The first clarification that the Board made was to replace the term *significant* with *substantial* to eliminate possible confusion with other financial reporting considerations. Some asked if the criterion applies to revenues or balances. Others questioned whether governments have to continuously analyze their special revenue funds to see if the relative levels of resources within a particular fund still satisfy the significant portion requirement. The Board agreed with those respondents that the intent of that provision should be more clearly explained in the final Statement. In response to the uncertainty about revenues or balances, paragraph 30 clarifies that the evaluation should be based on *inflows,* but it also provides for an additional consideration for revolving loan funds. The Board did not intend for governments to monitor the content of their special revenue funds using specific criteria on an annual basis. Therefore, the Board clarified in paragraph 31 that the substantial portion assessment should be based on a government's *expectation* about whether a substantial portion of the inflows will be from specific restricted or committed revenue sources. In addition, the Board agreed that governments should report the net resources of a special revenue fund in the general fund, for financial reporting purposes, if it becomes apparent that the government no longer expects that a substantial portion of the inflows will derive from restricted or committed revenue sources.

Capital Projects and Debt Service Fund Types

126. The Invitation to Comment asked whether the definitions of capital projects and debt service fund

types should be modified to limit the amounts that can be reported in those funds. The responses were divided between those who favored a more restrictive approach to include restricted and committed amounts only and those who prefer the flexibility implied in an approach that includes amounts intended for capital projects and debt service as well. Many of those that supported the more restrictive definition did so because they believe that intent is too imprecise. They also contended that the notion of intent is problematic because it is transitory, and there are many ways in which intent can be manifested. Other supporters of a more restrictive definition commented on the consistency and comparability they believe that approach promotes. Some of those respondents focused on consistency from year to year and comparability among governments, while others believe such an approach is consistent with the historical nature of those fund types.

127. Those that supported a broader approach (including assigned amounts) offered a variety of reasons for their preference. Many commented that a restrictive definition would affect the way governments use fund accounting to manage resources and suggested that the broader definition better reflects the way that many governments operate. Several of that method's supporters like the flexibility it provides, and others favor it because it allows for the accumulation of amounts for a particular capital project and could show the financial statement user all of the amounts used for a common purpose.

128. As was true for the special revenue fund type, the Board believes that the consistency arguments would be more compelling if the use of capital projects and debt service funds were required in all instances. Thus, the Board acknowledges that while comparability from government to government can be enhanced, without significant restructuring of fund type definitions, any higher level of comparability will be elusive. Under the more restrictive definitions, a higher level of comparability could be obtained *if* a government reported a capital projects or debt service fund, because then a reader would be assured that the amounts in those funds could not be used for any other purpose. Nevertheless, those readers would not be assured that other similarly restricted amounts were not reported elsewhere.

129. The Board does not believe that the contention that a narrower, more restrictive definition is consistent with the nature of the funds is supported by the literature. For example, the argument that capital projects funds are intended to account for only restricted or committed resources is contradicted by the language in paragraph 28 of NCGA Statement 1 , which characterizes those funds as *project-oriented* and further states that fund accounting records should reflect *total* project financial resources. Thus, one could conclude that a capital projects fund should report a complete *project,* not just the portion that is financed with restricted or committed resources. Similarly, paragraph 30 of that Statement , as amended, provides that debt service funds should be used when *financial resources* are being accumulated for future years' maturities. There is

no stipulation that the resources being accumulated are required to be restricted or committed to that purpose. The Board believes that those provisions of NCGA Statement 1 support the contention that broader definitions better reflect the way that many governments currently use those funds to manage their resources.

130. After considering the strengths and weaknesses of the comments made in support of the two approaches by respondents to the Invitation to Comment, the Board proposed broader definitions, including assigned amounts, for the Exposure Draft. The Board believes that interpreting the fund definitions as imposing restraints that many governments have not previously observed would not necessarily meet financial statement user needs. The Board concluded that the user needs intended to be addressed in this Statement can be met through effective fund balance classification and display requirements, and that such an approach is more consistent with the broader definitional approach-provided that what is meant by *intent* is clearly explained. The requirement in paragraph 23 to disclose a government's *assignment* process is expected to provide that clarity.

131. In deliberations leading to the Exposure Draft, the Board discussed the term *major capital facilities* in the capital projects fund definition from the perspective of whether the term is sufficiently descriptive to provide for consistent application. The Board is aware that some governments use capital projects funds to report equipment and other personal property acquisitions, while others limit their use to reporting the acquisition or construction of structures and ancillary capital items. The Board considered expanding the discussion of *facilities* in the proposed definition to clarify and limit the scope of activities that could be reported in those funds, but it recognized that various governments have different views about what constitutes capital facilities. The Basis for Conclusions section of the Exposure Draft, included a statement that the Board believes that capital projects funds are intended to be used to report the acquisition or construction of capital assets that clearly are *facilities* (buildings, building improvements, infrastructure assets, including ancillary items, for example) rather than those that clearly are not (buses, fire trucks, and computer workstation equipment, for example). Even though the capital projects fund definition proposed in the Exposure Draft used the same terminology from the previous definition ("acquisition or construction of major capital facilities"), many respondents reacted to the discussion of the Board's perception of intent as if the definition was significantly more restrictive than the previous one.

132. Many respondents objected to the proposed clarification because they believed that the application of the definition would result in significant changes to their current practices. There was much concern expressed about the fact that the clarified definition in the Exposure Draft did not appear to adequately provide for the appropriate reporting of the proceeds of debt issuances that are used to finance capital

projects. Several respondents suggested that the definition of a capital projects fund should reflect current practice as it has evolved. That is, they believe that the terminology in the definition (or the title of the fund itself) should be altered to be more representative of current practice. Some suggested that the term *major capital facilities* be defined to include items that clearly would not meet most definitions of *facilities* (equipment, for example), and others recommended that the reference be to capital *projects* rather than capital *facilities.* Other respondents suggested limiting the activity in the fund type to all capital expenditures requiring debt or the accumulation of resources, or the construction or acquisition of all "GAAP capital assets." The observation also was made that the activity reported in a capital projects fund should relate to a government's capital budget or long-range plan.

133. The Board considered the comments from the Exposure Draft respondents in light of the fact that the proposed definition did not substantively modify the existing one and evaluated alternative courses of action that could be taken. Ultimately, the Board agreed to modify the definition to focus on a broader, more consistently understood notion of capital outlays, rather than the inconsistently interpreted reference to capital facilities in the previous definition. The Board concluded that use of the term *capital outlays* allows for the inclusion of expenditures for items that are capital in nature but may not qualify for financial reporting as capital *assets* under a government's capitalization policy. Many Exposure Draft respondents were concerned about project resources that are spent for items that may not be capitalized. The Board recognizes that the definition in this Statement embraces current practice more so than the intent of the original definition. However, the Board does not believe that limiting the activity in capital projects funds to acquisition and construction of major capital facilities, as defined in the narrow sense, adequately captures the breadth of capital activities common in today's environment, or that it provides essential, decision-useful information.

Permanent Fund Type

134. The definition of the permanent fund type is included in this Statement only to incorporate minor wording changes in the interest of consistency with the other definitions in this Statement. This Statement does not affect the requirement to report permanent funds pursuant to the definition.

Basis for Board Member Dissent

135. Mr. Williams dissents because he disagrees with the provision in paragraph 18 for allowing the use of a spending prioritization policy to determine the composition of fund balance (restricted, committed, assigned, and unassigned) when an expenditure is incurred for a purpose for which some or any of those classifications could be applied. Instead, he believes qualifying amounts should be considered expended in

the hierarchy's descending order, which is consistent with the guidance in paragraph 18 for governments that have not established their own spending prioritization policies. He believes unless these higher level constraints are reduced first by qualifying amounts, a government's fund balance would show constrained amounts when expenditures have already satisfied those constraints. He therefore considers the application of a spending prioritization policy other than the hierarchy's descending order to be arbitrarily applied form over substance.

136. Mr. Williams believes a major purpose of the Board's changes in fund balance classifications is to increase transparency about applicable constraints. He believes allowing governments to apply the spending prioritization policy approach reduces transparency by reporting constraints on fund balance when such constraints have already been met. He also believes the spending prioritization policy approach will result in unduly complicated disclosures and less consistency, comparability, and usefulness of fund balance information.

Appendix C

ILLUSTRATION

137. The facts assumed in this example are illustrative only and are not intended to modify or limit the requirements of this Statement or to indicate the Board's endorsement of the approach illustrated. Application of the provisions of this Statement may require assessment of facts and circumstances other than those illustrated here. The disclosures required by this Statement are generally of a "policies and procedures" nature, which should be specific to each government. Consequently, to avoid unintentionally infiuencing the content of those disclosures, they are not illustrated in this appendix.

Illustrative Fund Balance Section

Exhibit 1 depicts the fund balance section of the balance sheet from the governmental funds financial statements of a hypothetical government. In this Exhibit, the government has chosen to present the specific purpose details required by paragraph 22 on the face of the balance sheet. Exhibit 2 illustrates the same fund balance information, but in this case, the government has chosen to display the fund balance classifications in the aggregate. The specific purpose details, in the latter case, would be disclosed in the notes to the financial statements. Alternatively, the government could have used a combination of both approaches-display some classifications in the aggregate and others in detail.

Exhibit 1

		Major	Major	Major			
		Special Revenue Funds	Debt	Capital			
	General Fund	Highway Fund	School Aid Fund	Service Fund	Projects Fund	Other Funds	Total
Fund Balances:							
Nonspendable:							
Inventory	$125,000	$108,000	$16,000				$249,000
Permanent fund principal						$164,000	164,000
Restricted for:							
Social services	240,000						240,000
Parks and recreation	80,000						80,000
Education	55,000						55,000
Highways					$444,000		444,000
Road surface repairs	24,000						24,000
Debt service reserve				$206,000			206,000
School construction					301,000		301,000
Law enforcement						214,000	214,000
Other capital projects					51,000		51,000

Other purposes	30,000						30,000
Commited to:							
Zoning board	16,000						16,000
Economic stabilization	210,000						210,000
Homeland security	110,000						110,000
Education	50,000		103,000				153,000
Health and welfare	75,000						75,000
Assigned to:							
Parks and recreation	50,000						50,000
Library acquisitions	50,000						50,000
Highway resurfacing	258,000						258,000
Debt service				306,000			306,000
Public pool					121,000		121,000
City Hall renovation					60,000		60,000
Other capital projects	50,000				471,000		521,000
Other purposes	80,000		73,000			176,000	329,000
Unassigned:	525,000						525,000
Total fund	**$1,746,000**	**$390,000**	**$192,000**	**$512,000**	**$1,448,000**	**$554,000**	**$4,842,000**

balances

This level of detail is not required for display on the face of the balance sheet. Fund balance categories and classifications may be presented in detail or in the aggregate if sufficient detail is provided in the notes to the financial statements.

Exhibit 2

		Major	Major	Major			
		Special Revenue Funds	Debt	Capital			
	General Fund	Highway Fund	School Aid Fund	Service Fund	Projects Fund	Other Funds	Total
Fund Balances:							
Nonspendable	$125,000	$108,000	$16,000			$164,000	$413,000
Restricted	405,000	24,000		$206,000	$796,000	214,000	1,645,000
Committed	461,000		103,000				564,000
Assigned	230,000	258,000	73,000	306,000	652,000	176,000	1,695,000
Unassigned	525,000						525,000
Total fund balances	$1,746,000	$390,000	$192,000	$512,000	$1,448,000	$554,000	$4,842,000

1

Throughout this Statement, the term *stabilization* is used to refer to economic stabilization, revenue stabilization, budgetary stabilization, and other similarly intended (including "rainy-day") arrangements.

2

For revolving loan arrangements that are initially funded with restricted grant revenues, the consideration may be whether those restricted resources continue to comprise a substantial portion of the *fund balance* in the fund's balance sheet.