

IMPLEMENTATION GUIDE

Guide to Implementation of GASB Statement 34 on Basic Financial Statements— and Management's Discussion and Analysis— for State and Local Governments

Questions and Answers



Governmental Accounting Standards Board
of the Financial Accounting Foundation

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401 Merritt 7, P.O. Box 5116, Norwalk, Connecticut 06856-5116

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FOREWORD

This guide was developed to assist financial statement preparers and attestors in the implementation and application of GASB Statement No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*.

Since the release of Statement 34 in June 1999, many questions have been posed to GASB staff regarding the implementation of that Statement and its application in various reporting situations. Although a significant number of those questions addressed initial implementation and transition issues, most of the questions have ongoing applicability. Because staff responses to individual technical inquiries reach only a small portion of the GASB’s constituents, the GASB adopted the Implementation Guide concept to broaden the application of staff guidance.

Guidance in an Implementation Guide is limited to clarifying, explaining, or elaborating on an underlying standard (usually a Statement, Interpretation, or Technical Bulletin). The topics addressed may include issues raised by constituents in due process or as a result of subsequent application of a standard, as well as issues anticipated by the GASB staff. The governments that have implemented Statement 34 early have been particularly helpful in raising issues that will benefit other governments as they begin implementation.

An Implementation Guide may also address issues related to the application of a standard to specific industries. Generally, a GASB Statement, Interpretation, or Technical Bulletin would be more appropriate to address new issues or to amend existing guidance on issues previously addressed.

The GASB’s Implementation Guides are classified as category (d) in the hierarchy of generally accepted accounting principles, as set forth in paragraph 12d of AICPA Statement on Auditing Standards No. 69, *The Meaning of “Present Fairly in Accordance with Generally Accepted Accounting Principles” in the Independent Auditor’s Report* (SAS 69). Category (d) includes “practices or pronouncements that are widely recognized as being generally accepted because they represent prevalent practice in a particular industry, or the knowledgeable application to specific circumstances of pronouncements that are generally accepted.” SAS 69 specifically states in the “Application to State and Local Governmental Entities” section that “category (d) includes implementation guides (Qs and As) published by the GASB staff. . . .” However, the illustrative examples and exercises accompanying the text of this Implementation Guide are nonauthoritative guidance.

This guide was prepared and published in accordance with the GASB’s Implementation Guide procedures. These procedures require public announcement of the project, exposure of the proposed guide to the Board and an advisory committee, and approval of the final guide by the director of research. Moreover, an Implementation Guide will not be published if a majority of Board members object to its issuance.

The publication of this guide would not have been possible without the concerted efforts of the GASB staff and the advisory committee. Senior project manager Kenneth R. Schermann served as the primary author of the guide, with project managers Randal J. Finden and Roberta E. Reese making substantial contributions by developing the capital asset–related questions, illustrations, and exercises. As with Statement 34, this truly was an entire staff effort with everyone contributing in some form to the process.

The application of GASB pronouncements is an ongoing process. A guiding principle in the GASB’s mission statement addresses the need to review the effects of past decisions and to provide additional guidance when appropriate. This staff Implementation Guide represents just one of the many methods that the GASB uses to fulfill this important responsibility.

In addition, several organizations are in the process of developing nonauthoritative companion guides for specific types of governmental entities and other books and materials related to Statement 34. All of these efforts will assist in the implementation and ongoing application of the new reporting model.

Norwalk, Connecticut
April 2000

David R. Bean
Director of Research

PREFACE

This Implementation Guide is intended to help preparers and auditors understand and implement the provisions of GASB Statement No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*. It includes nearly 300 questions and answers, over 50 illustrative financial statement exhibits, and 10 “how-to” exercises. The questions were developed primarily from four sources: respondents and testifiers who identified possible implementation issues during the various stages of due process, GASB staff during the deliberation and drafting stages of Statement 34, members of the advisory group, and individuals from governments that have already begun to implement the standard.

Statement 34 represents one of the most comprehensive financial reporting standards in the history of standards setting, and as a result provides almost unlimited opportunities for implementation questions. Despite the record number of questions addressed in this guide, new unanswered questions will surely begin to accumulate as more and more governments implement Statement 34. Therefore, the potential for a “sequel” to this Q&A is quite good. We intend to stay abreast of application issues and continue to provide guidance as necessary.

Professional judgment and materiality play important roles in implementing any standard, but probably never quite as much as with Statement 34. Readers of this guide should keep in mind that some of the questions are based on specific situations, and as the facts change, so too might the answer to the question. For some questions, the answers are stated within the context of satisfying *minimum* requirements. Governments are encouraged in several areas of Statement 34 to go beyond minimum requirements—for example, retroactive application of infrastructure reporting requirements for phase III governments or expanding the level of detail reported for programs in the statement of activities. In all cases, the answers to the questions presume that the subject of the question is material.

During the preparation of this guide, we had the invaluable support of an advisory group whose members commented on preliminary drafts. Their comments, suggestions, and recommendations were very helpful and contributed greatly to the quality and usefulness of this document. The advisory group members were:

<u>Name</u>	<u>Affiliation</u>
Mark D. Abrahams	The Abrahams Group
Nicholas C. A. Alioto	Eau Claire (WI) Area School District
Andrew Bailey	Virginia Department of Transportation
Madeleine Bloom	Federal Highway Administration
Lee Carter	Sterling Capital Management
Dr. Gilbert Crain	Montana State University
Frank Crawford	Crawford & Associates, PC
Richard Cristini	Bollenback & Forret
Stephen J. Gauthier	Government Finance Officers Association
Anthony R. Giancola	National Association of County Engineers
Maria Giannell	Maze & Associates
Paul E. Glick	The Carl Vinson Institute of Government
Leon E. Hank	State of Michigan
Denise Headrick	Grady Healthcare, Inc.
Staci Henshaw	Virginia Auditor of Public Accounts
L. Michael Howard	State of Ohio
J. Michael Inzina	Stagni and Co., LLC
North Jersild	Stein Roe & Farnham
Walter Kelly	Clifton, Gunderson, LLC
Michele Mark Levine	New York City Office of Management and Budget
Kevin McHugh	American Appraisal Associates, Inc.
G. Michael Miller	City of Orlando, FL
Clayton Murphy	State of North Carolina
Jim Pyers	City of Wooster, OH

<u>Name</u>	<u>Affiliation</u>
William Raftery	State of Wisconsin
Jack Reagan	KPMG, LLP
Andrew S. Rein	New York City Independent Budget Office
Robert W. Reinhart	Mellon Financial Markets, LLC
Pete Rose	Independent consultant
Dennis Ross	American Public Works Association
Bob Scott	City of Carrollton, TX
George Scott	Deloitte & Touche, LLP
Michael Shinn	Tennessee Department of Transportation
Al Warfield	Anne Arundel County, MD
Dr. Earl Wilson	University of Missouri–Columbia
Venita Wood	Independent consultant

The members of the advisory group do not necessarily approve of or agree with the answers provided in the Implementation Guide. Likewise, they are not responsible for the accuracy of the information provided.

We would also like to acknowledge *all* of the members of the GASB staff for their contributions to the guide—no one escaped without some contact with this Q&A. We especially want to thank Wes Galloway for contributing many of the questions and for tirelessly reviewing the drafts; Michelle Czerkowski and Denise Harry for their help in preparing the illustrative financial statements; Ellen Falk, Greta DeAngelis, and Patti Waterbury for their expert assistance in formatting, editing, and polishing the material in the guide; and former GASB senior project manager Suesan Patton for all that she contributed. Finally, special recognition should be given to the Production department—Glen Kudlicki, Ana Thiers, Susan Miller, Alison Fleitas, Steve Jaroszynski, and Eileen Mishley—for their dedication to publishing this guide on a very tight time schedule.

Ken Schermann
Randy Finden
Roberta Reese

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Questions and Answers

CONTENTS

	Page Number
Foreword	iii
Preface	v
	Question Numbers
Questions and Answers	
Scope and Applicability	1
Minimum Requirements for Basic Financial Statements and Required Supplementary Information	2– 5
Management’s Discussion and Analysis (MD&A)	6– 14
Government-wide Financial Statements	15–156
Basis of Presentation	15– 19
Measurement Focus and Basis of Accounting	20– 24
Capital Assets	25– 80
Capitalization of Interest	30– 31
Presentation in Statement of Net Assets	32– 35
Reporting Infrastructure Assets	36– 42
Calculating Depreciation	43– 52
Calculating Estimated Useful Lives	47– 50
Composite Methods	51– 52
Modified Approach	53– 75
Costs Expensed Versus Costs Capitalized	57– 61
No Longer Permitted to Use the Modified Approach	62– 65
Asset Management Systems	66– 69
Condition Level and Assessment	70– 75
Reporting Works of Art and Historical Treasures	76– 80
Statement of Net Assets	81–102
Net Assets Invested in Capital Assets, Net of Related Debt	88– 94
Restricted Net Assets	95–100
Unrestricted Net Assets	101–102

	Question Numbers
Statement of Activities	103–156
Expenses	105–114
Direct, Indirect, and Overhead Expenses	105–106
Depreciation Expense	107–110
Interest Expense	111–114
Revenues	115–138
Classification as Program or General Revenues	115–116
Charges for Services	117
Fines and Forfeitures	118
Grants and Contributions	119–123
Taxes	124–127
Special Assessments	128–129
Investment Earnings	130
Gain or Loss on Disposal of Capital Assets	131
Reporting Program Revenues	132–136
Reporting General Revenues	137–138
Special and Extraordinary Items	139–142
Reporting Activities of Enterprise Funds	143
Statement of Activities Format	144–146
Eliminations and Reclassifications	147–156
Fund Types—Overview	157–174
Governmental Funds	159
Proprietary Funds	160–170
Application to Specific Circumstances	166–170
Fiduciary Funds	171–174
Governmental and Proprietary Fund Financial Statements	175–226
Major Funds	175–188
Presentation of Major Funds	175–180
Application of Criteria	181–188
Required Reconciliation to Government-wide Statements	189–192
Required Financial Statements—Governmental Funds	193–205
Measurement Focus and Basis of Accounting	193
Reporting General Long-term Liabilities	194–196
Balance Sheet	197–201
Separate Display of Reserved and Unreserved Fund Balance	200–201

	Question Numbers
Statement of Revenues, Expenditures, and Changes in Fund Balances	202–205
Other Financing Sources and Uses.....	203
Special and Extraordinary Items	204–205
Required Financial Statements—Proprietary Funds.....	206–219
Internal Service Funds	206
Statement of Net Assets.....	207–209
Reporting Restricted Assets.....	209
Statement of Revenues, Expenses, and Changes in Fund Net Assets.....	210–218
Defining Operating Revenues and Expenses	214–215
Reporting Capital Contributions and Additions to Permanent and Term Endowments.....	216–217
Required Reconciliations	218
Statement of Cash Flows.....	219
Required Financial Statements—Fiduciary Funds and Similar Component Units	220–226
Measurement Focus and Basis of Accounting.....	224
Reporting Agency Funds	225–226
Reporting Interfund Activity	227–229
Basic Financial Statements—Notes to the Financial Statements.....	230–238
General Disclosure Requirements.....	230–231
Required Disclosures about Capital Assets and Long-term Liabilities.....	232–234
Segment Information.....	235–238
Reporting Component Units.....	239–244
Required Supplementary Information Other Than MD&A.....	245–256
Budgetary Comparison Schedules	245–254
Presentation of Budgetary Comparison Schedules	245–250
Original and Final Budgets.....	251–253
Disclosure Requirements	254
Modified Approach for Reporting Infrastructure	255–256
Basic Financial Statements Required for Special-purpose Governments.....	257–261
Engaged in a Single Governmental Program	258–259
Engaged Only in Business-type Activities.....	260
Engaged Only in Fiduciary Activities.....	261

Question
Numbers

Effective Date and Transition	262–290
Determining Appropriate Implementation Phase	262–264
Component Unit Implementation	265–266
Transition Provisions	267
Governmental Entities That Use the AICPA Not-for-Profit Model	268
Reporting General Infrastructure Assets at Transition	269–290
Modified Approach for Reporting Infrastructure Assets	278–281
Determining Major General Infrastructure Assets	282–285
Establishing Capitalization at Transition	286–290

Page
Number

Appendix 1: Standards Section from Statement 34	69
Appendix 2: Illustrative Financial Statements	105
Illustration A: Municipal Government	106
Illustration B: Independent School District	152
Illustration C: State Government	166
Appendix 3: Alternative Approaches for Certain Display and Disclosure Requirements	181
Appendix 4: Exercises	215
Topical Index	249

The Governmental Accounting Standards Board has authorized its staff to prepare Implementation Guides that provide timely guidance on issues encountered during the implementation and application of GASB pronouncements. The GASB has reviewed this Implementation Guide and does not object to its issuance.

The information in this Implementation Guide need not be applied to immaterial items.

QUESTIONS AND ANSWERS

Scope and Applicability

1. Q—Which governmental units should apply the Statement 34 standards?

A—Statement 34 applies to all state and local governmental entities, including general purpose governments, public school districts, public benefit corporations and authorities, public employee retirement systems, public utilities, public hospitals and other healthcare providers, and public colleges and universities. Application of the Statement 34 provisions to public colleges and universities was achieved through the issuance of Statement No. 35, *Basic Financial Statements—and Management’s Discussion and Analysis—for Public Colleges and Universities*.

Minimum Requirements for Basic Financial Statements and Required Supplementary Information

2. Q—What are the primary elements of the Statement 34 model?

A—The minimum requirements for the new model, outlined in paragraph 6,¹ are:

- Management’s discussion and analysis (MD&A) as required supplementary information (RSI)
- Basic financial statements (government-wide financial statements, fund financial statements, and notes to the financial statements)
- Required supplementary information other than MD&A.

Although the standard includes requirements for notes and RSI, these are not intended to be all-inclusive. Current requirements for notes and other types of RSI will continue to be in effect.

3. Q—Do the basic financial statements of Statement 34 replace the general purpose financial statements (GPFS)?

A—Yes, the basic financial statements (government-wide and fund financial statements) in Statement 34 replace the combined statements in GPFS. As illustrated in the diagram in paragraph 7, the basic financial statements and RSI required by Statement 34 *constitute the minimum requirements* for general purpose external financial statements.

¹Paragraph references are for Statement 34, unless otherwise stated.

4. Q—Can a government issue *only* the government-wide financial statements or *only* the fund financial statements as basic financial statements?

A—No. Except as provided for qualifying special-purpose governments in paragraphs 138 and 139 (see Q260), governments are required to present *both* the government-wide *and* the fund financial statements as basic financial statements. Omission of either the government-wide or the fund financial statements would constitute an incomplete presentation and would not meet the minimum requirements for general purpose external financial statements as depicted in paragraph 7.

5. Q—Can governments *combine* the government-wide and fund financial statements?

A—For most governments, the government-wide statements should not be combined with fund financial statements. However, certain single-program governments may combine their government-wide and fund financial statements as discussed in paragraph 136. (See Q146.)

Management’s Discussion and Analysis (MD&A)

6. Q—For governments that prepare a comprehensive annual financial report (CAFR), should MD&A be placed before or after the letter of transmittal?

A—Paragraph 8 requires only that MD&A precede the basic financial statements; however, it should be presented as part of the financial section of a CAFR. The letter of transmittal remains a part of the introductory section. Because the scope of the letter of transmittal introduces the CAFR, and because MD&A derives from the basic financial statements and generally limits its discussion and analysis to information in those statements, a logical progression would be to move from the letter of transmittal to MD&A to the basic statements. In addition, to place the letter of transmittal between MD&A (which is RSI) and audited basic financial statements might imply a higher level of auditor involvement with the letter of transmittal than is actually the case.

7. Q—How should the letter of transmittal be modified to avoid duplication with MD&A?

A—Some of the minimum requirements for the contents of MD&A set forth in paragraph 11 are similar to the information currently presented in the letter of transmittal. Governments that prepare a CAFR will present both a letter of transmittal and MD&A. Paragraph 8 (footnote 7) states: “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.” There are no authoritative requirements for letter of transmittal contents. Because MD&A is *required* (as RSI) and a letter of transmittal is *optional*, governments cannot *choose* which medium to use to communicate the “duplicate” information—it should be included in MD&A. As a result, letters of transmittal should be modified to minimize duplication.

Preparers should compose their letters of transmittal to avoid redundancy with MD&A. In areas where duplication could occur, the letter of transmittal could refer to the relevant discussion in MD&A and add insights that may go beyond the boundaries of MD&A. The letter of transmittal also provides a forum for government officials to discuss plans and other information that may not meet the “currently known facts, conditions, or decisions” criterion in paragraph 11h.

8. Q—If a government (a single-program government or a business-type activity [BTA], for example) presents *comparative financial statements*, is a separate MD&A required for each year presented? That is, would the government be required to include a complete MD&A for the current year and the prior year (each with comparative data from the preceding year)?

A—No. If the government provides comparative financial statements (that is, basic financial statements and RSI are presented for both years), MD&A is required to address both years presented in the comparative financial statements. The “comparative” MD&A would include comparative condensed financial information and related analysis for *both* years. However, completely *separate* MD&As are not required. (See also Q9 about presenting *comparative data*.)

9. Q—If a government (engaged in both governmental and business-type activities, for example) presents *comparative data* (for example, total reporting entity columns for the current and prior years in the government-wide statements) in its basic financial statements, are the MD&A requirements in paragraph 11 required to be met for both years presented?

A—No. If the government presents *comparative data* (as distinguished from a complete set of comparative statements, notes, and RSI), the requirements in paragraph 11 should be met for the *current* year (with comparisons to the prior year).

10. Q—Paragraph 11 implies that the contents of MD&A described in subparagraphs a through h are *minimum* requirements. Are governments permitted to discuss other issues, not included in the requirements of paragraph 11, in MD&A?

A—No. Because MD&A is regarded as *RSI*, the information presented should be limited to the areas required in a through h. Nevertheless, *each* specific requirement in paragraph 11 should be addressed *at a minimum* as described in the respective subparagraphs a through h. Some governments will provide only minimal information to meet each requirement, whereas others will provide additional analytical or descriptive data that exceed the *minimum* requirements. There is no limit (other than perhaps readability) to the information that may be provided *if it provides additional details about the required elements in a through h*.

For example, a government may, *at a minimum*, meet the requirements of paragraph 11h by focusing the discussion (of expected significant effects on financial position and results of operations) on its governmental and business-type activities. Governments are not required to discuss the effects as they relate to *individual functions or programs* in the statement of activities, but may choose to do so depending on the specific facts and the significance of the amounts. Additionally, service efforts and accomplishments (SEA) or performance data, *as separate categories of information*, are not among the required contents of MD&A in paragraph 11 and therefore should not be included. However, selected SEA or performance measures may be included in MD&A *if they provide additional details about required information*. For example, performance measures may add relevant insights into why certain operating results differ from one year to the next.

Information that does not address the required elements discussed in subparagraphs a through h should not be included in MD&A, but may be reported as supplementary information and could be discussed in the letter of transmittal.

11. Q—Paragraph 11a requires MD&A to provide information to assist readers in understanding why measurements and results reported in fund financial statements either reinforce information in government-wide statements or provide additional information. How might governments meet this requirement?

A—The primary objective of the requirement in paragraph 11a is to help readers of MD&A understand the relationship of the results reported in the *governmental funds* financial statements to the results reported for *governmental activities* in the government-wide statements. For example, if the statement of activities reports a significant decrease in the net assets of governmental activities and the fund financial statements show an increase in the fund balances of the governmental funds, MD&A should explain why that occurred. The explanation could be that significant bond proceeds were received and capital expenditures were unusually low in capital project funds, or that some long-term liabilities were reported in the government-wide statements that did not affect the governmental funds. The causes of differences should be evident in the reconciliations accompanying the fund financial statements (see paragraph 77), but MD&A should provide an overview of that information, in narrative fashion, to meet the requirement of paragraph 11a. On the other hand, if the reasons for the change in net assets of governmental activities and the change in fund balances of governmental funds are similar, MD&A should note that similarity.

12. Q—Paragraph 9 encourages the use of charts and graphs in MD&A. Can the comparison of condensed financial information required by paragraph 11b be provided with charts and graphs?

A—No. The information required by paragraph 11b should be presented in the form of *condensed financial statements*. Charts and graphs may be used to supplement, or elaborate on, information in the condensed statements, but should not be used *in place of* them. For example, a comparative bar graph could be used to display the net program costs of selected functions that are not apparent in the limited detail of the condensed statements of activities. Paragraph 9 further provides that the information in MD&A, including illustrative charts and graphs, should address the *positive and negative* aspects of the comparison. (See the illustrative MD&A in Appendix 2, Illustration A.)

13. Q—What are “currently known facts, decisions, or conditions” that may need to be discussed in MD&A to comply with the requirements in paragraph 11h?

A—As explained in footnote 6 to paragraph 8, “currently known” means to have been aware of at the date of the auditor’s report. The key word in this requirement is *known*—that is, this discussion should be based on events or decisions that have already occurred, or have been enacted, adopted, agreed upon, or contracted. Governments should not discuss in MD&A the *possible* effect of events that *might* happen (although such matters could be addressed in the letter of transmittal). The award and acceptance of a major grant, the adjudication of a significant lawsuit, a significant change in the property tax base, the completion of an agreement to locate a major manufacturing plant in a city, an adopted increase in a state’s sales tax rate, an approved increase in a university’s tuition, a flood that caused significant damage to a government’s infrastructure, and a renegotiated labor contract with government employees are just a few examples of facts, decisions, or conditions that are expected to have a significant effect on financial position or results of operations. On the other hand, predicting how much sales tax revenues would increase if a planned shopping mall is built or that a data-processing system under consideration “will pay for itself” over a certain period of time would be examples of statements that are *not* based on currently known facts, decisions, or conditions.

In some instances, issues discussed in MD&A as “currently known facts” will also be disclosed in the notes to the financial statements as subsequent events or contingencies. The discussion in MD&A should highlight but not repeat the information required to be disclosed in the notes.

14. **Q**—Paragraph 11h requires a discussion of currently known facts, 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). Should that discussion address the expected effect on governmental and business-type activities separately?

A—Yes. Paragraph 11c requires that the analysis of the government’s overall financial position and results of operations should address both governmental and business-type activities separately. The requirement in paragraph 11h should have the same focus; that is, the discussion should address expected effects on both governmental and business-type activities.

Government-wide Financial Statements

Basis of Presentation

15. **Q**—Paragraph 14 states that prior-year data may be presented in the government-wide statements. What information should be presented if a government chooses to provide prior-year data?

A—Comparative data are not *required*, but *may* be provided—so there is no specific presentation that *should* be made. The practicality of presenting prior-year information is often a function of the complexity of the reporting government. A government with only governmental or business-type activities and no component units could provide a side-by-side single-column comparison in the statement of net assets. At the other extreme, a government with both governmental and business-type activities and component units (and the required total column for the primary government) would have to add at least four columns to offer a full comparison, or add a total column for the reporting entity (optional) and its counterpart from the prior year to provide for a reporting entity comparison.

Presenting comparative data for the statement of activities again depends on the complexity of the operations of the reporting government. A government with only governmental activities and no component units could add a prior-year “net (expense) revenue and changes in net assets” column. However, the comparison becomes more difficult and space-consuming as more columns are presented (governmental activities, business-type activities, total primary government, and component units) for the current year.

Governments with complex structures and operations may find that the most useful comparisons (especially for the statement of activities) can be made only if the prior-year statements are reproduced and included with the current-year statements of net assets and activities. In all cases, the prior-year information should be clearly identified and distinguished from the current-year statements. (See Q8 and Q9 about comparative information in MD&A.)

16. **Q**—If a government accounts for certain assets held for others (certain deposits, for example) in a governmental or proprietary fund, does paragraph 13 require those assets and liabilities to be eliminated for the statement of net assets?

A—No. Those assets and liabilities *may* be eliminated, but elimination is not *required*. Because the assets would equal the liabilities, there would be no effect on net assets or the statement of activities.

17. **Q**—In the statement of activities, can the reporting government combine as a single function (higher education, for example) the data of the primary government and a discretely presented component unit?

A—No. Paragraph 42 of Statement No. 14, *The Financial Reporting Entity*, 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. Even though this combined “single-

function” approach would report the net (expense) revenue of the component unit in a separate column, users would not be able to distinguish between the expenses and program revenues of the primary government and its component units. Paragraph 14 of Statement 34 expands the meaning of discrete presentation to cover separate *rows* as well as columns. It states, “Separate rows and columns should be used to distinguish between the total primary government and its discretely presented component units.”

18. Q—Can activities that are accounted for in enterprise *funds*—a transit system, for example—be reported as governmental activities in the government-wide statements?

A—Yes. The terms *activity* and *fund* are not synonymous; that is, “activity” generally refers to programs or services, whereas a “fund” is an accounting and reporting device. A single fund could account for several activities and a single activity could be accounted for in multiple funds. As indicated in paragraph 15, the statement of activities *usually* follows the categorizations used in the fund financial statements—governmental activities are those that usually are accounted for in governmental funds, and business-type activities are those that usually are accounted for in enterprise funds. Nevertheless, governments can realign their activities if they believe that it more faithfully represents their operating objectives and philosophies. The reconciliations from the governmental and enterprise fund financial statements to the government-wide statements would explain the reclassification.

19. Q—Can an activity accounted for in an enterprise fund be combined with activities accounted for in governmental funds and reported as governmental activities in the government-wide statements? For example, can a city combine its parks department (accounted for in the general fund) and its driving range enterprise fund as a *parks and recreation* governmental program in the statement of activities?

A—Yes, *if* the minimum requirements in paragraph 39 are satisfied. That paragraph provides that governmental activities should be presented at least at the level of detail required in the governmental fund statement of revenues, expenditures, and changes in fund balances, and that business-type activities should be presented at least by segment. (See Q104 about segment reporting, also.) Therefore, the city could combine its parks department and its driving range operation as a single governmental program unless the driving range is a “segment” or the “parks department” is a required functional category in the fund financial statements. Nevertheless, if the paragraph 39 requirements prohibit combination, both items could be *separately reported* as governmental activities under a “parks and recreation” heading. The reconciliations from the governmental and enterprise fund financial statements to the government-wide statements would explain the reclassification of the driving range enterprise fund.

Measurement Focus and Basis of Accounting

20. Q—Based on paragraph 17, can governments exercise the option to apply FASB (Financial Accounting Standards Board) pronouncements issued after November 30, 1989 (as provided for in paragraph 7 of GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*) for an internal service fund *if it will be included in business-type activities* in the government-wide statements?

A—No. Paragraph 94 provides that 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 Statement 34. Paragraph 423 in the Basis for Conclusions explains that the option in Statement 20 does not extend to internal service funds. Paragraph 17 states that business-type activities may also exercise the option in paragraph 7 of Statement 20. The intent of paragraph 17 is to summarize the measurement focus and basis of accounting

(MFBA) used in the government-wide statements; thus it includes the reference to paragraph 7 of Statement 20 to acknowledge that those FASB pronouncements may apply (*if the election was made for the underlying enterprise funds*). It is not meant to imply that governments can make an additional separate election to apply paragraph 7 *for the government-wide statements*. The election to exercise the option in paragraph 7 of Statement 20 is made only once—for *enterprise funds*.

21. Q—For governmental activities reported under the accrual basis of accounting in the statement of net assets, should an unfunded actuarial liability of a government’s pension plan(s) be reported as a liability?

A—No. Statement 34 does not change the measurement and recognition standards in Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*. Therefore, the net pension obligation (NPO) as defined in Statement 27, rather than the unfunded actuarial liability, should be reported in the statement of net assets as a liability (or asset). Statement 27, paragraph 17, sets forth the expense, liability, and asset recognition requirements under the *accrual* basis. It says: “. . . A positive (negative) year-end balance in the NPO should be recognized as the year-end liability (asset) in relation to the ARC [annual required contribution]. Pension liabilities and assets to different plans should not be offset in the financial statements.” Liabilities should also be reported in the statement of net assets for *short-term differences* and *pension-related debt* as defined in paragraphs 11 and 39, respectively, of Statement 27. (See Q84 about how to classify an NPO in a classified statement of net assets.)

22. Q—A government issues tax-supported general obligation bonds to fund the *unfunded actuarial liability* of its employee pension plan. How should the pension obligation bonds be reported?

A—The pension obligation bonds should be reported as a governmental activities liability in the statement of net assets. The government now recognizes a long-term accounting liability (bonds payable) where none was quantified or recognized before. (The unfunded actuarial liability is not an accounting liability—see Q21.) If any proceeds of the bonds have not been remitted to the pension plan, they should be included in the governmental activities assets.

23. Q—If a government accounts for its risk financing activities in its general fund (using the modified accrual basis of accounting), how should its claims liabilities and expenses be recognized in its government-wide financial statements?

A—The requirements for claims liability and expense recognition on the accrual basis are provided in Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, paragraphs 53 through 57, as amended.

24. Q—What are the recognition and reporting requirements for a government’s other postemployment benefits (OPEB) expense and liability in the government-wide financial statements?

A—An OPEB recognition and measurement project is on the GASB’s technical agenda. As stated in paragraph 13 of Statement No. 12, *Disclosure of Information on Postemployment Benefits Other Than Pension Benefits by State and Local Governmental Employers*, until that project is completed, governments are not required to change their accounting and financial reporting for OPEB. Governments are, however, required to make the disclosures set forth in Statement 12. Governments that choose to measure and recognize an OPEB liability and expense may do so as provided for in paragraph 24 of Statement 27, or they may apply the provisions of FASB Statement No. 106, *Employers’ Accounting for Postretirement Benefits Other Than Pensions*.

Capital Assets

25. Q—What are land improvements?

A—Land improvements consist of betterments, other than buildings, that ready land for its intended use. Examples of land improvements include site improvements such as excavation, fill, grading, and utility installation; removal, relocation, or reconstruction of property of others, such as railroads and telephone and power lines; retaining walls; parking lots; fencing; and landscaping.

26. Q—Are library books depreciable capital assets?

A—If library books are considered to have a useful life of greater than one year, they are capital assets and are depreciable. Because most library collections consist of a large number of books with modest values, group or composite depreciation methods (as discussed in paragraphs 163 through 166) may be appropriate. (See Q51.) In certain situations, library books may be considered works of art or historical treasures and could be reported using the provisions in paragraphs 27 through 29.

27. Q—What is an inexhaustible capital asset?

A—An inexhaustible capital asset is one whose economic benefit or service potential is used up so slowly that its estimated useful life is extraordinarily long. Land and certain land improvements are inexhaustible capital assets.

28. Q—Donated capital assets should be reported at their estimated fair value at the time of acquisition, according to paragraph 18. How may estimated fair value be calculated?

A—Fair value is the amount at which the asset could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Estimated fair value at acquisition may be calculated from manufacturers' catalogs or price quotes in periodicals, recent sales of comparable assets, or other reliable information. Professional assistance may be helpful, but is not required.

29. Q—Does Statement 34 prescribe a minimum level for the capitalization of assets?

A—No. However, subparagraph 115e requires disclosure of the capitalization policy—the dollar value above which asset acquisitions are added to the capital asset accounts. Different types of assets, subsystems, or networks may have different capitalization policies. Additionally, different thresholds may be set for management control purposes or for compliance with laws and regulations.

Capitalization of Interest

30. Q—Does the requirement in paragraph 18, to include construction period interest as a component of historical cost of capital assets, apply to all *general governmental* capital assets?

A—As stated in paragraph 17, governments should apply FASB standards issued on or before November 30, 1989 (unless they conflict with or contradict GASB standards) to governmental activities in the government-wide statements. The GASB recently added a project to its technical agenda that may readdress the applicability of capitalized interest standards to general governmental capital assets.

31. Q—When capitalization of interest is required, what provisions should be considered?

A—FASB Statement No. 34, *Capitalization of Interest Cost*, as amended, establishes the requirements for capitalizing construction period interest. Paragraphs 9 and 10 of FASB Statement 34 describe the types of capital assets for which capitalizing interest is required. References from those paragraphs that appear to have applicability for *general governmental* capital assets, follow (italics added):

9. . . . Interest *shall be capitalized* for the following types of assets (“qualifying assets”):

a. Assets that are constructed or otherwise produced for an enterprise’s own use . . .

10. . . . In addition, interest *shall not be capitalized* for the following types of assets:

a. Assets that are in use or ready for their intended use in the earning activities of the enterprise

b. Assets that are not being used in the earning activities of the enterprise and that are not undergoing the activities necessary to get them ready for use.

FASB Statement No. 62, *Capitalization of Interest Cost in Situations Involving Certain Tax-Exempt Borrowings and Certain Gifts and Grants*, adds the following to paragraph 10:

f. Assets acquired with gifts and grants that are restricted by the donor or grantor to acquisition of those assets to the extent that funds are available from such gifts and grants. . . .

When construction-period interest has been capitalized, governments should disclose in the notes to the financial statements the total amount of interest expense for the period and the amount thereof that has been capitalized. (See Q114 about other interest expense disclosures.)

Presentation in Statement of Net Assets

32. Q—Should construction in progress be included in capital assets?

A—Yes. Construction in progress should be included with capital assets in the statement of net assets. It should be reported with other assets not being depreciated, such as land, land improvements, and infrastructure accounted for using the modified approach. (See Q34 about presentation of capital assets on the statement of net assets, and see Q232 for note disclosure requirements related to capital assets.)

33. Q—How should accumulated depreciation be reported on the statement of net assets?

A—Accumulated depreciation may be netted against capital assets or may be reported separately. Regardless of the presentation in the statement of net assets, the notes to the financial statements should disclose accumulated depreciation separately in addition to changes in accumulated depreciation as described in Q232.

34. Q—Are assets not being depreciated—such as land, construction in progress, and infrastructure assets reported using the modified approach (see Q53)—required to be displayed separately from depreciable assets in the statement of net assets?

A—Yes. Capital assets not being depreciated should be reported separately from capital assets being depreciated.

35. Q—A county has determined that a portion of the cost of a road improvement project includes nondepreciable land improvements, such as removal of existing structures and excavation. Are these costs required to be reported separately from the depreciable costs of the project?

A—Yes. The portion of the cost attributable to nondepreciable land improvements (see Q25) should be reported with other assets not being depreciated, such as land and infrastructure accounted for using the modified approach.

Reporting Infrastructure Assets

36. Q—What are infrastructure assets?

A—Infrastructure assets are long-lived capital assets that normally can be preserved for a significantly greater number of years than most capital assets and that normally are stationary in nature (paragraph 19). Examples of infrastructure assets include roads, bridges, tunnels, drainage systems, water and sewer systems, dams, and street lighting systems. Buildings, except those that are an ancillary part of a network of infrastructure assets, should not be considered infrastructure assets.

37. Q—What are examples of the types of buildings that may be an ancillary part of a network or subsystem?

A—Rest area facilities associated with a turnpike, road maintenance structures such as shops and garages associated with a highway system, and water pumping buildings associated with water systems are examples.

38. Q—What is the difference between a network and a subsystem?

A—A network is composed of all assets that provide a particular type of service for a government. A subsystem is composed of all assets that make up a portion or segment of a network. For example, a water distribution system of a government could be considered a network. Pumping stations, storage facilities, and distribution mains could be considered subsystems of that network. Airport pavements could also be considered a network, with runways, taxiways, and aprons considered as subsystems. Another example of a network is a storm sewer system, with catch basins, storm drains, and inlets considered as subsystems.

39. Q—May a network or a subsystem consist of dissimilar items?

A—Yes. A government may account for dissimilar assets in networks or subsystems. The government may account for any of its capital assets in groupings that best suit its needs. For example, a road network could consist of pavements, traffic control devices, and signage.

40. Q—Should capital projects that mitigate the environmental impact of other *previously constructed* capital projects (for example, noise abatement walls along highways, storm water remediation, and roadside beautification projects) be expensed in the period incurred or be reported as infrastructure assets?

A—If such projects result in assets that are used in operations, have long useful lives, are normally stationary, and normally can be preserved for a long period of years, they should be capitalized as infrastructure assets.

41. **Q**—If a road is being depreciated, how should the cost of a project to remove and replace or to resurface the road be reported?

A—If the project is considered maintenance—a recurring cost that does not extend the road’s original useful life or expand its capacity—the cost of the project should be expensed. On the other hand, if the project increases the serviceability—increases load capacity, for example—or extends the original useful life of the road, the project should be capitalized. In that case, the cost of the replaced roadway surface and its associated accumulated depreciation should be removed. (See Q60 about removing and replacing or resurfacing roads that are reported under the modified approach.)

42. **Q**—When infrastructure assets are sold or otherwise disposed of, how is a gain or loss calculated for the statement of activities?

A—Gain or loss would be calculated in the same manner as for other capital assets. The net book value of the infrastructure asset would be subtracted from the net amount realized from the sale or disposal. If the infrastructure asset was being depreciated, its net book value would be its historical cost or estimated historical cost less accumulated depreciation. If the modified approach was being used, its net book value would be historical cost or estimated historical cost. (See Q52 about removing assets that were depreciated using a composite method and Q131 about how to report the gain or loss in the statement of activities.)

Calculating Depreciation

43. **Q**—Should depreciation be calculated for each individual asset?

A—Depreciation of individual assets is not required. Depreciation may be calculated for a class of assets, a network of assets, a subsystem of a network, or individual assets.

44. **Q**—What are examples of “any established depreciation method”?

A—Any rational and systematic method may be used. Some of the common categories of depreciation methods include:

- The straight-line method
- Decreasing-charge methods, which include declining balance, double-declining balance, and sum-of-the-years’-digits, among others
- Increasing-charge methods, which include sinking fund and annuity methods
- Unit of production/service methods which allocate the depreciable cost of an asset over its expected output.

45. **Q**—How is the residual value of a capital asset (including infrastructure) determined?

A—Residual value is the estimated fair value of a capital asset, infrastructure or otherwise, remaining at the conclusion of its estimated useful life. In most cases, it is probable that many infrastructure assets will have no residual value, given the cost of demolition or removal.

46. **Q**—Are land improvements depreciable?

A—Improvements that produce permanent benefits—for example, fill and grading costs that ready land for the erection of structures and landscaping—are not depreciable. Alternatively, improvements that are considered part of a structure or that deteriorate with use or the passage of time, such as parking lots and fencing, should be considered depreciable. (See Q25.)

Calculating estimated useful lives

47. Q—How is estimated useful life calculated?

A—In determining estimated useful life, a government should consider an asset's present condition, use of the asset, construction type, maintenance policy, and how long it is expected to meet service and technology demands. Useful lives should be based upon the government's own experience and plans for the assets. Although comparison with other governments or other organizations may provide some guidance, property management practices, asset usage, and other variables (such as weather) may vary significantly between governments.

48. Q—Is there a recommended schedule of useful lives?

A—No. The GASB does not recommend a specific schedule. Schedules of useful lives recommended by professional organizations may be a helpful starting point. However, schedules of depreciable lives established by federal or state tax regulations are generally not intended to represent useful lives.

49. Q—What are sources of useful life information?

A—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. Examples of internal information include property replacement policies for equipment or vehicles, property disposal records, and budget documents.

50. Q—Once a depreciable asset's useful life is estimated, is it ever necessary to review the estimate in later years?

A—Yes. Because depreciation is a method of allocating an asset's cost over its useful life, a periodic review of this useful life is necessary for depreciation to reflect that allocation. Any change in useful life is applied prospectively in accordance with paragraph 10 of APB Opinion No. 20, *Accounting Changes*. As many factors may affect the useful life of an asset, periodic reassessment of estimated useful lives may be appropriate. For example, equipment may not be replaced according to property management policies if appropriations for the replacement costs are not made. Planned preventative maintenance may not be performed, resulting in a reduction in the useful life of an asset. The use of the asset may have changed, or the asset may have been damaged or impaired by weather or other circumstances.

Composite methods

51. Q—What are composite depreciation methods? Is composite depreciation similar to group depreciation?

A—Composite depreciation refers to calculating depreciation for a collection of dissimilar assets, such as all assets composing a transportation network or a building. Group depreciation refers to calculating depreciation for a collection of similar assets, such as traffic signals or lane-miles of pavement of a road system. There is no distinction between composite and group depreciation in the method of accounting. A single composite depreciation rate is applied annually to the acquisition cost of the collection as a whole. This composite rate may be calculated in different ways, a few of which are illustrated in Exercise #1 in Appendix 4. The estimated life for the group may be based upon the weighted average or simple average of the useful lives of the assets in the group or upon assessment of the life of the group as a whole. The depreciation rate may be based upon any established depreciation method.

52. Q—A government reports its rural secondary roads as a subsystem. This subsystem includes traffic control devices, signs, lighting, roadway subsurface foundations, roadway surfaces, and bridges with a span of 50 feet or less. Depreciation is calculated on a composite basis for the entire subsystem. What is the effect on capital asset balances when a major length of roadway is removed and replaced?

A—Composite depreciation assumes that all assets are retired at the end of their useful lives, and therefore no gain or loss is recorded. The cost of the replaced road would be removed from both the capital asset account and the accumulated depreciation account. Cost methods commonly used with composite depreciation include average cost, first in-first-out, and specific identification. The replacement roadway would be added to the capital account of the composite group and be depreciated using the composite rate. (See Exercise #2 in Appendix 4 for an example of journal entries for assets accounted for using the composite depreciation method.)

Modified Approach

53. Q—What is the modified approach for reporting infrastructure assets?

A—The modified approach is an alternative to depreciation that may be applied for eligible infrastructure capital assets (see Q54) that meet two requirements. First, the assets should be managed using an asset management system that meets the criteria in paragraph 23. Second, the government should document that the assets are being preserved at or above a condition level established by the government as required by paragraph 24. Under the modified approach, depreciation expense is not recorded for these assets. Rather, costs for both maintenance and preservation of these assets should be expensed in the period incurred. Additions and improvements, on the other hand, are capitalized. (See Exhibit 14 in Appendix 3 for an illustration of the information required to be presented as RSI for eligible infrastructure assets reported using the modified approach.)

54. Q—What is meant by “*eligible* infrastructure assets” referred to in Q53?

A—Eligible infrastructure assets are those that compose either a network or a subsystem. (See Q38.) Therefore, if used, the modified approach should be applied to *all* assets within the selected network or subsystem.

55. Q—Can governments use the modified approach for eligible infrastructure assets reported in an enterprise fund?

A—Yes. The modified approach is not limited to general infrastructure assets—that is, infrastructure assets associated with governmental activities. Eligible infrastructure assets of enterprise funds that were previously depreciated may also be reported using the modified approach. This permits similar assets (for example, all roads, including toll highways) to be reported using the same approach regardless of whether the assets are reported as a governmental or a business-type activity. The assets would be reported using the same approach in both the enterprise fund and government-wide statements.

56. Q—May one agency or department select the modified approach and another select depreciation accounting?

A—The selection of the modified approach is made individually for each subsystem or network of infrastructure assets. However, if agencies or departments report parts of the same network or subsystem, the same approach should be applied by both.

Costs expensed versus costs capitalized

57. Q—Under the modified approach, costs for both maintenance and preservation of an asset should be expensed in the period incurred. Is this treatment different from traditional depreciation?

A—Yes. Maintenance costs allow an asset to continue to be used during its originally established useful life. Maintenance costs are expensed in the period incurred, regardless of the method of accounting for the asset. Preservation costs extend the useful life of an asset beyond its previously established useful life. Preservation costs are capitalized and depreciated if the asset is accounted for using traditional depreciation, but are expensed in the period incurred if the asset is accounted for using the modified approach.

	Modified Approach	Depreciation
Maintenance costs	Expense	Expense
Preservation costs (see Q58)	Expense	Capitalize
Additions and improvements	Capitalize	Capitalize

58. Q—What are “preservation” costs?

A—Although the term is not defined in Statement 34, “preservation” costs generally are considered to be those outlays that extend the useful life of an asset beyond its original estimated useful life, but do not increase the capacity or efficiency of the asset. (See Q57 for discussion of accounting for preservation costs.)

59. Q—A road reported using the modified approach undergoes a major reconstruction. As with most reconstruction efforts, the project consists of preserving the existing road as well as making additions and improvements. Should the cost of the project be expensed or capitalized?

A—The cost of preserving the existing road should be expensed, and the cost of the additions and improvements should be capitalized. Any reasonable approach may be used to estimate the capitalizable and noncapitalizable portions of the project.

60. Q—Should the cost of removing and replacing or resurfacing an existing roadway be capitalized if the modified approach is used?

A—Under the modified approach, maintenance and preservation costs are expensed in the current period. However, if the project also increases the roadway’s capacity or efficiency (see Q61), such as lane widening or alignment improvements that permit speed limits to be raised, the portion of costs associated with the increased capacity or efficiency should be estimated and capitalized. (See Q41 about removing and replacing or resurfacing roads that are being depreciated.)

61. Q—What constitutes a change in capacity or efficiency?

A—A change in capacity increases the level of service provided by an asset. For example, additional lanes could be added to a road or the weight capacity could be increased. A change in efficiency maintains the same service level, but at a lower cost. For example, an electric generating plant could be reengineered so that it produces the same megawatts per day using less fuel.

No longer permitted to use the modified approach

62. Q—When is a government no longer permitted to use the modified approach for its infrastructure assets?

A—The determination of whether the modified approach may be used is made on a network-by-network or subsystem-by-subsystem basis. A government may no longer use the modified approach for the eligible infrastructure asset if it fails to meet the requirements of paragraphs 23 and 24 for that asset. Reasons could include failure to perform a replicable condition assessment at least every three years, failure to document the condition assessment, a condition assessment that demonstrates that the asset was not maintained approximately at or above the condition level established by the government, and failure to estimate the annual amount needed to maintain and preserve the asset.

63. Q—If a government is not permitted to continue to use the modified approach because the infrastructure assets no longer meet the requirements of paragraphs 23 and 24, in what year is the change to the traditional depreciation approach reported? How is the change reported?

A—Depreciation of the infrastructure assets would begin in the year subsequent to the year that the requirements to use the modified approach are not met. This change would be accounted for prospectively as a change in accounting estimate, as provided for in footnote 21 to paragraph 26. Application of the modified approach essentially equates to the estimation of a useful life of such length that the amount of annual depreciation is insignificant. Therefore, a change in the estimated useful life from almost infinite to a shorter, finite life over which depreciation will be recorded should be reported as a change in estimate. The useful life and residual value of the asset would be estimated and a depreciation method selected at the conversion date. The historical cost of the asset would be depreciated over the period from the cessation of the modified approach through the end of the remaining life of the asset.

64. Q—A government performs condition assessments on a three-year cyclical basis and the condition assessment from the second year shows that the condition is significantly below the level established by the government. Is the government required to stop reporting based on the modified approach and begin depreciating the assets?

A—No. The determination of whether the requirements to use the modified approach have been met is made at the conclusion of a condition assessment cycle (footnote 19).

65. Q—A government has maintained its infrastructure assets above the government's established condition level. Because of the consequences of a major storm in the final year of the three-year assessment cycle, the actual condition level no longer meets or exceeds the condition level established by the government. May the government continue to use the modified approach?

A—The answer depends upon a number of factors. If a government is unable to document that the infrastructure assets are being preserved approximately at (or above) the condition level established by management, the modified approach should *not* continue to be applied. The documentation of condition level includes the results of the *three* most recent complete condition assessments. In the example cited, the government should consider the results of its three most recent complete condition assessments—nine years of data if assessments have been performed using three-year assessment cycles—and should apply professional judgment to ascertain whether the modified approach should continue to be applied. Additionally, a government may reevaluate the condition level appropriate for the infrastructure assets based upon additional information and experience and, through appropriate administrative or executive policy or by legislative action, may lower the condition

level. If the documented condition level meets or exceeds the revised condition level, the modified approach may be continued. The change in the established condition level and the effect of the change on the estimated annual amount to maintain and preserve the infrastructure assets should be disclosed as RSI. (See Q255 and Q256.)

Asset management systems

66. Q—What are the minimum requirements of an asset management system?

A—Paragraph 23 provides that an asset management system should:

- Report an up-to-date inventory of eligible infrastructure assets
- Perform and document replicable condition assessments of the eligible infrastructure assets and summarize the results using a measurement scale
- Estimate each year the annual amount to maintain and preserve the eligible infrastructure assets at the condition level established and disclosed by the government.

67. Q—An asset management system should include an up-to-date inventory. Would that require each road sign, light pole, and traffic signal to be tagged and inventoried annually?

A—No. The level of detail in the asset management system is determined by the capitalization policies selected and implemented by the government. (See also Q29 about capitalization policies.) Capital assets may be recorded at the class, network, subsystem, or individual asset level. The following possibilities describe some of the alternatives:

- All of the roads of a government could be capitalized collectively as the road network.
- A government could record its roads at the subsystem level by considering interstate highways, state highways, and rural roads each as separate subsystems.
- Roads could be recorded as subsystems consisting of different geographic regions.
- Roads could be recorded as subsystems consisting of the major components of a road—for example, roadbed, overlay, curbs and gutters, lighting, traffic signals, signage.
- A government may capitalize one type of infrastructure asset at the network level and capitalize other infrastructure assets at the subsystem or even the individual asset level.
- If a government decided that a greater level of detail was needed for internal management purposes, it could select a lower capitalization threshold for management control, which would not be reflected in the financial statements.

68. Q—According to Statement 34, are there minimum training requirements for staff that carry out the functions of an asset management system?

A—No. However, the condition assessment performed as part of the asset management system should be based on sufficiently understandable and complete measurement methods such that different measurers using the same methods would reach substantially similar results.

69. Q—There are numerous asset management systems. Have any asset management systems been sanctioned as meeting the minimum characteristics to support the modified approach?

A—No. However, the specified minimum characteristics that an asset management system should exhibit in order to support use of the modified approach, as noted in Q66, should be met.

Condition level and assessment

70. Q—Is there a *minimum* condition level at which a government should preserve its infrastructure assets in order to apply the modified approach?

A—Statement 34 does not establish a minimum condition level. However, this level should be established in a formal, documented manner through appropriate administrative or executive policy, or by legislative action. This level and any subsequent changes to the established level should be disclosed annually in the notes to RSI.

71. Q—Who establishes the condition level of an infrastructure asset?

A—The government reporting the subsystem or network of infrastructure assets sets the condition level. This decision should be documented by administrative or executive policy or by legislative action and be disclosed in the notes to RSI. For example, a capital budget prepared by the executive branch and approved by the legislative branch could be used to document the established condition level.

72. Q—May established condition levels for a network or subsystem consist of multiple elements?

A—Yes. A government may, for example, establish its condition level such that a certain proportion of the asset—85 percent of lane-miles—should exceed an upper-end condition level—an International Roughness Index of 4 (surface imperfections). At the same time the policy could indicate that a different proportion—10 percent of lane-miles—should not fall below a low-end condition level—International Roughness Index of 6 (frequent minor depressions). (See also Appendix 3, Exhibit 14, for another example of a condition level with multiple elements.)

73. Q—What is a *complete* condition assessment? Does that refer to an assessment of all components of the network or subsystem?

A—A complete condition assessment measures the collective condition of assets within a network or subsystem. The assessment may be performed using statistical or other samples that are representative of the eligible infrastructure assets for the condition measurement established by the government.

74. Q—Does Statement 34 require governments to use the same condition assessment measures?

A—No. One government, for example, may select road smoothness as its condition measurement for its roads. Another government may select a measurement of distresses on the pavement. Yet, another government may select a measurement that reflects both of these aspects of a road. Any of these condition assessment measures is acceptable.

75. Q—May a government establish multiple methods of assessing condition for an individual network or subsystem?

A—No. However, a government may use different methods for different networks or for different subsystems within a network.

Reporting Works of Art and Historical Treasures

76. Q—Are monuments considered “noncapitalizable works of art, historical treasures, or similar assets”?

A—Monuments are capital assets that may qualify as works of art, historical treasures, or similar assets if they meet the requirements of paragraph 27.

77. Q—Should the organizational policy referred to in paragraph 27c be a formal policy?

A—Statement 34 does not require this to be a formal policy; however, there should be some evidence to support the existence of the policy.

78. Q—If an organization at the time of the passage of Statement 34 has had capitalized collections, may it de-recognize the collection according to paragraph 27?

A—No. Collections capitalized prior to passage of Statement 34 should continue to be reported (footnote 22), and additions to the collections should be capitalized.

79. Q—A government has multiple collections, works of art, and historical treasures. Should the recognition provisions of paragraph 27 be applied for the entire entity or on a collection-by-collection basis?

A—The provisions of paragraph 27 may be applied on a collection-by-collection basis.

80. Q—What is meant by “inexhaustible” collections or individual works of art or historical treasures?

A—Inexhaustible collections or individual works of art or historical treasures are those with extraordinarily long useful lives. Because of their cultural, aesthetic, or historical value, the holder of the asset (or assets) applies efforts to protect and preserve the asset in a manner greater than that for similar assets without such cultural, aesthetic, or historical value.

Statement of Net Assets

81. Q—Can the statement of net assets be presented in a classified format, similar to what is required for enterprise funds?

A—Yes. Governments are *encouraged* to present assets and liabilities in order of their relative liquidity but may, instead, use the classified format, which distinguishes between all current and long-term assets and liabilities. Exhibit 1 in Appendix 3 illustrates a classified format.

82. Q—If the “order of liquidity” approach is used in the statement of net assets, where should *restricted assets* be reported?

A—Paragraph 31 indicates that an asset’s *liquidity* is affected by restrictions that may limit the government’s ability to use it. If the restrictions are short-lived—for example, cash that is held in a bond and interest reserve account that is required to be used to pay current maturities—the cash could be reported with unrestricted cash. On the other hand, if the conditions underlying the restrictions are such that they will not be met in the short or medium term, restricted assets would be reported lower in the statement of net assets. Permanently restricted resources, for example, are essentially as illiquid as capital assets. Term restrictions may indicate that the assets should be reported at approximately the same liquidity level as long-term receivables, depending on the length of the restrictions. (See Q209 about how to report restricted assets using a “classified” approach.)

83. Q—Paragraphs 31 and 119c require governments to report and disclose the portion of compensated absences that is “due within one year of the statement date.” How should governments determine when compensated absences are “due”?

A—Compensated absences liabilities become “due” upon the occurrence of relevant events such as resignations, retirements, and uses of leave balances by covered employees. Because these occurrences and related dollar amounts generally cannot be known reliably in advance, the portion of compensated absences due within

one year should be estimated. The estimate could be based on such factors as historical trends or budgeted amounts and may be affected by other factors including the government's policy regarding whether unused amounts from prior years must be used before amounts earned in the current period.

84. Q—If a government reports a liability for a net pension obligation (NPO) in its government-wide statement of net assets, how is the “amount due within one year” determined?

A—The nature of an NPO is such that there is no amount that is “due” within one year, and therefore, the entire amount should be reported as a long-term liability. The NPO affects the actuarial calculation of future annual required contributions and thus does not represent a liability that is subject to a payment schedule with current and noncurrent installments.

85. Q—What are the requirements and limitations for reporting the difference between assets and liabilities in the government-wide statement of net assets?

A—The difference between a government's assets and its liabilities is its *net assets*. Terms such as *equity*, *net worth*, or *fund balance* should not be used in the statement of 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*. Designations (of fund balances) should not be reported on the face of the statement of net assets.

86. Q—Paragraph 32 requires that net assets be reported in three components. (See Q85.) That paragraph and paragraph 35 also set forth reporting requirements for supporting details of restricted net assets. Can those details (major categories, expendable/nonexpendable) be provided in the notes?

A—No. Paragraphs 32 and 35 both state that the information *should be displayed*; therefore, disclosure is not an option. (See Q94 about disclosing unrestricted net asset details that are *not* required.)

87. Q—A government accrues and reports a long-term liability for accretion of interest on deep-discount (capital appreciation) debt that was issued for capital purposes. Which component of net assets should be reduced by the liability?

A—Accrued interest on deep-discount capital debt generally should be included in the computation of the *invested in capital assets, net of related debt* component of net assets. However, if the government has established a “sinking” fund to accumulate cash to pay off the debt at maturity, the accrued interest would be included in (reduce) the same component of net assets as the sinking fund resources.

Net Assets Invested in Capital Assets, Net of Related Debt

88. Q—In which component of net assets should *capital* assets with externally imposed restrictions (for example, federal surplus property) be reported?

A—All capital assets, including those that are subject to restrictions, should be included in the *invested in capital assets, net of related debt* component of net assets. The requirement to segregate restricted and unrestricted net assets was established primarily to provide information about the availability of *financial* resources.

89. Q—A government issues bonds late in the year to purchase capital assets. The proceeds are received, but no capital assets have been purchased as of the balance sheet date. Which net asset component should include the debt?

A—Paragraph 33 states that, 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*. Therefore, if no capital assets have been purchased or constructed from the debt proceeds, the entire amount of the debt would reduce *net assets restricted for capital projects*. If some capital assets have been purchased or constructed from the debt proceeds, that portion of the debt would be considered “capital-related.” The remainder—the unspent portion of the debt—would be included in the calculation of *net assets restricted for capital projects*. Generally, the effect on net assets will be negligible—restricted cash will approximate related debt outstanding. Reporting both within the same classification of net assets prevents one classification from being overstated while another is understated by a similar amount.

90. Q—How is the “unspent portion” of capital debt proceeds determined?

A—The precision with which the unspent proceeds can be determined depends on the government’s accounting records. Most governments are required to, or choose to, account for bond issues separately—either in separate funds or in an account or memorandum fashion in a multipurpose fund—and can identify what has been spent and what remains. Those governments whose accounting systems do not lend themselves to that type of specific tracking should use their best estimates—in a manner that can be documented—to determine the unspent portion.

91. Q—Often, debt is issued for capital purposes, but some of the proceeds are spent for assets that are not capitalized. Should some of the debt be removed from the *invested in capital assets, net of related debt* component of net assets?

A—Governments are not expected to categorize all uses of bond proceeds to determine how much of the debt actually relates to assets that have been capitalized. Unless a significant portion of the debt proceeds is spent for noncapitalizable purposes, the entire amount could be considered “capital-related.”

92. Q—If debt is issued to refund existing capital-related debt, is the new debt also considered capital-related?

A—Yes. Even though the direct connection between the capital assets and the debt issued to finance the construction or acquisition has been eliminated, the replacement debt assumes the capital characteristics of the original issue.

93. Q—If a government has capital assets, but no related debt, should the net asset account be titled “invested in capital assets”?

A—Yes. The net asset title “invested in capital assets, net of related debt” denotes that there is capital debt and may mislead readers if used when there is no debt.

94. Q—A general purpose government issues bonds to construct school buildings for the independent school districts within its geographic boundaries. The bonds are a liability of the issuing government, but the buildings will be reported as capital assets of the respective school districts. Which component of the government’s net assets should be reduced by the long-term debt?

A—The issuing government acquires no capital assets; therefore, the debt is not “capital-related.” The effect of the noncapital debt should be reflected in the *unrestricted net assets* component of the government’s net assets. The fact that the bonds are related to capital assets of another entity does not make the debt “capital” debt of the issuing government—even though the assets acquired may benefit its residents. The government has incurred a liability, decreasing its net assets, with no corresponding increase in its capital or financial assets. The effect on the government’s total net assets should be the same regardless of whether it (1) gave the school districts cash from existing resources, (2) constructed the buildings and donated them to the schools, or (3) issued debt to finance the construction. In all three instances, the government has decreased its net assets.

If the effect on unrestricted net assets is significant, the government may disclose additional details of unrestricted net assets in the notes to the financial statements to isolate the effect of debt issued for others.

Restricted Net Assets

95. Q—When should net assets be reported as “restricted”?

A—Restricted net assets, as defined in paragraph 34, should be reported 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.

The basic concept is that restrictions are not unilaterally established by the reporting government itself, and cannot be removed without the consent of those imposing the restrictions or through formal due process.

The definition of *restricted* in paragraph 34 is intended to identify resources that were received or earned by the government with an explicit understanding between the government and the resource providers that the funds would be used for a specific purpose. For example, grants, contributions, and donations are often given under those kinds of conditions. Bond indentures similarly limit the use of proceeds.

96. Q—Net assets may be restricted by virtue of “enabling legislation,” which restricts resources to be used “only for the specific purpose stipulated in the legislation.” Should all special revenue fund balances be included in restricted net assets in the government-wide statement of net assets?

A—No. Even though that reference in the definition of enabling legislation appears similar to the definition of a special revenue fund in NCGA Statement 1, *Governmental Accounting and Financial Reporting Principles*, paragraph 26 (“legally restricted to expenditure for specified purposes”), the use of a special revenue fund is not limited to “legally restricted” resources. NCGA Statement 1, paragraph 23, states that funds may also be created by the governing body to achieve sound and expeditious financial administration and reporting or to comply with grant or contract accounting and financial reporting requirements. Thus, in practice, many governments use special revenue funds for purposes that would not meet the definition of *restricted* in paragraph 34.

97. Q—How precise should the specific purpose be for resources to be considered *restricted* in the statement of net assets?

A—The purpose can run the gamut from broad to narrow and still be considered “restricted,” as long as the restrictions meet the definition in paragraph 34—provided that the purpose is narrower than that of the reporting unit in which it is reported. For instance, resources that are required to be used for “governmental activities” are not considered “restricted” in the governmental activities column in the statement of net assets, but those that are required to be used for fire protection, for example, would be considered restricted. (See Q200 about reserves and restrictions.)

98. Q—Generally, when permanent endowments are mentioned in Statement 34, the discussion also includes term endowments. (See paragraphs 53, 100, 101, and 103, for example.) However, paragraph 35 states that when permanent endowments or permanent fund principal amounts are included, “restricted net assets” should be displayed in two additional components—expendable and nonexpendable. Does this display requirement also apply to *term* endowments?

A—No. The objective of the requirement in paragraph 35 is to identify net assets that *cannot be spent*. Term endowments may “currently” be nonexpendable, but at some point in the future (when the term expires) they will become expendable. Thus, the requirement in paragraph 35 applies only when the unavailability of net assets is *permanent*.

99. Q—Does the restricted component of net assets represent only restricted assets, or do liabilities *related to those assets* affect the balance?

A—The restricted component of net assets represents restricted assets reduced by liabilities related to those assets. (Exercise #3 in Appendix 4 illustrates the calculation of net asset balances for governmental activities.)

100. Q—A state legislature passes a law to “earmark” a percentage of the state’s sales tax revenues for a specific purpose. Does this action constitute “enabling legislation” that would restrict those net assets in the state’s financial statements?

A—No. “Earmarking” an existing revenue is not equivalent to enabling legislation. The state legislature’s action constitutes a designation (management’s intent) rather than a restriction for financial reporting purposes. The limitations are internally imposed and thus are subject to change at the discretion of the legislature.

The enabling legislation part of the definition in paragraph 34 covers situations when the government passes a law that gives them the ability to levy a tax or otherwise raise revenues, and *in that law*, the government commits to using those resources for a particular purpose. That arrangement is tantamount to a legally binding agreement between the government and the resource providers (the taxpayers) establishing limitations on how those funds can be used. The government generally cannot unilaterally decide to do something else with those resources. This is different from situations when a government passes a law that says existing resources are restricted to a specific purpose or “earmarks” a portion of an existing revenue source. In those two situations the government does not obtain funds under restrictive conditions; thus, the limitations imposed indicate designations, not restrictions. (See Q125 through Q127 about reporting restricted general revenues.)

Unrestricted Net Assets

101. Q—Which component of net assets should include an equity interest in a joint venture?

A—An equity interest in a joint venture that is reported as an asset in the government-wide statement of net assets (or as an asset of an enterprise *fund*) should be included in the computation of unrestricted net assets. An equity interest in a joint venture is generally not “restricted,” as defined in paragraph 34, nor is it a “capital” asset, even though it may represent equity primarily in capital assets of the joint venture. (See Q199 about governmental fund reporting.)

102. Q—Are there specific criteria that should be considered in determining whether net assets are unrestricted?

A—No. Unrestricted net assets is the “residual” component of net assets. It consists of net assets that do not meet the definition of “restricted” or “invested in capital assets, net of related debt.”

Statement of Activities

103. Q—What is the minimum level of detail that is required to be reported as functions or programs in the statement of activities? Does this level need to be as detailed as the fund financial statements?

A—The statement of activities has a “program” focus, and governments are encouraged to report their activities at the program level, whenever practical. Paragraph 39 establishes the *minimum* levels of reporting for both governmental and business-type activities. *Governmental* activities should be presented 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*, as discussed in NCGA Statement 1, paragraphs 111 through 116. *Business-type* activities should be presented at least by *segment*, as discussed in paragraph 122. (See Q104 and Q235.) The statement of activities requirements are tied to the fund reporting *minimum requirements*, rather than what is actually displayed in the fund financial statements; thus, governments can provide additional details for fund financial statements without also having to do so for the statement of activities.

104. Q—Based on the definition in paragraph 122, a government is required to disclose information about numerous “segments.” Would it be allowable to group related segments together as a single “function” in the statement of activities?

A—Yes. It would be allowable to group common segments for the statement of activities—for example, the separate residence halls discussed in Q236 would qualify as common segments within a single function. (Nevertheless, the *disclosures* required by paragraph 122 would still be presented for each segment.) The primary objective of the segment disclosure requirement in paragraph 122 is to provide information about pledged revenues and related expenses. That objective is met in the required disclosures. The basis for establishing “segments” as the minimum requirement in the statement of activities is to identify *different activities* accounted for in a multipurpose fund that should be reported separately in the statement of activities—for example, water and electric operations accounted for in a single fund. In the case of the separate residence halls in Q236, the segments do not represent different activities; therefore, it would not be contrary to the objective of the statement of activities to combine them.

Expenses

Direct, indirect, and overhead expenses

105. *Q*—If the minimum requirement, as set forth in paragraph 41, is to report direct expenses by function, how should expenses that are, by nature, *not* direct be reported?

A—The “direct” expenses of some “overhead” functions—general government, support services, administration, and interest on indebtedness, for example—are, in essence, the “indirect” expenses that could be allocated to the other functions. As explained in paragraph 42, governments are not required to allocate those indirect expenses to other functions, but may report them as “direct” expenses of an “overhead”-type function.

106. *Q*—The illustrative statement of activities in Exhibit 2 of Appendix 3 presents a separate column to report the allocation of indirect expenses to governmental activities. Is indirect expense allocation limited to governmental activities, or can it also be extended to business-type activities?

A—Indirect expenses can be allocated to any of the primary government’s functions or programs. Although there are no standards, there should be a reasonable basis for expense allocations to specific functions. In Exhibit 2, for example, there would likely be no basis for allocating interest on long-term debt to the business-type activities. On the other hand, the indirect expenses in the “general government” functional category may be allocable to both governmental and business-type activities. However, making allocations that cross the governmental/business-type activities boundary would affect the net assets and changes in net assets of both types of activities. As a result, the allocation would necessitate an adjustment to the internal balances of each activity and create an additional difference that should be explained in the reconciliations.

Depreciation expense

107. *Q*—In determining whether to charge depreciation as a direct expense of a government’s functions, what is the difference between a “shared” capital asset and one that “essentially serves all functions”?

A—The difference is generally in the number of functions that *share* the asset. As the number of functions increases, the ease, practicality, and usefulness of assigning depreciation to those functions decreases. Therefore, depreciation of assets that serve many, or “essentially all,” functions is not required to be included in the direct expenses of those many functions. A shared capital asset is generally used by only a few functions, and its use can be specifically identified to those functions. Usage of a shared asset is generally such that an objective measurement can be made for the assignment of costs—based on square footage for a building or mileage for a vehicle, for example.

108. *Q*—Should depreciation be charged to specific functions or programs in the government-wide statements?

A—Depreciation expense for the following types of capital assets is required to be included in the direct expenses of functions or programs:

- Capital assets that can be specifically identified with a function or program
- “Shared” capital assets (for example, a facility that houses the police department, the building inspection office, and the water utility office).

Depreciation expense for capital assets that essentially serve all functions, such as a city hall or a state administrative office building, may be:

- Included in an indirect expense allocation (optional) to the various functions or programs (Appendix 3, Exhibit 2)
- Reported as a separate line in the statement of activities; however, the account title should make the reader aware that it does not include all depreciation (for example, “unallocated depreciation”) (Appendix 2, Exhibits 21 and 33)
- Reported as part of the “general government” (or its counterpart) function (Appendix 2, Exhibit 2).

Depreciation expense for infrastructure assets associated with governmental activities should be reported as either:

- A direct expense of the function (for example, public works or transportation) that is normally used for capital outlays for and maintenance of infrastructure assets (Appendix 2, Exhibit 2)
- A separate line in the statement of activities (again noting the extent of the depreciation expense presented) (Appendix 2, Exhibits 21 and 33).

109. *Q*—When initially adopting GAAP financial reporting, some governments recorded a group of capital assets collectively, such as all general capital assets acquired prior to July 1, 1980. Can the depreciation on these assets be reported as a separate line in the statement of activities?

A—No. Although this group of general capital assets, collectively, serves several functions, the individual assets within the group serve different functions. Reporting all costs of a function or program, including costs of capital assets, enhances the usefulness of the statement of activities. The depreciation on general capital assets grouped in this manner should be allocated to the appropriate functions.

110. *Q*—Paragraph 44 states that 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. What are the alternatives for *clearly indicating* this notice on the face of the statement?

A—There are two ways that the information can be presented on the face of the statement. The line item description itself can include the notice “Depreciation expense not included in other functions” or “Unallocated depreciation,” for example. The other method is to cross-reference the line item description to a notation on the same page that provides the notice. For example, the expense line could simply be titled “Depreciation,*” with the asterisk referencing a description at the bottom of the page that states, “This amount does not include the depreciation that is included in the direct expenses of the various programs.” In either case, it would be useful to refer the reader to the note disclosure required by paragraph 117 that provides the details of the amounts charged to each of the functions.

Interest expense

111. *Q*—A government obtains a bank loan for noncapital purposes and uses the proceeds for a particular program. Should the interest on the loan be included in the direct expenses of the program?

A—No. Even though the interest can be tied directly to a specific program, it should not be included in the direct expenses of that program, but rather should be included with other interest expense in the separate “Interest” line item. (See Q114.) As explained in paragraph 364 of the Basis for Conclusions, borrowing is a financing

decision that involves government-wide considerations. If the government borrows for program A and pays cash for similar purposes in program B, that is a management decision about *financing* but is not an indication that one program's *costs* are greater than another's costs. (See Q113 for an example of when it is appropriate to include interest expense in direct expenses.)

112. **Q**—Is the interest expense associated with a capital lease a direct expense of the function that uses the capital asset subject to the lease?

A—No. Interest on capital leases or interest expense resulting from vendor financing arrangements should not be reported as direct expenses of specific programs. (See Q111.)

113. **Q**—A state government has a program to make reduced-rate loans to school districts in the state. The initial funding for the program was provided by a large bond issue. Should the interest on the bonds be included in the direct expenses of the loan program?

A—Yes. The loan program is an example of the limited instances discussed in paragraph 46 “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.” In this example, the loan program would not exist and could not continue without the underlying bonded debt. In addition, the debt would not have been issued for any other program, and no other resources could have been substituted for the bond proceeds. To ignore the cost of borrowing when the program itself is completely dependent on the borrowing would be to inappropriately imply that the program was without cost.

114. **Q**—Paragraph 46 states that most interest on general long-term liabilities 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. If no direct interest expense is excluded, is the caption “Interest on long-term debt” sufficient to indicate that there is no direct interest expense?

A—Yes. The notice is required only if there is direct interest that has been excluded. In addition, if any direct interest expense has been excluded, the amount should be disclosed in the notes or presented on the face of the statement, as required by paragraph 46. (See Q30 about capitalized interest disclosures.)

Revenues

Classification as program or general revenues

115. **Q**—Paragraph 47 describes type a revenue as being provided by “those who purchase, use, or directly benefit from the goods or services of [a] program.” It states that this type of revenue is always program revenue. What are common examples of type (a) revenues?

A—Examples of revenue from those who *purchase* goods or services include payments from residents for city-operated garbage collection and charges to private construction companies for traffic control around construction sites. Revenues from those who *use* goods or services include golf course fees and swimming pool fees. Fishing and hunting licenses and building permits are examples of revenues from those who *directly benefit* by paying for the privilege or authorization to accomplish certain tasks or engage in certain regulated activities.

116. Q—How should a specific revenue be reported if the source of that revenue fits the description of more than one source of financing in paragraph 47?

A—The financial reporting requirements for classifying revenues in the statement of activities are provided in paragraphs 48 through 53. The descriptions in paragraphs 49 through 53 focus on the *revenues* themselves, rather than the *sources* of the revenues, and are mutually exclusive. For example, a revenue that meets the criteria to be reported as a charge for services in paragraph 49 does not also satisfy the criteria for grants and contributions in paragraph 50. There is no direct one-to-one relationship between the sources of revenue discussed in paragraph 47 and the reporting requirements in paragraphs 48 through 53. For example, the reporting requirement for revenues from those who purchase, use, or directly benefit from the goods or services (regardless of whether the purchaser is a citizen, an outside party, or the government itself) is set forth in paragraph 49, *charges for services*. Reporting requirements for revenues from parties outside the reporting government's citizenry are established in paragraph 50, *program-specific grants and contributions*, and in paragraph 52 (for grants and contributions that are not restricted). General revenues from the government's taxpayers are discussed in paragraph 52.

Charges for services

117. Q—A city charges its departments or programs for building permits related to the construction of and improvements to its own buildings. Should these “internal” building permits be considered revenue from “those who purchase, use, or directly benefit from the goods or services of [a] program” (paragraph 47a)?

A—Yes. These building permits are charges for services, and thus would be reported as program revenue. As discussed in the previous question (Q116), revenue should not be regarded as general revenue if it meets the criteria for program revenue in paragraphs 49 through 51. (See Q151 about eliminations.)

Fines and forfeitures

118. Q—Should fines and forfeiture revenues be classified as program or general revenues?

A—Fines and forfeitures should be reported as program revenues based on the definition in paragraph 48. They “derive directly from the program” and “reduce the net cost of the function to be financed from the government's general revenues.” Because fines and forfeitures are generated *by the program*, they are more like charges for services than grants and contributions; therefore, they should be classified in the charges for services category.

Grants and contributions

119. Q—A school district is awarded an operating grant from the state department of education. The grant agreement states that the department will reimburse the school district for all eligible expenses of three specific programs. The grant award, however, does not specifically identify the *amounts* restricted to each program, as required by paragraph 50, because they will not be known until the school district submits its after-the-fact request for funding. Can the school district report the grant as program revenues for the three programs, or should it be reported as general revenue?

A—The school district should report the grant as program revenues of the three programs based on the amounts of reimbursable expenses of each program. In substance, the state has said that it would pay the expenses of the three programs (whatever the actual expenses are); thus, it *has* agreed to finance specific programs in specific amounts (even though unknown when the grant is made). Furthermore, because the payments to the school district are *reimbursements* of specific expenses, the resources are, in essence, “restricted” for use in paying those expenses.

120. Q—A local government is awarded a categorical grant that finances a large number of its programs. The grant award lists the programs covered but does not restrict any specific amounts to specific programs. Should the government allocate the grant among the covered programs and report it as program revenue?

A—No. Paragraph 50 provides that the grant award is required to specify the programs to be funded and the “amounts restricted to each program.” In this case, even though the funded programs are specifically identified, the grant should be reported as general revenue because specific amounts are not restricted to each program; thus, the recipient government has the ability to allocate the grant revenue among the programs at its discretion.

121. Q—Are pass-through grants, on-behalf payments, and food stamp revenues reported in accordance with the requirements of Statement No. 24, *Accounting and Financial Reporting for Certain Grants and Other Financial Assistance*, general or program revenues?

A—Revenues recognized pursuant to the requirements of Statement 24 are examples of type b revenues in paragraph 47 and should be reported as *program* revenues because they are specifically attributable to a program and reduce the net cost of that program to the reporting government.

122. Q—State law allocates a percentage of the state’s sales tax revenues to local governments. A portion of the local share is restricted to education. At the local level, is the sales tax allocation to education *program* or *general* revenue?

A—From the local government perspective, the allocation is a shared revenue (a voluntary nonexchange transaction) rather than a tax. If the reporting government is an independent school district that reports a typical set of functional categories, the sales tax allocation should be reported as general revenue because it is restricted only to “education.” (See Q97 and Q124.)

123. Q—A local government receives a large bequest from the estate of a wealthy benefactor. The corpus of the donation cannot be spent, but instead is required to be invested to provide earnings that are restricted to a special use. Because the principal amount can never be spent, how should it be reported?

A—As explained in paragraphs 431 through 434 in the Basis for Conclusions, Statement 34 adopts a “change in net assets” approach. In that regard, paragraph 433 clarifies that there are no “direct-to-equity” transactions. In this case, the government would account for the bequest in a permanent fund. (See Q159.) In the governmental fund statements, the donation would be reported as revenue and ultimately would be included in reserved fund balance. For the government-wide statement of activities, paragraph 53 requires contributions to permanent funds to 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. (See Q98 about how permanent endowments are reported in net assets.)

Taxes

124. Q—Does the requirement to report *all taxes* as general revenues in paragraph 52 apply to taxes imposed by another government that are shared with the reporting government?

A—No. The requirement in paragraph 52 applies to taxes levied or imposed by the reporting government on its own taxpayers. (See paragraph 47a.) Taxes imposed or levied by another government and shared with the reporting government are regarded as *shared revenues* and should be reported as either program or general revenue based on the requirements in paragraph 50. (See Q122.)

125. *Q*—A county government imposes a separate sales tax, the proceeds of which are required to be used for public safety or health and welfare programs. Because of the restrictions on use, these taxes are not “discretionary” revenues. Should they be reported as program revenues of the public safety and health and welfare functions?

A—No. As taxes imposed by the reporting government, they should be reported as general revenues. General revenue is not synonymous with discretionary revenue. Even though the taxes cannot be used for any other purposes, they are general revenues, as stated in paragraph 52. Program revenues, as defined in paragraph 48 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. These derived tax revenues are levied against *all* sales transactions—not only those within the public safety and health and welfare environments. Thus, the revenues do not derive directly from the programs themselves, but rather they are *restricted* general revenues provided by the reporting government’s constituency to finance the net cost of *specific* programs. (See Q126 about separately reporting dedicated tax revenues.)

126. *Q*—If a city levies a special tax that is restricted for use within a specific program or function (a separate property tax levied to pay debt service costs, for example), is that tax revenue considered a *program* revenue?

A—No. Even though the taxes are required to be used for a specified purpose within a single function, they are, nevertheless, general revenues. In this example, the special tax levy does not *reduce the net cost* of the general government function to the city’s taxpayers. Rather, it is one source of revenues from the city’s taxpayers to *pay the net cost* of the general government function. The government can, however, report the dedicated taxes as a separate line item in the general revenues section. (See Appendix 2, Exhibit 22.)

127. *Q*—A county government has enacted a transient occupancy (hotel/motel) tax, a percentage of which is required to be used for “tourism” programs in the county. The county has significant tourism activity and reports it as a separate function in its statement of activities. The county maintains that the revenue comes from “those who directly benefit from the goods or services of the program,” and consequently should be reported as charges for services. Should those taxes be reported as program revenues?

A—No. Despite the argument that the taxes are tantamount to user fees generated by the tourism program, they are nevertheless *taxes* and should be reported as general revenue (restricted to tourism programs), as required by paragraph 52. The relationship of the program to the tax is too indirect to be treated as user fees. Although the lodging industry in the county certainly benefits from the tourism activity, it is not reasonable to assume that it results from it. For example, many travelers use lodging facilities but do not engage in “tourism” activities. (See Q126 about separately reporting dedicated tax revenues.)

Special assessments

128. *Q*—Are operating special assessments considered general revenues like property taxes? Both revenues derive from property owners.

A—No. Although both special assessments and property tax revenues are derived from property owners, as indicated in paragraph 49, operating special assessments are program revenues. Operating special assessments differ from property taxes in the sense that only the property owners who benefit from the special assessment project are assessed. For example, the property owners in a remote area of town want additional snow-plowing services and agree to a special assessment to pay the town for those additional services. Only the property owners whose streets are plowed (rather than the entire real estate tax base) are assessed; thus, the assessments are equivalent to *charges for services* and qualify as program revenues.

129. *Q*—Are *capital* special assessments also program revenues?

A—Yes. Capital special assessments qualify as program revenues in the “program-specific capital grants and contributions” category. As described in paragraph 5 of Statement No. 6, *Accounting and Financial Reporting for Special Assessments*, capital special assessments enhance the utility, accessibility, or aesthetic value of the affected properties. The benefited property owners pay the government for those improvements through special assessments, either in a lump sum or in installments over time. Paragraphs 19 and 23 of Statement 6 characterize the property owner assessments as *capital contributions*.

Investment earnings

130. *Q*—If the earnings of a permanent fund, which are required to be used for a specific purpose, are not distributed in the current year, but rather are left to accumulate and carry over to next year, should the earnings be reported as program revenue, as required by paragraph 51, in the current year?

A—Yes. The statement of activities is based on functions or programs, not *funds*. Therefore, regardless of fund structure or internal cash flows, the investment earnings should be reported when earned as program revenues of the function to which they are restricted, even if they are not distributed or spent. (See Q136.)

Gain or loss on disposal of capital assets

131. *Q*—If a government sells or disposes of capital assets used in a specific program, is the gain or loss on the transaction a program revenue/direct expense of the program?

A—No. A loss on disposal of a capital asset is not a *direct* expense of the program and a gain resulting from the sale of a capital asset does not *derive directly from the program*. Losses should be included in general government-type expenses; gains should be reported as general revenues. As a practical matter, however, insignificant gains or losses could be eliminated by adjusting the current period’s depreciation expense by the amount of the gain or loss.

Reporting program revenues

132. *Q*—Can revenue items, such as fines and forfeitures, licenses and permits, and intergovernmental revenues (for specific programs), be netted against expenses in the statement of activities?

A—No. Program revenues should not be “netted” against expenses—program expenses should be reported at gross.

133. *Q*—State law requires that 20 percent of the state’s lottery sales revenue are required to be used for elementary and secondary education programs in the state. Should the 20 percent be allocated to the *education* function as program revenue?

A—No. Ticket sales are program revenues of the *lottery* function. As defined in paragraph 48, the revenue derives directly from the program itself. However, presentation of charges for services as a program revenue does not necessarily imply that those resources are restricted to that program. The lottery’s net program revenue (a portion of which is restricted to elementary and secondary education programs) reduces the state’s need to use general revenues to support the education function.

134. *Q*—State gas taxes are shared with eligible local governments. The local governments have discretion over when and how the money is spent, as long as it is for road and highway projects. Even though a high percentage of the revenue will likely be spent for capital purposes, maintenance and repair expenses are also allowable. How should the revenue (grants and contributions) be reported by the local governments—capital, operating, or some combination?

A—The local governments should report the gas tax revenues as *operating* grants and contributions. Paragraph 50 requires that classification because the revenues may be used *either* for operating expenses *or* for capital expenditures of the program at the discretion of the reporting government.

135. *Q*—A government charges indirect expenses to its human services program through an indirect cost plan and is reimbursed by the federal and state grantor agencies for the costs of the program. However, in the statement of activities, the government does not allocate the indirect expenses to the human services program, but rather, reports them in the general government function. Should the portion of the grant that reimburses the *indirect* expense be reported as program revenues of the human services or general government function?

A—The reimbursement should be reported as program revenue of the function or program that includes the reimbursed expenses. If indirect expenses are not allocated to the human services program in the statement of activities, the indirect expense portion of the grant should be reported as program revenue of the general government function. If the indirect expenses are allocated, the entire reimbursement should be reported as program revenue of the human services program.

136. *Q*—Where should investment earnings that qualify as program revenues be reported?

A—Legally restricted earnings as discussed in paragraph 51 are similar in nature to program-specific grants and contributions and should be reported in either the capital or operating column, as appropriate. (See Q130.)

Reporting general revenues

137. *Q*—In the statement of activities, should estimated uncollectible taxes be recorded as bad debt expense or a reduction of revenue?

A—Taxes that are estimated to be uncollectible should be accounted for as a reduction of revenue. Paragraphs 16 and 18 in Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, require that derived taxes and imposed nonexchange revenues, respectively, should be recognized net of estimated refunds and estimated uncollectible amounts.

138. *Q*—Statement 33 requires *nonexchange revenues* to be recognized net of estimated refunds and estimated uncollectible amounts. Paragraph 100 (footnote 41) requires *proprietary fund revenues* to be recognized net of discounts and allowances. How should uncollectible *exchange* transaction revenues of governmental activities be reported in the statement of activities?

A—Consistent with the requirements in Statement 33 and paragraph 100, exchange revenues for governmental activities should be recognized *net of uncollectible amounts*.

Special and Extraordinary Items

139. Q—Unusual in nature and infrequent in occurrence are key characteristics of extraordinary (paragraph 55) and special (paragraph 56) items. What is the difference between “unusual in nature” and “infrequent in occurrence”?

A—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* (paragraphs 20 through 22), defines both terms as follows:

20. Extraordinary items are events and transactions that are distinguished by their unusual nature *and* by the infrequency of their occurrence. Thus, *both* of the following criteria should be met to classify an event or transaction as an extraordinary item:

- a. *Unusual nature*—the underlying event or transaction should possess a high degree of abnormality and be of a type clearly unrelated to, or only incidentally related to, the ordinary and typical activities of the entity, taking into account the environment in which the entity operates. (See discussion in paragraph 21 [below].)
- b. *Infrequency of occurrence*—the underlying event or transaction should be of a type that would not reasonably be expected to recur in the foreseeable future, taking into account the environment in which the entity operates. (See discussion in paragraph 22 [below].)

21. *Unusual Nature.* The specific characteristics of the entity, such as type and scope of operations, lines of business, and operating policies should be considered in determining ordinary and typical activities of an entity. The environment in which an entity operates is a primary consideration in determining whether an underlying event or transaction is abnormal and significantly different from the ordinary and typical activities of the entity. The environment of an entity includes such factors as the characteristics of the industry or industries in which it operates, the geographical location of its operations, and the nature and extent of governmental regulation. Thus, an event or transaction may be unusual in nature for one entity but not for another because of differences in their respective environments. Unusual nature is not established by the fact that an event or transaction is beyond the control of management.

22. *Infrequency of Occurrence.* For purposes of this Opinion, an event or transaction of a type not reasonably expected to recur in the foreseeable future is considered to occur infrequently. Determining the probability of recurrence of a particular event or transaction in the foreseeable future should take into account the environment in which an entity operates. Accordingly, a specific transaction of one entity might meet that criterion and a similar transaction of another entity might not because of different probabilities of recurrence. The past occurrence of an event or transaction for a particular entity provides evidence to assess the probability of recurrence of that type of event or transaction in the foreseeable future. By definition, extraordinary items occur infrequently. However, mere infrequency of occurrence of a particular event or transaction does not alone imply that its effects should be classified as extraordinary. An event or transaction of a type that occurs frequently in the environment in which the entity operates cannot, by definition, be considered as extraordinary, regardless of its financial effect.

140. Q—What is the difference between “extraordinary” items and “special” items?

A—Special items are significant transactions or other events within the control of management that are either unusual in nature *or* infrequent in occurrence. Special items differ from extraordinary items in two ways. The first difference is that special items should be *within the control of management*, whereas extraordinary items are not

required to be within the control of management. The other difference is that extraordinary items are required to be *both* unusual in nature *and* infrequent in occurrence, whereas special items are only unusual in nature *or* infrequent in occurrence, but not both.

141. Q—What are some examples of “extraordinary” and “special” items?

A—Determining whether an event or transaction is extraordinary or special and therefore should be reported separately is often a matter of professional judgment and should be done on a case-by-case basis considering geographic location and size and type of government. An event that is infrequent in occurrence for one government may be almost commonplace for another. Similarly, what is unusual for one government may be ordinary for another. Examples of events or transactions that may qualify as extraordinary or special items may include:

Extraordinary items:

- Costs related to an environmental disaster caused by a large chemical spill in a train derailment in a small city.
- Significant damage to the community or destruction of government facilities by natural disaster (tornado, hurricane, flood, earthquake, and so forth) or terrorist act. Geographic location of the government may determine if a weather-related natural disaster is *infrequent*.
- A large bequest to a small government by a private citizen.

Special items:

- Sales of certain general governmental capital assets
- Special termination benefits resulting from workforce reductions due to sale of utility operations
- Early-retirement program offered to all employees
- Significant forgiveness of debt.

142. Q—Can a transaction or event meet the definition of *both* an extraordinary item *and* a special item? If so, how should it be reported?

A—No. If a transaction or event is both unusual in nature and infrequent in occurrence, it should be reported as an extraordinary item without regard to management involvement.

Reporting Activities of Enterprise Funds

143. Q—Paragraph 100 requires the statement of revenues, expenses, and changes in fund net assets of proprietary funds to distinguish between operating and nonoperating revenues and expenses. How should the operating statement information of enterprise funds be reported in the statement of activities?

A—The operating/nonoperating distinction is significant only in the fund financial statements and is not required to be made in the statement of activities. Direct expenses reported in the statement of activities include both operating and nonoperating expenses. Some nonoperating revenues satisfy the criteria to be reported as program revenues, whereas some may be reported as general revenues. Capital contributions should be reported as program revenues as discussed in paragraph 50. Transfers and special and extraordinary items should be reported in the statement of activities in accordance with the requirements of paragraph 53.

Statement of Activities Format

144. Q—Can a government that wants to provide more detail (more programs or more details of general revenues, for example) than fits on one page divide and report the statement of activities on two pages?

A—Yes. Exhibit 3 in Appendix 3 illustrates a two-page approach for the municipal government that is illustrated in Appendix 2, Illustration A. In this case the government presents its governmental functions or programs in more detail than is displayed in the fund financial statements. The expanded net program cost information is presented on the first page, and general revenues and changes in net assets information is displayed on the second page. The state government illustrated in Appendix 2, Exhibit 33, also uses a two-page approach to provide additional details of its general revenues.

145. Q—A government provides services within a few functional categories, and all are classified as governmental activities. Is there a reporting alternative that would simplify the presentation of the statement of activities for this type of government?

A—Yes. Exhibit 4 in Appendix 3 illustrates an approach that would be appropriate for governments that have only a few functions within a single type of activity. This alternative display method presents the functional categories (programs) in columns rather than rows, with the total column on the left rather than the right side of the statement. This display technique also allows all of the descriptions to follow consecutively in a single column. The advantages of using this approach quickly erode, however, as the number of columns increases.

146. Q—Are there any alternative formats for the statement of activities that are specifically available to single-program governments?

A—Yes. Paragraph 136 discusses alternative presentation methods for single-program governments. 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. 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. These formats and the related alternatives for the statement of net assets are illustrated in Exhibits 5 through 9 of Appendix 3. (See Q258 about what is meant by *single-program*.)

Eliminations and Reclassifications

147. Q—How is the “effect” of internal service fund activity eliminated, as required by paragraph 59?

A—As explained in paragraph 314 of the Basis for Conclusions, 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 or functions. Conversely, an internal service fund net loss would require a pro rata *increase* in the amounts charged to the participating funds or functions. Exercise #4 in Appendix 4 provides an example of eliminating the effect of internal service funds.

148. Q—In eliminating the effects of internal service fund activity, what happens to transactions with outside parties?

A—The internal service fund activity pertaining to outside parties is not eliminated, but instead would be included with the appropriate function in the statement of activities. Exercise #4 in Appendix 4 includes an internal service fund that conducts business with outside parties.

149. Q—A government accounts for its central supplies activity in the general fund and charges other funds for the cost of supplies used. The payments from the other funds are recorded as revenue in a general fund account called “interfund charges.” Should that “revenue” be eliminated for the statement of activities, or does it constitute program revenue of the general government function?

A—Paragraph 112a(2) defines interfund services provided and used as sales and purchases of goods and services between funds for a price approximating their external exchange value. It also states that interfund services provided and used should be reported as revenues in seller funds and expenditures or expenses in purchaser funds. Paragraph 112b(2) defines interfund reimbursements as repayments from the funds responsible for particular expenditures or expenses to the funds that initially paid for them. It further stipulates that reimbursements should not be displayed in the financial statements.

Paragraph 59 requires reimbursement-type activity to be eliminated for the statement of activities, so that the allocated (reimbursed) expenses are reported only by the function to which they were allocated. Conversely, paragraph 60 *prohibits* the elimination of interfund services provided and used. The interfund activity described in this question meets the definition of a *reimbursement*. (See Q150.) Therefore, the government should not display the “revenue,” but should instead reduce the appropriate expenses (in the function from which they were initially paid) for the reimbursed amounts. This process in effect “eliminates” the interfund activity for the statement of activities.

150. Q—What distinguishes the interfund charges for supplies by the general fund in the preceding question from the interfund charges for water or electric use by a utility fund in paragraph 60?

A—The purchase and resale of office supplies is not a program of the general fund. Rather, as an economy and efficiency measure, the government uses the general fund to buy office supplies and spreads the cost to programs based on use or requisitions. On the other hand, the treatment and distribution of water and the generation and sale of electricity are programs of the utility enterprise funds. The government’s programs are purchasers of the utility enterprise fund’s services (like its other customers); therefore, the internal activity is characterized as interfund services provided and used rather than reimbursements.

151. Q—A city charges its departments and programs for building permits in connection with construction of and improvements to its own buildings. Should these internal revenues and expenses be eliminated for the statement of activities?

A—No. Paragraph 60 states that the effect of interfund services provided and used *between functions* should *not* be eliminated because to do so would misstate both the expenses of the purchasing function and the program revenues of the selling function. If the purchase and sale of the permits are within the *same* function, the expenses and revenues should be eliminated to remove the grossing up of both direct expenses and program revenues within that category. However, as discussed in paragraph 315 in the Basis for Conclusions, as a practical matter, eliminations of this kind are not necessary unless the effect on direct expenses or program revenues is material. (See Q117 about program revenues.)

152. Q—Is a government required to eliminate an “indirect” element of interfund charges by reversing the portion of the charges that is attributable to overhead markup?

A—No. As stated in paragraph 43, the government is not required to reduce the interfund charges to eliminate the indirect portion of the amount charged. For example, if a government accounts for its central supplies activity in the general fund and charges other funds for supplies used plus an additional amount to cover “overhead” costs—such as a percentage of certain office employees’ salaries and related office expenses—it would not be required to eliminate the overhead markup. However, the summary of significant accounting policies should disclose that direct expenses includes that element.

153. Q—What is the difference between “overhead expenses” discussed in paragraph 59 (which should be eliminated) and “administrative overhead charges” referred to in paragraph 43 (which need not be eliminated)?

A—There really is no difference in the two terms, but there is a difference in the objectives of the two paragraphs. The intent in paragraph 59 is to eliminate the “doubling up” of internal allocations (that is, reducing the expenses of the allocating function by the amount allocated [the internal “revenue”] to others) so that only one function reports the expense. The concept is similar to accounting for interfund reimbursements. The provision in paragraph 43 is a practical consideration that relieves governments of the burden of removing and reclassifying any “indirect” elements of internal charges from the *direct* expenses of a function. (See the examples in Q149 and Q152.)

154. Q—To what extent should interfund transfers be eliminated for the statement of activities?

A—Interfund transfers, as defined in paragraph 112b(1), *within* governmental activities and *within* business-type activities should be eliminated for the statement of activities. Only the net amount transferred *between* governmental and business-type activities should be reported. The internal “eliminations” can be achieved and the “net” amount easily determined by combining transfers in and transfers out within each category as a single “transfers” amount for the statement of activities.

155. Q—A state maintains an internal service fund to account for its telecommunications system, including debt service on bonds issued to purchase the equipment. The state reports the telecommunications equipment as an asset and the related bonds as a liability of the internal service fund, and charges the various state departments for equipment usage. How will the expenses of the internal service fund be allocated among the governmental and business-type activities in the statement of activities?

A—There are three main components of this internal service fund’s expenses—interest on the debt, depreciation of the assets, and other operating expenses. In essence, the charges made to the participating departments already “allocate” the internal service fund’s expenses to the governmental and business-type activities. For reporting in the statement of activities, however, two adjustments are necessary—(1) to identify interest expense for separate reporting and (2) to eliminate the “doubling-up” effect of internal charges.

As explained in paragraph 314 of the Basis for Conclusions, 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. However, because interest expense should be reported separately, it first should be added back to the net revenue or expense of the internal service fund. The remaining *net* revenue or expense can then be allocated among the participating functions in the same ratio as the original use charges. This process is illustrated in Exercise #4 of Appendix 4. It is not necessary to make additional adjustments for depreciation expense of the internal service fund assets, but the amount of depreciation expense included in the internal service fund charges should be included in the disclosure required by paragraph 117d.

156. *Q*—How will the assets and liabilities of the internal service fund in the preceding question be reported in the statement of net assets?

A—The capital assets and the long-term liabilities of the internal service fund constitute general capital assets and general long-term liabilities, respectively, and therefore should be reported in the governmental activities column. The “look-back” adjustment that results from eliminating the effects of the internal service fund’s charges to business-type activities would increase or decrease the internal balances reported in the statement of net assets. An example of this process is illustrated in Exercise #4 in Appendix 4. Exercise #4 also includes an internal service fund that serves *only* enterprise funds.

Fund Types—Overview

157. *Q*—Do fund types still exist?

A—Yes. Fund types are still a feature of the governmental reporting model, but their role in basic financial statements has been modified by Statement 34. Statement 34 actually creates two *new* fund types—permanent funds and private-purpose trust funds. As mentioned in paragraph 381 in the Basis for Conclusions, as the new model began to evolve, users consistently endorsed the efforts to retain the “details” of the previous model. However, as time passed, it became more apparent 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 original proposal to provide only *fund-type* information in the basic financial statements was eliminated in favor of information primarily 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.

Some fund-type information is reported in the basic statements. Fiduciary funds are reported by fund type, internal service funds are reported separately from enterprise funds (paragraph 96), and paragraph 84 requires that unreserved fund balances of nonmajor funds should be displayed *by fund type* on the face of the governmental funds’ balance sheet.

158. *Q*—For governments that prepare a CAFR, does Statement 34 affect the requirement to provide combining statements by fund type?

A—Statement 34 does not amend the CAFR requirements in NCGA Statement 1 to provide combining statements by fund type, except to limit the combining statement requirement to *nonmajor* funds. Footnote 36 to paragraph 75 states, “Combining statements for nonmajor funds are not required, but may be presented as supplementary information.” (Optional combining statements are illustrated in Exhibits 15 through 19 in Appendix 2.)

Governmental Funds

159. *Q*—Paragraph 65 states that 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. Does this apply to permanent endowments of entities that report as special-purpose governments engaged only in business-type activities (a public college or university, for example)?

A—No. Entities that apply the provisions of paragraph 138 are not required to report their permanent endowments in a governmental fund. They should report the net assets of their permanent endowment funds as nonexpendable restricted net assets (segregated by purpose of restriction).

Proprietary Funds

160. Q—Are there any specific *activities* that should *always* be reported in an enterprise fund?

A—Only state unemployment compensation funds (see Q164) and public entity risk pools (paragraph 18 in Statement 10) are *required* to be reported in enterprise funds. The criteria in paragraph 67 are not based on the *nature* or *type* of activity, but rather on debt financing, revenue-raising requirements, or objectives of the activity. In subparagraph a, the requirements are based on provisions of debt instruments to provide security for bondholders; in subparagraph b, the requirements to recover costs derive from legal mandates; cost recovery is also the objective of the pricing policies in subparagraph c.

161. Q—Paragraph 67 states that the criteria for enterprise fund reporting should be applied in the context of the *activity's* principal revenue source. Is an “activity” the same as a “fund”?

A—No. The term *activity* as used in paragraph 67 is not synonymous with *fund*. As a result, applying the criteria in a through c could have two consequences—(1) if an activity accounted for as a separate fund meets any of the criteria, that fund should be reported as an enterprise fund, and (2) if a “multiple activity” fund (the general fund, for example) includes a *significant* activity (see the discussion in footnote 33) whose principal revenue source meets any of the criteria, that activity should be reclassified as an enterprise fund. (See Q18.)

162. Q—Paragraph 76 provides specific criteria for identifying major funds. Is there a similar test to ascertain what is a “principal revenue source” for applying the criteria in paragraph 67?

A—No. Determining whether an activity has a “principal” revenue source is a matter of professional judgment. Paragraph 387 in the Basis for Conclusions suggests that, with regard to criterion a, a government should compare its pledged revenue to its total revenues. A similar approach for criteria b and c would compare an activity's fees and charges to its total revenues.

163. Q—Criteria b and c in paragraph 67 require that rates be set to recover costs, including depreciation or debt service. Depreciation applies to all capital assets, but debt service could apply to all, some, or none of an activity's capital assets. If there are limited debt service requirements, is the pricing policy required to include a depreciation factor?

A—No. The requirement to use enterprise fund accounting and reporting principles applies if the pricing policy is designed to recover *either* depreciation *or* debt service requirements (principal and interest). There is no stipulation that debt service requirements should be comparable to depreciation expense.

164. Q—State unemployment compensation funds were previously required to be reported in an expendable trust fund. Statement 34 eliminates the expendable trust fund type. How should those funds be reported under Statement 34?

A—Footnote 34 to paragraph 67b requires those funds to be reported as enterprise funds. Paragraph 391 in the Basis for Conclusions explains the decision based on the criterion in paragraph 67b—that is, that unemployment compensation funds are similar to public entity risk pools. The assessments against employers are similar in substance to insurance premiums, designed to recover the cost of claims paid.

165. Q—The definition in paragraph 68 states that an internal service fund should not be used if the reporting government is not the “predominant participant” in the activity. At what point is a government not the predominant participant?

A—Statement 34 does not establish an exact point at which the reporting government is or is not the predominant participant. The notion of using an internal service fund only if the reporting government is the predominant participant was initiated in Statement 10. Paragraph 126 in the Basis for Conclusions of that Statement states that application of the term *predominant* will require preparer and auditor judgment. Usually, the predominance of the government will be clear, but in cases when it is not, preparers and auditors might consider whether the fund’s primary purpose is to serve the government (and the “outside” activity is incidental to that purpose), or whether the fund’s primary purpose is to provide, and charge a fee for, goods or services (and the government is a “customer”).

Application to Specific Circumstances

166. Q—A county government created a recreation authority to construct recreational facilities. The authority financed the cost of building the facilities by issuing revenue bonds. The county leases the facilities from the authority. The lease payments are equivalent to the debt service requirements of the authority and serve as security for the bonds. The collection of the lease payments from the county and the retirement of the debt are the only activities of the authority. Is the authority required to use enterprise fund accounting and reporting principles in its separate financial statements?

A—Yes. It meets the criteria in paragraph 67a. The authority’s activity is financed by debt that is secured solely by the lease charges to the county.

167. Q—A local government issued revenue bonds for its water and sewer fund. The operating revenues of the fund are pledged as security for the bonds, but in order to enhance the marketability of and perhaps lower the interest rates on the bonds, the city also secondarily backs the bonds with its full faith and credit. The possibility that the city would have to use its general revenues to service the debt is remote. Is the city required to use an enterprise fund for the water and sewer operations, based on paragraph 67a?

A—No. The government *may* use an enterprise fund, but is not *required* to do so. Paragraph 67a requires use of an enterprise fund when the debt is secured *solely* by the operation’s revenues. 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.

168. Q—The governing board of a local government is concerned about providing low-cost water to its citizens and has a policy to recover 80 percent of the water fund’s costs, including operating expenses, debt service, and indirect costs, through user charges. A transfer from the general fund finances the remaining 20 percent of the costs. Is the government *required* to use an enterprise fund?

A—No. The government *may* use an enterprise fund, but is not *required* to do so. Paragraph 67c states that enterprise fund reporting is *required* if the pricing policies of the activity establish fees and charges designed to recover its costs, including capital costs (such as depreciation or debt service). Because the policy is designed to recover *less* than the cost, the enterprise fund reporting requirement does not apply.

169. Q—The pricing policy for a city’s water and sewer fund is to set rates that recover all operating costs, including depreciation, except for the city’s contribution to the employee retirement system. The city’s contribution to the pension plan is funded by a dedicated tax levy that covers all employees, including the water and sewer fund personnel. The appropriate share of the taxes is reported as nonoperating revenue in the water and sewer fund. Is the city required to use an enterprise fund?

A—No. The requirement in paragraph 67c is to recover all costs; therefore, the city *may* use an enterprise fund—and probably would because *depreciation* is a factor in the pricing scheme—but is not *required* to do so.

170. Q—A government has an activity with a pricing policy that covers its direct costs, including debt service requirements. *Indirect* costs are not included in the fee determination. Do the provisions in paragraphs 67b and c, based on recovery of direct costs, also include indirect costs?

A—No. The criteria set forth in paragraphs 67b and c are based on laws and policies designed to recover *direct* costs. Therefore, the government should report the activity in this question in an enterprise fund.

Fiduciary Funds

171. Q—How should Internal Revenue Code (IRC) Section 457 plans that meet the criteria for reporting be presented?

A—IRC Section 457 plans, if reported, meet the definition of a pension (and other employee benefit) trust fund in paragraph 70.

172. Q—How should a government report resources or an activity that benefits *both* the government *and* private parties? Should it be reported in two funds—a special revenue fund and a private-purpose trust fund?

A—Two separate funds may be used, but are not required. The government could reclassify the expendable trust fund as a special revenue fund, if the government itself is the predominant beneficiary. If a special revenue fund is used, the “private-purpose” component of fund balance (if identifiable) should be reported as reserved. If “private purposes” are the predominant use of the resources in the fund, use of separate funds—for example, a private-purpose trust and a special revenue fund—would be more appropriate.

173. Q—The definition of private-purpose trust funds in paragraph 72 requires that principal and income benefit individuals, private organizations, or other governments. How should a fund be classified if its principal or income benefits a discretely presented component unit?

A—Paragraph 69 states that 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. For purposes of that definition, the term *government* refers to the financial reporting entity, and *government’s own programs* includes the discretely presented component units. Thus, the fund in this case should be classified as a special revenue fund.

174. Q—The definition of a private-purpose trust fund in paragraph 72 includes the phrase “such as a fund used to report escheat property.” Does this reference mean that all escheat property is required to be reported in a private-purpose trust fund?

A—No. The reference in paragraph 72 merely points out that private-purpose trust funds may be used for escheat funds. It should not be interpreted as a *requirement*. The financial reporting requirements for escheat property are established in Statement No. 21, *Accounting for Escheat Property*. Statement 34 amends that guidance by eliminating the expendable trust fund type. Based on the requirements of Statement 21, as

amended by Statement 34, escheat property held for individuals, private organizations, or another government should be reported in a private-purpose trust fund or in the governmental or proprietary fund in which escheat property is otherwise reported, offset by a liability. (See Q172.)

Governmental and Proprietary Fund Financial Statements

Major Funds

Presentation of Major Funds

175. Q—Can major funds be presented in a combined column with details provided in a combining statement, or should *each* major fund be presented in a *separate* column in the fund financial statements?

A—Each major fund should be presented in a separate column. Paragraph 75 clearly states that fund statements should present the financial information of each major fund in a separate column. As explained in paragraph 381 in the Basis for Conclusions, the major fund reporting requirements were instituted because users wanted information about important individual funds that is obscured when it is embedded in fund types. Combining the funds in a major funds column would similarly obscure the information about important individual funds.

176. Q—Can governments use more than one column for nonmajor funds—for example, separate columns by fund type?

A—No. Paragraph 75 states that nonmajor funds should be aggregated and presented in a *single* column. If a government wants to present a specific fund separately in the basic financial statements, even if it does not meet the percentage criteria, it should be reported as a major fund, rather than as a separate “nonmajor” fund. With regard to fund type, paragraph 380 in the Basis for Conclusions explains that, 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 focus of fund-based reporting in basic financial statements was changed from fund types to major funds. Nevertheless, to provide for some continuity from the previous model and to provide users with information about the character of the nonmajor fund balances available for appropriation, paragraph 84 requires that unreserved fund balances of nonmajor funds should be displayed by fund type on the face of the balance sheet.

177. Q—Is it allowable to report a particular fund (a capital projects fund, for example) as a major fund for only one or two years?

A—Yes. Although many funds will continue to pass the major fund test year after year, capital projects funds often experience uneven expenditure levels and may exceed the major fund percentages for only a brief period (or sporadically over a longer period). Governments can, however, in the interest of consistency, choose to report a fund as a major fund even if it does not meet the percentage criteria.

178. Q—Can an internal service fund that the government believes is particularly important to users be reported in a separate column like a major fund?

A—As explained in paragraph 385 of the Basis for Conclusions, internal service funds were excluded from the major fund reporting requirements primarily because of the potential distortion that their inclusion would cause when applying the major fund percentage criteria. Governments *should not* include internal service fund data in the major fund calculation. In addition, the intent in Statement 34 is that the basic statements should provide an *overview* of the internal service funds’ balances and activity. Details of *individual* internal service funds may be

provided in combining statements, just as was done in the prior model. Paragraph 96 states that 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.

179. Q—Can a fiduciary fund that the government believes is particularly important to users be reported in a separate column like a major fund?

A—No. Fiduciary fund data *should not* be displayed separately as major funds. Paragraph 106 requires *a separate column* to be presented for *each* fiduciary fund *type* (pension trust funds, investment trust funds, private-purpose trust funds, and agency funds), and further addresses additional disclosure requirements for individual defined benefit pension plans and postemployment healthcare plans. In addition, similar separate disclosure requirements for each individual *investment trust fund* is required by paragraph 19 of Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools* (as amended). Governments may present combining statements for the fiduciary fund types if they want to provide financial statements for individual funds.

180. Q—Are interfund balances and activity required to be eliminated from the nonmajor funds column?

A—No. Interfund transactions and balances *may* be, but are not *required* to be, eliminated when nonmajor funds are combined.

Application of Criteria

181. Q—A city has a component unit that meets the criteria for blending and is included with its special revenue funds. Do the major fund reporting requirements apply to blended component units?

A—Yes. The concept of blending is based on the notion that certain component units are so closely related to the primary government that they are, in substance, the same as the primary government. As stated in paragraph 52 of Statement 14, the component unit's balances and transactions should be reported in a manner similar to the balances and transactions of the primary government itself. Therefore, if a component unit is blended into the reporting entity's financial statements as a special revenue fund, for example, it would be evaluated against the major fund criteria with the reporting entity's other governmental funds.

182. Q—Paragraph 76a states that governments should apply the 10 percent major funds criterion to all funds of that *category* or *type*. When should “category” be used and when should “type” be used?

A—The major fund reporting requirement applies to all funds in the governmental category; thus, the 10 percent criterion should be applied to the governmental funds *category*. The major fund reporting requirements apply to enterprise funds but do not apply to internal service funds; thus, the 10 percent criterion should only be applied to the enterprise fund *type*, rather than the proprietary fund category. Exercise #5 in Appendix 4 illustrates the application of the major fund criteria.

183. Q—If an individual governmental or enterprise fund meets the initial 10 percent criterion for one element (total assets, liabilities, revenues, or expenses/expenditures), and meets the 5 percent benchmark for a *different* element, is that fund required to be presented as a major fund?

A—No. An individual governmental or enterprise fund is required to be reported as a major fund if it passes *both* the 10 percent *and* 5 percent tests for the same element. The criteria in paragraph 76a and b provide for a two-step test, rather than two separate tests.

184. Q—In applying the major fund criteria to enterprise funds, should the government consider both operating and nonoperating revenues and expenses?

A—Yes. The major fund determination is based on total fund revenues and expenses, which includes both operating and nonoperating categories.

185. Q—For determining major governmental funds, are other financing sources and uses included in the calculations?

A—No. The major fund criteria are set forth in paragraph 76. Revenues do not include other financing sources, and expenditures do not include other financing uses.

186. Q—Can the budgetary basis of accounting be used to determine major funds?

A—No. The budgetary basis might be useful in making an initial assessment, but ultimately, the major fund calculations should be done using GAAP bases of accounting. Governmental funds should be evaluated based on modified accrual measurements; enterprise funds should be tested using accrual-basis measurements.

187. Q—For major fund determination, should total assets, liabilities, revenues, or expenditures/expenses include the effects of the items in the reconciliation of the fund statements to the government-wide statements?

A—No. The totals to be used for the major fund determination should be the unreconciled combined amounts. An individual fund's significance is measured by its status among *funds*; thus, comparisons against government-wide amounts would not be appropriate.

188. Q—Are interfund balances and transactions required to be eliminated from the totals in the major fund test?

A—No. Statement 34 does not *require* any adjustments to the combined totals for assets, liabilities, revenues, and expenditures/expenses. However, because the major fund criteria focus on assets and liabilities *separately*, significant interfund balances could influence the outcome of the major fund test. Interfund balances should not be *eliminated*, but if there are significant interfund receivables and payables, governments may adopt a policy (and use it consistently from year to year) to use a single “net” amount for each fund and for the combined totals. For example, if total assets for the combined governmental funds includes \$9,000 due from other funds and total liabilities includes \$12,000 due to other funds, the net amount of \$3,000 due to other funds could be used in the major fund calculation. The same “netting” approach would be used for the individual funds.

In the fund *operating* statements, transfers in and transfers out are not included in the major fund calculation (revenues and expenditures/expenses) and do not affect the major funds determination. Interfund services provided and used are not distinguished from other revenues or expenditures/expenses.

Required Reconciliation to Government-wide Statements

189. Q—Because the data presented in the financial statements should derive from the account balances in the accounting records, should the accounting records for governmental funds include the adjustments necessary to report governmental activities on the accrual basis in the government-wide financial statements?

A—No. The accounting records for governmental funds are generally established *by fund* and are maintained on a day-to-day basis using the cash, modified accrual, or budgetary basis of accounting. The adjustments (or reconciliation items) necessary to prepare the government-wide statements are adjustments of the *combined* governmental funds, rather than each individual fund. *The funds are not converted to the accrual basis.* Governments would not allocate the adjustments to the individual funds, but instead would treat them as part

of the process of converting fund-based statements to government-wide statements. Illustrative notes 4a and 5a in Exhibit 10 in Appendix 3 illustrate a “spreadsheet” approach to applying the reconciliation adjustments. Exercise #6 in Appendix 4 explains the reconciliation process.

190. *Q*—Where should the reconciliation of the fund financial statements to the government-wide statements be located?

A—Paragraph 77 states that the reconciliation should be presented at the bottom of the fund financial statements or in an accompanying schedule. The “accompanying schedule” should be considered a continuation of the fund financial statement; therefore, the schedule should be on the page immediately following the statement it supports. The “accompanying schedule” alternative was provided to avoid overcrowding the face of the statement and to give governments more space to explain the differences between fund-based and government-wide information. This approach is illustrated in Appendix 2, Exhibits 5, 24, 26, 35, and 37.

191. *Q*—Paragraph 77 states that a detailed explanation should be provided in the notes if a reconciling item is so summarized that it obscures the nature of the individual elements of an adjustment. When is the disclosure *required*?

A—Generally, the disclosure is required if a reconciling item on the face of the statement (or in an accompanying schedule) is a *combination* of several similar balances or transactions, or is a *net* adjustment. Illustrative notes 4 and 5 in Exhibit 11 of Appendix 2 provide examples.

Note 4 illustrates a disclosure for a combined adjustment. The reconciliation includes a single amount to recognize long-term liabilities of the governmental activities in the statement of net assets. The note discloses the relative amounts for bonds and notes payable, compensated absences, and claims and judgments. Note 5 illustrates a disclosure for a net adjustment. The reconciliation presents a single number representing the adjustment to remove the debt service (principal) transactions for the statement of activities. The note discloses the details of the proceeds and repayments.

192. *Q*—A city finance director wants to provide in-depth explanations of the differences between the city’s fund financial statements and its government-wide statements. Where should those explanations be presented—on the face of the fund financial statements, in accompanying schedules, or in the notes to the financial statements?

A—For readability, the reconciling items presented on the face of the fund financial statements should be aggregated and the explanations of them should be brief. Lengthy explanations would not be appropriate on the face of the statements. If the reconciliation is presented on a separate page as a continuation of the financial statement, more space is certainly available to accommodate expanded explanations and, therefore, may be sufficient. Generally, the most suitable location for in-depth explanations of the items in the reconciliations would be in the notes to the financial statements. Exhibit 10 in Appendix 3 illustrates two possible approaches that governments might use in the notes to provide in-depth explanations of the items in the fund-to-government-wide-statement reconciliations.

Required Financial Statements—Governmental Funds

Measurement Focus and Basis of Accounting

193. Q—If state law requires a government to budget on a “GAAP basis,” what basis of accounting is required after Statement 34 is implemented?

A—Most budget laws require governments to budget by *fund*—the MFBA for governmental and proprietary funds were not changed by Statement 34. Thus, GAAP for budgetary purposes is based on the MFBA required to be used in the particular fund. If the fund is a governmental fund, the modified accrual basis is required; if it is a proprietary or fiduciary fund, the accrual basis is required. However, interpretations of laws should be determined on a state-by-state basis.

Reporting General Long-term Liabilities

194. Q—Should special assessment debt for which the government is “obligated in some manner” be reported in the statement of net assets?

A—Yes. Statement 34 does not modify the criteria in paragraph 16 of Statement 6 for determining if a government is “obligated in some manner” for special assessment debt. Debt issued to finance capital projects that will be repaid wholly or in part from special assessments should be reported in accordance with the provisions of paragraph 17 of Statement 6. Therefore, governments should report special assessment debt with governmental commitment in the statement of net assets and either display it separately—on the face of the statement—or disclose it in the notes if combined with other liabilities on the statement as required by paragraph 119 of Statement 34.

195. Q—Should conduit debt be reported as a liability in the statement of net assets?

A—Statement 34 does not modify the requirements of Interpretation No. 2, *Disclosure of Conduit Debt Obligations*. Interpretation 2 requires disclosure of certain information about a government’s conduit debt, but does not require recognition of a liability. Paragraph 4 of that Interpretation says that governments that already report conduit debt as a liability are not required to “de-recognize” it. Consequently, some governments currently report conduit debt as a liability. Therefore, conduit debt that was recognized in the prior model may continue to be recognized in the Statement 34 model. Note, however, that paragraph 12 in the Basis for Conclusions of Interpretation 2 states, “The Board concluded that issuers of conduit debt obligations should not be required to recognize a liability, but that such debt should be disclosed and quantified. The Board currently has on its agenda a conceptual framework project that will address the definition of elements of financial statements, including liabilities. Therefore, it has decided that questions relating to accounting recognition for conduit debt transactions should be reconsidered after further progress is made on that project.”

196. Q—A governmental fund incurs a liability to the general fund with no specific repayment arrangement. Should the interfund payable be reported as a fund liability of that governmental fund under the modified accrual basis of accounting?

A—The government should either report the amount as a fund liability in accordance with paragraph 81 or reclassify it as a transfer, as discussed in paragraph 112a(1). Paragraph 81 states that liabilities arising from interfund activities do not constitute general long-term liabilities and therefore should be reported in governmental funds. Paragraph 112a(1) provides that, 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. (See Q227 about the meaning of *reasonable time*.)

Balance Sheet

197. *Q*—For governmental funds, does Statement 34 change the reporting for long-term receivables and related deferred revenues?

A—No. Statement 34 does not change measurement and recognition standards for governmental funds. Asset (long-term receivables) and revenue recognition for *exchange* transactions is determined by when revenue is earned and when it becomes available. Asset and revenue recognition for *nonexchange* transactions (in *both* the government-wide *and* fund financial statements) is determined by the requirements of Statement 33. Revenue that does not meet the “availability” criterion of the modified accrual basis of accounting is deferred in governmental funds. Statement 34 *does not change* that provision.

198. *Q*—Are governments required to report interfund loan balances in two categories—“due to/from other funds” for the short-term amounts and “advances to/from other funds” for the amounts that will be repaid over several years? That reporting technique was common practice in the previous model.

A—No. Although governments may classify interfund balances, they are not required to do so. Paragraph 112 only requires “interfund receivables” and “interfund payables” to be reported. Governments are required, however, to report a reservation of fund balance in governmental funds for the noncurrent portion of interfund receivables. (See Q227 about reclassifying interfund loan balances.)

199. *Q*—How is an equity interest in a joint venture by a governmental fund reported?

A—Because the equity interest in a joint venture generally represents equity primarily in capital assets and otherwise does not meet the definition of a financial resource, it is inappropriate to report the entire “net investment in joint venture” as an asset in a governmental fund. The participating government’s total equity interest should be calculated in accordance with the joint venture agreement. The amount that should be reported in the governmental fund, however, should be limited to amounts appropriately reported under the current financial resources measurement focus and the modified accrual basis of accounting. Amounts reported in the governmental fund balance sheet may include, for example, an amount payable to, or receivable from, the joint venture. The governmental fund statement of revenues, expenditures, and changes in fund balances should report changes in joint venture equity interests only to the extent that the amounts received or receivable from the joint venture or the amounts paid or payable to the joint venture satisfy the revenue or expenditure recognition criteria for governmental funds. The entire equity interest in a joint venture should be reported in the government-wide statement of net assets. (See Q101 and Q259.)

Separate display of reserved and unreserved fund balance

200. *Q*—Should restricted net assets of governmental activities in the government-wide statement of net assets be equal to reserved fund balances in governmental funds?

A—The two amounts will usually be different. Paragraph 34 (footnote 24) states that, 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*, 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.

NCGA Statement 1, paragraph 118, defines reserves as “not appropriable for expenditure or is *legally segregated for a specific future use*” (italics added). One could infer from that definition and the explanation in footnote 24 that *reserved* is broader in scope than *restricted*. However, *restricted* net assets (as defined in paragraph 34) would not always be reported as *reserved* in the fund financial statements. To illustrate, consider the following four local government revenue sources—all of which meet the definition of *restricted* in paragraph 34:

- #1 Federal and state grants that are restricted by the grant agreements for specific purposes
- #2 Gas tax distributions from the state that, pursuant to state statute, are restricted to road maintenance and traffic control expenditures
- #3 Various local taxes approved by voter referendums, which, pursuant to the referendums, are restricted to certain specified purposes
- #4 Impact fees that, by contract, are restricted to expansion of infrastructure and storm sewer systems.

If any or all of those revenues were accounted for in the general fund, each would be reported as “reserved” because they are “legally segregated for a specific future use” that is more specific than the general restrictions of the fund. Similarly, if any of those revenues were accounted for in a fund whose restrictions were broader than the one pertaining to that specific revenue, they would also be reported as “reserved.” On the other hand, if the impact fees in #4, for example, were reported in a separate fund to be used only for that purpose, they would *not* be reported as reserved because the use of the separate fund itself communicates the “legal segregation for a specific future use.” Thus, in the last case, accumulated impact fees would be restricted in the statement of net assets but would be unreserved in the governmental fund statements.

Generally, resources that are *reserved* in governmental funds because they are legally segregated for a specific future use are also *restricted*, whereas resources reserved in governmental funds because they are otherwise unavailable for appropriation (for example, reserved for inventories) are not restricted. (See Q97.)

201. Q—The answer to Q200 implies that restricted resources reported in a separate governmental fund are not classified as “reserved” because the use of the separate fund itself communicates the “legal segregation for a specific future use.” Should similar resources be reported as “reserved” when they are included in the nonmajor funds column?

A—No. The answer to Q200 relates to major funds and should not be applied to the nonmajor funds column in the governmental fund financial statements. Paragraph 84 requires the *unreserved* fund balances of the nonmajor funds to be displayed by fund type, even though the restrictions on the use of the resources in those funds may be narrower than the restrictions of nonmajor funds in the aggregate. As a result, the unreserved components of fund balance will not be different from what is displayed in the nonmajor funds combining statement, if one is presented.

Statement of Revenues, Expenditures, and Changes in Fund Balances

202. Q—In the statement of revenues, expenditures, and changes in fund balances, can a government report other financing sources with revenues and other financing uses with expenditures?

A—No. The presentation of the statement of revenues, expenditures, and changes in fund balances is limited to one format; therefore, other financing sources and uses should be reported after the “excess (deficiency) of revenues over expenditures,” as illustrated in paragraph 86.

Other financing sources and uses

203. Q—Can debt *proceeds* be reported net of premiums, discounts, and issuance costs?

A—No. Paragraph 88 requires proceeds of long-term debt to be reported as an other financing source. That paragraph also includes issuance premium or discount among the items that should be reported as other financing sources or uses, and paragraph 87 states that debt issue costs paid out of debt proceeds, such as underwriter fees, should be reported as expenditures. The list of other financing sources and uses in paragraph 88 should refer to the “face amount” of long-term debt, rather than the *proceeds*. Therefore, the description of the financing source would be “long-term debt issued,” rather than “long-term debt proceeds.”

Special and extraordinary items

204. Q—For special and extraordinary items, at which level—government-wide or fund reporting—is “materiality” or “significance” determined?

A—Determining the materiality or significance of a transaction for purposes of separately reporting extraordinary and special items is relative to the focus of the particular financial statement in question. Because the government-wide statement focuses on governmental and business-types *activities*, the transaction should be evaluated in relation to the appropriate type of activity—either governmental or business-type. The fund financial statements emphasize *major funds*; thus, a transaction should be evaluated in the context of the major fund, or nonmajor funds in the aggregate. (See Q205.)

205. Q—Can a transaction be reported as a special or extraordinary item in the fund financial statements but not in the statement of activities?

A—Yes. For example, assume that a government sold a significant governmental capital asset for a large amount, but at a negligible gain or loss. Significant proceeds from the sale would be reported in the governmental fund financial statements; however, because the gain or loss is insignificant, it would not be reported as a special item in the statement of activities. On the other hand, the reverse situation—a transaction is an extraordinary or special item in the statement of activities but not in the fund financial statements—also could occur. For example, a local government assumes the debt of another organization, either because it is required to as a guarantor, or because it chooses to under a “moral” obligation. There has been no flow of financial resources; thus, there is no extraordinary or special item required to be reported in the statement of revenues, expenditures, and changes in fund balances. In the statement of activities, however, the event results in a change in net assets and would be reported.

Required Financial Statements—Proprietary Funds

Internal Service Funds

206. Q—Are combining statements for internal service funds required in the basic financial statements?

A—No. Combining statements for internal service funds are accorded the same status as combining statements for nonmajor funds—they are not required, but may be presented as supplementary information. (See Q158 about combining statements in a CAFR.)

Statement of Net Assets

207. Q—Paragraph 98 states that capital contributions should not be displayed as a separate component of net assets. Can contributed capital be reported as a “subcomponent” of one of the required net asset categories—for example, “invested in capital assets, net of related debt”?

A—No. Contributed capital should not be separately identified, even as a “subcomponent” under a broader classification. As explained in paragraph 430 in the Basis for Conclusions, 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.

208. Q—What happens to the existing contributed capital equity accounts in enterprise funds?

A—The entire equity section of an enterprise fund should be combined into a single combined “total net assets” amount and recast into the separate components required by paragraph 98. As a result, much of what was previously reported as contributed capital will be included in the “invested in capital assets, net of related debt” component of net assets. However, some former contributed capital amounts also may be included in the restricted and unrestricted components.

Reporting restricted assets

209. Q—Paragraph 99 requires restricted assets to be reported separately in the proprietary fund statement of net assets. How should restricted assets be reported under the *classified* approach?

A—Restricted assets should often be reported as “noncurrent” assets. Accounting Research Bulletin (ARB) 43, Chapter 3, paragraph 6a, excludes from *current* assets “cash and claims to cash which are restricted as to withdrawal or use for other than current operations, are designated for expenditure in the acquisition or construction of noncurrent assets, or are segregated for the liquidation of long-term debts.” Restricted assets that will be used in current operations—certain grants and contract revenues, for example—should be reported as current assets. (See Q82.)

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

210. Q—Paragraph 100 states that governments should identify revenues used as security for revenue bonds in the proprietary fund operating statement. The illustrative statement in Exhibit D-3 of Appendix C in Statement 34, however, does not provide that identification. What is required?

A—The purpose of the requirement is to segregate revenues that are “pledged” as security for revenue bonds from other revenues. In Exhibit D-3, *all* charges for services were pledged against the revenue bonds of the two enterprise funds, so separate identification was not necessary. If, however, those funds had other major revenue sources that were not pledged toward repayment of those bonds, those revenues would have been displayed separately and identification of the pledged revenues would have been required. Governments are *not* required to identify the pledged revenues *by segment* on the face of the statement—that information would be provided by the disclosure of “operating revenues by major source” required by paragraph 122.

211. Q—In the statement of revenues, expenses, and changes in fund net assets for proprietary funds, are governments required to report expenses by natural (object) classification?

A—No. A specific type or level of detail is not *required*. Paragraph 101 indicates only that the presentation of operating and nonoperating expenses should be “detailed.” Therefore, some governments may use *natural classifications* (for example, salaries and wages, employee benefits, supplies, utilities) and others may use *functions*. (A public university, for example, may use instruction, academic support, student services, and so forth.)

212. Q—Do the additional display/disclosure requirements in paragraph 89 (for significant transactions or other events that are either unusual or infrequent but are not within the control of management) for governmental funds also apply to proprietary funds?

A—Yes. Governments are required to display or disclose those events and transactions for their proprietary funds. The display/disclosure requirements in paragraph 89, in essence, apply the requirements of paragraph 26 of 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*, to governmental fund reporting. Because proprietary funds were already subject to that requirement in APB 30, it was not necessary to repeat the language in paragraph 89 for proprietary funds. (See Q139 about the definitions of *unusual* and *infrequent*.)

213. Q—A government has a business-type activity that it reports in a separate enterprise fund. The government received a grant from a private foundation and used the grant proceeds to purchase equipment for that activity. How should the grant be reported in the enterprise fund’s financial statements? How should it be reported in the government’s statement of activities?

A—In the enterprise fund, the answer depends on whether the grant is restricted for capital purposes. In the statement of activities, the answer depends on whether the grant was restricted to the specific activity. If the grant was not restricted for capital purposes, but could have been used for any purpose within the activity, the government should report the grant as *nonoperating revenue* in the enterprise fund. On the other hand, if the grant was restricted to capital purposes, it would be reported as a *capital contribution* in the enterprise fund’s statement of revenues, expenses, and changes in fund net assets, as illustrated in paragraph 101. If the grant was restricted to that specific activity (or function), the government would report it as a program revenue (either operating or capital, as appropriate) in the statement of activities. If it was not restricted to that activity (or function), the grant would be reported as general revenue in the statement of activities.

Defining operating revenues and expenses

214. Q—Paragraph 102 links the determination of operating revenues and expenses to the classification of transactions in the statement of cash flows. However, paragraph 16 of Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*, describes cash flows from operating activities as generally those that “enter into the determination of operating income.” How can the guidance in Statement 9 be used to identify “operating” revenues and expenses for proprietary fund operating statements?

A—The reference to the Statement 9 categories is intended to serve only as a guideline and should not be considered a requirement or limitation for defining operating revenues. Paragraphs 17 and 18 of Statement 9 identify specific cash inflows and outflows that should be included in the operating activities category. Generally, revenues and expenses related to those particular cash flows would likely also be regarded as “operating.” Paragraph 19 of Statement 9 discusses the limited instances when governments can classify certain investing activities as operating cash flows. Statement 34 (footnote 42) indicates that governments can apply the concept

from Statement 9, paragraph 19, on a broader scale for identifying operating revenues and expenses. That is, if the nature of an enterprise is such that its “operating activities” would fall under a financing or investing cash flows category, the revenues and expenses may, nevertheless, be considered “operating.”

215. **Q**—Some BTAs that are component units of a state or local government receive annual operating subsidies or capital-related appropriations from their primary government. Should those payments from the primary government be reported as operating or nonoperating revenues?

A—Appropriations for capital-related purposes should be reported separately after nonoperating revenues and expenses. Paragraph 102 indicates that governments should establish a policy that defines operating revenues and expenses that is appropriate to the nature of the activity being reported. It further suggests that Statement 9 be used as a consideration for determining how individual transactions would be categorized for operating/nonoperating purposes. Paragraph 21b (footnote 9) of Statement 9 specifically includes grants or subsidies provided to finance operating deficits in the noncapital financing category, rather than the operating activities category. Based on that guidance, annual operating grants and subsidies should be reported as *nonoperating* revenues. Paragraphs 50 through 52 in the Basis for Conclusions section of Statement 35 discuss the issue from the perspective of public colleges and universities.

Reporting capital contributions and additions to permanent and term endowments

216. **Q**—Should capital contributions from joint venture participants who have an *equity interest* (“owners”) be reported in the joint venture’s statement of revenues, expenses, and changes in net assets, or are those transactions exceptions that can be reported as direct additions to net assets/equity?

A—There are no exceptions to the requirement in paragraph 103. It states that 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. Contributions to a governmental joint venture from its participant-owners are included (as capital contributions) in the “all-inclusive” reporting requirements.

217. **Q**—If, as discussed in Q216, contributions from joint venture participants are reported in the joint venture’s statement of revenues, expenses, and changes in net assets, rather than as direct additions to equity, does that increase the “earnings” to be distributed to the participants or adjusted to equity interests?

A—No. The distribution of earnings to the participants (a nonoperating expense) and the calculation of equity interests should not be affected by the manner in which additional paid-in capital (and payments to the participant-owners) is *reported* in a joint venture’s financial statement. Appendix D of Statement 14 (paragraph 147) discusses a joint venture example and illustrates the calculation of the joint venture’s equity and the equity interest of a participant. The calculations illustrated in that example are the same regardless of whether payments to/from the “owners” are reported in the operating statement as changes in net assets (under Statement 34) or as direct additions to equity/net assets (as was previously done).

Required reconciliations

218. **Q**—Under what circumstances would a reconciliation between enterprise funds and business-type activities be required?

A—Generally, only two circumstances would create a difference between total enterprise funds and business-type activities. One difference would arise when enterprise funds are the predominant or only participants in an internal service fund. Paragraph 62 requires the internal service fund balances to be combined with the enterprise funds in the business-type activities column of the statement of net assets. Similarly, if a “look-back” adjustment is needed to eliminate the effect of internal service fund activity (see paragraphs 59 and 314)

involving enterprise fund participants, the enterprise funds' operating expenses would be adjusted for the statement of activities. (See Exhibits 6 and 7 in Appendix 2.) The other difference would occur when, as discussed in Q18 and Q19, a government chooses to report activities accounted for in enterprise funds as governmental activities (or vice versa) in the government-wide statements. (See Q106 about allocating indirect expenses to business-type activities.) Exhibits 6B and 6C in Appendix 4 illustrate the details of a reconciliation between enterprise fund financial statements and government-wide statements when internal service funds' results and balances are allocated to business-type activities.

Statement of Cash Flows

219. Q—Can governments “indirectly” determine direct method cash flows?

A—Yes. Paragraph 440 (footnote 82) in the Basis for Conclusions refers to guidance provided in FASB Statement No. 95, *Statement of Cash Flows* (paragraphs 115–118 of the Basis for Conclusions), for “indirectly determining amounts of operating cash receipts and payments.” Generally, governments can estimate certain direct method cash flow amounts by adjusting for beginning and ending receivables and payables. Exercise #7 in Appendix 4 illustrates how that can be done.

Required Financial Statements—Fiduciary Funds and Similar Component Units

220. Q—Does Statement 34 change the display, disclosure, or measurement and recognition requirements in Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Notes Disclosures for Defined Contribution Plans*; Statement No. 26, *Financial Reporting for Postemployment Healthcare Plans Administered by Defined Benefit Pension Plans*; and Statement 27?

A—The measurement and recognition requirements of Statements 25 and 27 remain unchanged. Statement 34 amends those Statements only as necessary to adapt their display and disclosure requirements to the new reporting model structure. Most significantly, paragraph 106 clarifies how the plan financial statements required by Statements 25 and 26 should be presented when pension or postemployment healthcare plans are reported as fiduciary funds in the employer's financial report. Fiduciary fund financial statements (like those required by Statement 25) should be presented by fund type. If separate financial statements complying with Statements 25 and 26 exist for each plan, the employer's report should refer readers to them; if not, the employer should include financial statements for each plan in the notes to its financial statements.

221. Q—Does Statement 34 require disclosure of the financial statements of external investment pools in the notes to the sponsoring government's financial statements?

A—Paragraph 106 states that financial statements for individual pension plans and postemployment healthcare plans should be presented in the notes to the financial statements of the primary government if separate GAAP financial reports have not been issued. The notes at the bottom of the illustrative statement of fiduciary net assets and statement of changes in fiduciary net assets (Exhibits E-1 and E-2) in Appendix C of Statement 34 indicate that the notes should also disclose the financial statements of individual external investment pools. The requirement to disclose condensed financial statements of individual external investment pools, if separate financial statements are not issued, is not a provision of Statement 34, but rather comes from Statement 31, paragraph 19c.

222. *Q*—Are the financial reporting formats required for investment trust funds similar enough to pension trust funds so that they can be reported on the same statement?

A—Yes. Paragraph 18 of Statement 31 requires only that a statement of net assets and a statement of changes in net assets be presented for investment trust funds in the financial statements of the sponsoring government. The only other display requirement is that the difference between the external pool's assets and liabilities should be captioned "net assets held in trust for pool participants." Those requirements are easily accommodated in the pension trust fund display requirements set forth in Statement 25. To accommodate the Statement 25 requirements for additional details of investments and investment income, governments should also provide that level of detail for all other fiduciary funds or clearly note that summarized amounts exclude the more detailed pension data that is displayed.

223. *Q*—Paragraph 106 does not require a separate column for component units that are fiduciary in nature. How should those component units be displayed in the fiduciary fund financial statements?

A—Each fiduciary component unit should be reported within the appropriate fiduciary fund types, rather than aggregated in a separate fiduciary component units column.

Measurement Focus and Basis of Accounting

224. *Q*—How does the basis of accounting change for an expendable trust fund in the previous model that is reported as a private-purpose trust fund under Statement 34?

A—Expendable trust funds in the previous model were reported under the modified accrual basis of accounting. Private-purpose trust funds under Statement 34 are reported using the accrual basis. However, in the previous model, NCGA Statement 1, paragraphs 34 and 107, provided for certain capital assets and long-term liabilities, respectively, to be reported as fund assets and liabilities in *trust funds*. Therefore, the effect of the change in the basis of accounting may be negligible for many governments.

Reporting Agency Funds

225. *Q*—A county tax collector collects property taxes for all taxing bodies in the county, including the tax-levying funds of the county. The county uses an agency fund as a distribution mechanism for the taxes. At year-end, the collector is holding \$3,450,000 in the tax distribution account. Of that total, \$750,000 will be distributed to the county funds, and the remaining \$2,700,000 represents taxes collected for the other taxing bodies in the county. How does the county apply the "clearing account" provision in paragraph 111 for agency funds?

A—In the county's financial statements, the tax collector's agency fund would report only the \$2,700,000 in cash with an equal amount as a liability to other taxing bodies. The \$750,000 collected and on hand for the county's funds would be reported as cash (rather than taxes receivable or due from agency funds) in the appropriate funds. In essence, the collector has a "pooled" cash account, similar to an internal investment pool. The allocation of cash balances to the county funds is consistent with the requirement in paragraph 14 of Statement 31 that requires the "equity position" of each fund in an internal investment pool to be reported as assets in those funds.

226. *Q*—If a government uses a central payroll system and reports all payroll deductions in an agency fund, should the unremitted balances in the agency fund at year-end be reclassified to the funds from which the payroll deductions arose?

A—No. The clearing account provision in paragraph 111 pertains to *assets* held in an agency fund pending distribution to the government's funds. In this case, the operating funds have transferred the withheld amounts to the agency fund, and thus have no further liability. The agency fund appropriately reports the unremitted amounts as liabilities.

Reporting Interfund Activity

227. *Q*—Paragraph 112a(1) discusses interfund loans (including balances previously termed “advances”) and states that 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. What does “expected within a reasonable time” mean?

A—There is no precise definition of the provision. Preparers will have to exercise professional judgment in determining whether an interfund loan should be reclassified. The *expectation* aspect of the phrase means that the government intends to, and has the ability to, repay the amount loaned. For example, recurring payments made to reduce the interfund loan balance may provide evidence that “repayment is expected.” What constitutes a *reasonable time* for repayment is again a matter of professional judgment, but the notion is not without precedent in financial reporting standards. Statement 10 invokes a “reasonable time” consideration in paragraphs 66b and 68 with regard to recovery of the full cost of internal service fund expenses.

228. *Q*—How are “quasi-external transactions” reported?

A—Statement 34 does not use the term *quasi-external transaction*, but rather refers to this form of internal activity as “reciprocal interfund activity.” Paragraph 112 explains that there are two types of reciprocal interfund activity—interfund loans and interfund services provided and used. Items previously reported as quasi-external transactions meet the definition of “interfund services provided and used,” and are reported as if they were external transactions, as revenues and expenditures/expenses.

229. *Q*—How should a government report a “payment in lieu of taxes” from its enterprise utility fund to its general fund?

A—The payment would be reported either as an interfund transfer or as interfund services provided and used—that is, as an expense in the enterprise fund and a revenue in the general fund. As discussed in paragraph 112, the distinction is based on whether the payment in lieu of taxes is a payment for, and reasonably equivalent in value to, the services provided by the general fund.

Basic Financial Statements—Notes to the Financial Statements

General Disclosure Requirements

230. *Q*—Paragraph 115a requires governments to provide a description of the government-wide statements in the summary of significant accounting policies. How does this disclosure differ from the requirement in paragraph 11a to include in MD&A a brief discussion of the basic financial statements?

A—The requirement for additional significant accounting policies disclosure in paragraph 115a relates only to the government-wide statements and essentially calls for descriptive comments about the purposes and scope of the statements of net assets and activities. For example, this disclosure could address:

- What are governmental and business-type activities
- The absence of fiduciary funds and similar component units
- What are the components of net assets
- What are the key elements of the statement of activities.

The MD&A discussion required by paragraph 11a relates to *both* government-wide *and* fund statements and is oriented more toward the *relationship* of government-wide statements to fund financial statements.

231. *Q*—Paragraph 115h requires disclosure of a government’s policy regarding the use of restricted resources. What information should be included in this disclosure?

A—Governments are required to state their policy for *when* they use restricted resources. That is, do they spend restricted funds only when unrestricted amounts are insufficient or unavailable, or do they spend restricted funds first and use unrestricted resources when the restricted funds are depleted? Disclosure of this policy should help readers understand the significance of restricted and unrestricted net assets relative to total net assets.

Required Disclosures about Capital Assets and Long-term Liabilities

232. *Q*—What detailed disclosures are required for capital assets?

A—The detailed disclosure should present for each major class of capital asset: governmental activities separate from business-type activities, capital assets being depreciated separate from those that are not being depreciated, and historical costs separate from accumulated depreciation. For each of the classes, the following information should also be presented, as applicable:

Beginning- and end-of-year balances

Capital acquisitions

Sales or other dispositions

Current depreciation expense.

Additionally, the amounts of depreciation expense charged to each of the functions in the statement of activities should be disclosed. Note 1 in Exhibit 11 of Appendix 2 illustrates the detailed disclosure requirements.

233. *Q*—What are examples of major classes of capital assets?

A—Land, infrastructure, buildings and improvements, vehicles, machinery and equipment, and construction in progress are examples of major classes of capital assets.

234. *Q*—Paragraph 119d requires governments to disclose which governmental funds have been used in the past to liquidate certain long-term liabilities. If the government has decided to depart from the historical trend and uses other funds to liquidate those liabilities (for example, through a change in budgetary policy), should that fact also be disclosed?

A—Yes. The purpose of that disclosure is to provide readers additional information about future claims against financial resources to assist them in assessing the fund balances of specific funds. In this case, the past payment trends would not assist readers in making that assessment.

Segment Information

235. *Q*—A city uses a single enterprise fund to account for its water and sewer operations. Although both operations are accounted for in a single fund, the city maintains separate asset, liability, revenue, and expense accounts for each. There are outstanding revenue bonds that pertain to the water reservoir and distribution lines. The sewer operation has no long-term debt attributable to it. What are the segment reporting requirements for the Water and Sewer Fund?

A—The disclosures set forth in paragraph 122 are required for the water operation, but not for the sewer operation. The primary motive in requiring the segment disclosures was to ensure the availability of information about activities financed by revenue-backed debt, even if the activity was not reported in a separate fund. Therefore, even though the sewer operation is an identifiable activity with its own asset, liability, revenue, and expense accounts, the segment disclosures in paragraph 122 are not required because of the absence of revenue-backed debt.

236. *Q*—A public university has fifteen residence halls on its campus, ten of which have individual bonded debt secured by the room fee revenues of the specific dorm. Is the “identifiable activity” the entire group of fifteen residence halls, or only those with revenue bonds outstanding?

A—Paragraph 122 requires governments to disclose information about “segments” of enterprise funds in the notes to financial statements. One essential characteristic of a segment is that it is an “identifiable activity.” The “identifiable activity” is the *source* of the pledged revenues. If the bond indenture specified that the pledged revenues were the fees from all the dorms, the dorm *system* would be the identifiable activity. In this case, however, because each dorm’s debt is secured by its own revenues, segment disclosures should be made for *each* of the ten residence halls that meet *all* the criteria in paragraph 122. The primary purpose of the disclosure required by paragraph 122 is to provide information about “coverage” of pledged revenues, not to disaggregate all of the operating results of enterprise funds.

237. *Q*—To meet the requirement for segment reporting, is it necessary for the debt to be secured *solely* by the pledged revenue stream, or can it also be backed by the full faith and credit of the issuing government?

A—The definition of a segment in paragraph 122 includes a requirement that there is a specific identifiable revenue stream pledged in support of revenue bonds or other revenue-backed debt. It is not a requirement that the debt be backed solely by the pledged revenues. The additional “full faith and credit” support does not negate the requirement to make the segment disclosures if all the criteria in paragraph 122 are met.

238. *Q*—If a government determines that segment disclosures for a major discretely presented component unit should be included in the notes, is a condensed statement of cash flows required?

A—No. A condensed statement of cash flows would not be required in the segment disclosures for a major component unit. Cash flow reporting is not required for component units anywhere else—not in the government-wide statements and not in the major component unit information. Paragraph 456 in the Basis for Conclusions states that users interested in cash flow information about a specific component unit should refer to the component unit’s separately issued financial statements.

Reporting Component Units

239. *Q*—Is there any change in the method by which blended component units are included in a reporting entity’s financial statements?

A—No. Statement 34 does not change the method used to blend component units. Component units that meet the criteria for blending in paragraph 53 of Statement 14 should be included in the reporting entity’s fund financial statements in accordance with paragraphs 52 through 54 of that Statement. (See Q181 about major fund reporting.)

240. *Q*—What criteria are used to determine which discretely presented component units are “major”?

A—Statement 34 does not modify the guidance in paragraph 51 of Statement 14 for determining which component units are major. That paragraph states: “In determining which component units are ‘major,’ consideration should be given to each component unit’s significance relative to the other component units and the nature and significance of its relationship to the primary government.”

241. *Q*—If a component unit has component units of its own, but does not present a reporting entity *total column*, what information should be “rolled up” to the primary government’s reporting entity financial statements?

A—Paragraph 126 states that 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 unit’s statements of net assets and activities. The reference in paragraph 126 should be to “the *totals*” from the component unit’s statements of net assets and activities, rather than “total *columns*.” Statement 34 does not amend the requirement in paragraph 43 of Statement 14. That paragraph states that the component unit financial data that are incorporated into a reporting entity’s financial statements should include the data from all of its component units. Therefore, the data that should be taken from the component unit’s financial statements are the amounts that *would be* in its entity total column if one had been presented. Exhibit 11 in Appendix 3 illustrates the combining statement approach for reporting major component unit information.

242. *Q*—If a discretely presented component unit does not issue a separate report, what additional reporting is required for that component unit in the financial reporting entity’s financial statements?

A—Paragraph 50 in Statement 14 requires the reporting entity’s CAFR to include fund-type information for a discretely presented component unit that does not issue a separate report. Statement 34 amends that requirement to be consistent with the change in the focus of fund-based reporting from *fund type* to *major funds*. Consequently, if a component unit does not issue separate financial statements, fund financial statements (including major funds) for that component unit should be included in the reporting entity’s CAFR as supplementary information.

243. *Q*—Paragraph 456 explains that users interested in cash flow information about a specific component unit should refer to the component unit’s separately issued financial statements. If a component unit does not issue separate financial statements, is cash flow information for the component unit required to be presented in the reporting entity’s CAFR?

A—Yes. As explained in the answer to Q242, if a component unit does not issue separate financial statements, fund financial statements for that component unit should be included in the reporting entity’s CAFR. Therefore, if the component unit has proprietary funds, cash flow statements for those funds would be included in the major component unit information in the reporting entity’s CAFR as supplementary information.

244. *Q*—If a discretely presented component unit is not fiduciary in nature, but has fiduciary funds, are those fiduciary funds reported in the reporting entity’s financial statements?

A—No. Fiduciary funds of a discretely presented component unit are not included in the reporting entity’s financial statements. As explained in paragraph 126, the “aggregated total” financial information of a discretely presented component unit is taken from its statement of net assets and statement of activities. Paragraph 13 defines the scope of those statements to exclude fiduciary funds. (However, see Q242 about including fund financial statements of a component unit that does not issue separate financial statements.)

Required Supplementary Information Other Than MD&A

Budgetary Comparison Schedules

Presentation of Budgetary Comparison Schedules

245. *Q*—If a special revenue fund does not meet the percentage criteria in paragraph 76a and b, but is nevertheless reported as a major fund because the government’s officials believe it is particularly important to financial statement users (for example, because of public interest or consistency), is a budgetary comparison schedule required for that “major” special revenue fund?

A—Yes. The extended use of major fund reporting as set forth at the end of paragraph 76 allows governments to report *any* (governmental or enterprise) fund *as a major fund*. If a fund is *voluntarily* reported as a major fund, all of the major fund reporting requirements (including budgetary comparison schedules, if applicable) should be met.

246. *Q*—Should governments that issue the full financial section of a CAFR, including budgetary comparisons for debt service, capital projects, nonmajor special revenue funds, and other funds that have legally adopted budgets, apply the provisions of paragraphs 130 and 131 to those additional comparisons?

A—Statement 34 establishes standards for the basic financial statements, MD&A, and certain RSI other than MD&A. It does not prescribe requirements for the data presented as supplementary information—combining and individual fund statements and statistical information, for example. Governments that present additional budgetary comparisons as supplementary information may choose to, but are not required to, present that information in accordance with the provisions of paragraphs 130 and 131.

247. *Q*—Can a government present some of its required budgetary comparison information (for the general fund, for example) in the basic statements (as provided for in footnote 53 to paragraph 130) and the remainder in schedules as RSI?

A—No. The required budgetary comparison information—for the general fund and each major special revenue fund that has a legally adopted budget—should be reported together.

248. *Q*—If a government chooses to present its required budgetary comparisons in the basic statements, where should they be located?

A—Budgetary comparison statements for governmental funds should be reported with the fund financial statements after the statement of changes in revenues, expenditures, and changes in fund balances.

249. Q—What format should governments use for presentation of the budgetary comparison?

A—Paragraph 131 states that governments may use the format, terminology, and classifications used in the underlying budget documents or those used in the governmental funds' operating statement. Both formats are allowed, and neither is preferred over the other. Examples using a budget document format are presented in Exhibits 12 and 13 in Appendix 2, and an example of the governmental operating statement format is presented in Exhibit 13 in Appendix 3.

250. Q—The requirement in paragraph 130 for reporting budgetary comparison schedules refers to “legally adopted annual budgets.” Are governments that budget on a biennial basis *exempt* from this requirement?

A—No. The budgetary comparison reporting requirements also apply to governments with biennial budgets. Statement 34 does not change the provision in paragraph 15 of NCGA Interpretation 10, *State and Local Government Budgetary Reporting*; therefore, governments with biennial budgets may continue to report budgetary periods in the manner used in the previous model.

Original and Final Budgets

251. Q—Some governments begin a fiscal year using interim budgets that cover a short period (for example, three months) and serve as temporary spending authority. Should an interim budget be considered the “original” budget?

A—No. The original budget should be the first budget that covers the entire fiscal period.

252. Q—Should the automatic carryover of encumbrances be included as part of the original budget even though the exact amount of the encumbrances may not be known at the time the budget is adopted?

A—Yes. Paragraph 130a states that 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. In essence, the adopted budget includes a provision to cover prior-year encumbrances in whatever amounts they may be. The amounts will likely be known (or can be reasonably estimated) by the time the financial statements are issued after the year-end.

253. Q—Does the final budget include amendments made to the budget (transfers of appropriations between line items, for example) *after* the fiscal year ends?

A—Yes. Paragraph 130b states that the final budget should incorporate amendments regardless of when signed into law or otherwise legally authorized.

Disclosure Requirements

254. Q—If the budgetary comparison information is presented as RSI, should *material* violations of budgetary spending limitations (excess of expenditures over appropriations) be disclosed in notes to RSI?

A—Paragraph 131 states that notes to RSI should disclose *any* excess of expenditures over appropriations in individual funds. In addition, if the excess is considered to be a material violation of finance-related legal provisions, a disclosure in the notes to the basic financial statements is required.

Modified Approach for Reporting Infrastructure

255. *Q*—In what circumstances could a government change aspects of performing the condition assessment for the modified approach, yet maintain consistency?

A—Statement 34 requires that condition assessments be performed in a consistent manner and that RSI disclosures include 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. Consistency is achieved if the condition assessment is performed using the same method, basis, and scale for a complete assessment. For example, if a government performs its condition assessment over a three-year cycle, it should use the same method, basis, and scale throughout the three years in order to maintain consistency. A government may change the method, basis, or scale prior to beginning the subsequent complete assessment. If a change is made, it should be disclosed in RSI.

256. *Q*—Can a government change its condition assessment methods as frequently as new condition assessment methods become available?

A—As the knowledge base of asset management grows, new methods of condition assessment will become available. Governments may adopt new condition assessment methods before beginning the next condition assessment. System upgrades that do not change the basic assessment methodology would not be considered a change in assessment methodology.

Basic Financial Statements Required for Special-purpose Governments

257. *Q*—What is a special-purpose government, and why is it important to distinguish it from a general government?

A—Paragraph 134 discusses special-purpose governments, but does not offer a definition of the term. It presents a short list of typical general purpose governments—states, cities, counties, towns, and villages—but other forms, such as boroughs and certain townships, may also be considered “general purpose.” General purpose governments are thought to be those that offer more than one type of *basic governmental services*—for example, general government, public safety, transportation, health and welfare. Special-purpose governments generally provide a limited (or sometimes a single) set of services or programs—for example, fire protection, library services, mosquito abatement, and drainage.

The general purpose/special-purpose distinction is important to clarify that references and illustrations to general purpose governments throughout Statement 34 should not be interpreted as limiting its applicability to only those governments. It also helps in understanding that *all* provisions need not be applied to *all* governments. Nevertheless, a definition of *special-purpose* is not required to determine the applicability of the provisions in paragraphs 134 through 141. The term *special-purpose* could have been omitted from those paragraphs without losing any of the clarity of the explanations. For example, paragraph 136 applies to *any governments* engaged in a single governmental program, paragraph 138 applies to *any governments* engaged only in business-type activities, and paragraph 139 applies to *any governments* engaged only in fiduciary activities.

Engaged in a Single Governmental Program

258. *Q*—If the scope of a government’s services is equivalent to, or within, a single functional category, is that an indication that it is a *single-program government* for purposes of applying the provisions of paragraph 136?

A—No. Functional categories are generally broader than programs. For practical reasons, *functional categories* was established as the minimum level of detail for reporting governmental activities of a general purpose government. A special-purpose government may provide several programs that are all within a single functional category. For example, a park district falls under the “culture-recreation” functional category, but may provide multiple programs—golf, swimming, recreation leagues, tennis, skating, and so forth. As indicated in paragraph 137, if the park district budgets, manages, or accounts for those programs as separate activities, it should not be considered a “single-program” government.

259. *Q*—A government has an equity interest in a joint venture. The joint venture uses the governmental fund structure; therefore, the participating governments’ equity interests are based (per the joint venture agreement) on financial interests in fund balances or amounts in account groups. Under Statement 34, the joint venture will present government-wide statements using the economic resources measurement focus and the accrual basis of accounting. What effect will this change in reporting have on the equity interests reported by the participants?

A—Participants in the joint venture should continue to measure their equity interests in accordance with the explicit terms of the joint venture agreement. For example, equity interests based on fund balances of governmental funds would not automatically change when the joint venture implements Statement 34. However, because the Statement 34 model does not include account groups, equity interests in capital assets and long-term liabilities could be calculated based on amounts reported in the statement of net assets.

Engaged Only in Business-type Activities

260. *Q*—A primary government is a special-purpose government engaged only in business-type activities but has component units (that do not meet the requirements for blending) that are engaged in governmental activities. How should the component units’ information be presented?

A—Even though the primary government is a special-purpose government engaged only in business-type activities, the financial reporting entity is not. Therefore, the entity should present government-wide statements as provided for in paragraph 135.

Engaged Only in Fiduciary Activities

261. *Q*—How does Statement 34 affect the external financial statements of a public employee retirement system (PERS)?

A—Statement 34 modifies the external financial reporting requirements for PERS in two ways. First, it requires that MD&A be included as RSI, and second, it provides an *option* to present a separate column for each defined benefit pension plan and each related postemployment healthcare plan it administers in the statement of plan net assets and statement of changes in plan net assets, rather than in separate combining statements.

Effective Date and Transition

Determining Appropriate Implementation Phase

262. *Q*—Are capital contributions of an enterprise fund included in the “total annual revenue” calculation for determining the appropriate implementation phase?

A—No. As described in paragraph 143, revenues include all revenues (not other financing sources) of the primary government’s governmental and enterprise funds, except for extraordinary items as defined in paragraph 55. Although capital contributions are reported as revenues under Statement 34, in the prior model (within which “total revenues” are determined) they were reported as direct additions to equity, and thus would not be included in determining the appropriate implementation phase.

263. *Q*—When determining the appropriate implementation phase, are “transfers” between a primary government and a discretely presented component unit included in total revenues?

A—No. Paragraph 143 specifically excludes other financing sources. Although these transactions will be reported as *revenue* under Statement 34, they are reported as other financing sources when the implementation phase is determined; therefore, they would not be included. (See Q262.)

264. *Q*—When determining the appropriate implementation phase, are governmental fund revenues actual or budgeted amounts?

A—Actual governmental fund revenues, on the modified accrual (GAAP) basis, should be used to determine the proper implementation phase.

Component Unit Implementation

265. *Q*—Paragraph 143 sets forth implementation guidance for primary governments and component units. It states that all component units should implement the requirements of the Statement no later than the same year as their primary government, regardless of the amount of each component unit’s total revenues. If a component unit is required to, or chooses to, implement Statement 34 *before* its primary government, how should the component unit’s financial information be included in the reporting entity’s financial statements?

A—If the component unit is engaged only in business-type activities (and therefore follows the guidance in paragraph 138 of Statement 34), incorporating its financial information into the reporting entity’s financial statements is relatively straightforward in accordance with paragraphs 44 and 46 of Statement 14. If the component unit is engaged in governmental activities, its government-wide *statement of net assets* can be included in the reporting entity’s combined balance sheet as described in paragraph 44 of that Statement. On the other hand, the component unit’s *statement of activities* is in a different format from the combined operating statements of governmental and proprietary funds and, thus, cannot be included under the methods described in paragraphs 45 through 47. However, the different format and MFBA of the statement of activities presents a situation similar to the one addressed in paragraph 48 of that Statement. Because of its incompatibility with the combined operating statements in the reporting entity’s financial statements, the component unit’s statement of activities should be presented on a separate page—just as paragraph 48 of Statement 14 required in the previous model for a college or university component unit’s statements of changes in fund balances and current funds revenues, expenditures, and other changes.

266. Q—A state government is required to implement Statement 34 for its fiscal year ended June 30, 2002. It has a component unit with a December 31 fiscal year that qualifies for phase 2 implementation (that is, for its fiscal year ended 12/31/03). Should the component unit implement Statement 34 for its 12/31/01 financial statements (in effect, *before* phase 1 governments are required to apply it)?

A—Yes. Paragraph 142 requires that 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. Because paragraph 59 in Statement 14 requires that the reporting entity's financial statements should incorporate financial statements for the component unit's fiscal year ending during the reporting entity's fiscal year, component units would be required to apply Statement 34 for their financial statements included in the state's 6/30/02 financial statements—in this case, the component unit's 12/31/01 statements. However, as a practical matter, if the component unit is a business-type activity (using the enterprise fund model), *early* implementation may not be necessary. All the information required by Statement 34 for incorporation into the reporting entity's government-wide financial statements would be provided in the component unit's financial statements under the previous model. Information that may be needed for major component unit display or disclosure—for example, the required components of net assets and the operating/nonoperating distinction—would need to be provided, however. Note that the financial statement requirements for a BTA in paragraph 138 differ very little from the previous model (except for MD&A and the direct method requirement in the cash flow statement—neither of which affects the reporting entity's financial statements).

On the other hand, the information taken from the combined financial statements of a *governmental* component unit (under the previous model) would *not* be compatible with the reporting entity's statements of net assets and activities; therefore, early implementation of Statement 34 would be necessary.

Transition Provisions

267. Q—When a government first implements Statement 34, if it has general obligation bonds outstanding resulting from an advance refunding, are the deferral and amortization requirements of Statement No. 23, *Accounting and Financial Reporting for Refundings of Debt Reported by Proprietary Activities*, applicable? Should any premiums, discounts, and debt issuance costs related to general obligation bonds be calculated, deferred, and amortized pursuant to APB Opinion No. 21, *Interest on Receivables and Payables*?

A—No. Governments may, but are not required to, calculate those beginning balances at implementation. Paragraph 146 allows governments to apply the provisions of all those pronouncements to governmental activities, *prospectively*.

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

268. Q—Paragraph 147 states that governmental entities that report as of the issuance date of Statement 34 using the AICPA Not-for-Profit model, as defined in Statement No. 29, *The Use of Not-for-Profit Accounting and Financial Reporting Principles by Governmental Entities*, but that do not meet the criteria in paragraph 67 may use enterprise fund accounting and financial reporting. Does that provision establish an *exception* to the requirements of paragraph 67 for governmental not-for-profit organizations?

A—Yes, but on a very exclusive basis. The exception to paragraph 67 applies *only* to governmental entities that report as of June 30, 1999 using the AICPA Not-for-Profit model, as defined in Statement 29. Those qualifying entities are exempt from the limitations imposed by paragraph 67; that is, they *may* apply the provisions of paragraph 138, as a government engaged only in business-type activities. Other governmental not-for-profit organizations that previously used the Governmental model, rather than the AICPA Not-for-Profit model, are subject to the requirements and limitations of paragraph 67.

Reporting General Infrastructure Assets at Transition

269. Q—If a phase 3 government (total annual revenues of less than \$10 million in the first fiscal year ending after June 15, 1999) grows and its revenues increase to more than \$10 million after the implementation period was determined, would it then have to retroactively capitalize its infrastructure assets?

A—No. Governments that qualify as phase 3 governments are exempt from the requirement to retroactively apply the infrastructure reporting provisions. However, retroactive application is encouraged.

270. Q—A primary government qualifies for phase 1 implementation and is therefore required to retroactively apply the major general infrastructure reporting provisions. If the primary government has a discretely presented component unit that qualifies for phase 3 implementation, is that component unit also required to retroactively apply those infrastructure requirements?

A—No. The component unit would be required to implement Statement 34 at the same time as the primary government, but the exemption provided to phase 3 governments in paragraph 148 is not affected by the reporting requirements of the primary government.

271. Q—What provisions have been made to minimize the cost of reporting infrastructure assets?

A—Some of the provisions to minimize cost include:

- Several methods of estimating historical cost are permitted, including deflated current replacement cost and the use of bond documents and capital budgets (paragraphs 158 and 160). See Exercise #8 in Appendix 4.
- Accumulated depreciation at transition may be calculated using weighted-average acquisition years (paragraph 159). See Exercise #9 in Appendix 4.
- Although all governments are encouraged to report all infrastructure assets at the effective dates of the Statement, phase 1 and 2 governments (paragraph 143) are permitted to defer retroactive reporting of infrastructure for four years. The smallest governments—phase 3 governments—are not required to capitalize existing infrastructure assets.
- Required capitalization is limited to major general infrastructure assets as defined by paragraph 148 (footnote 66). See Q282 and Exercise #10 in Appendix 4.
- The required retroactive capitalization period need not extend back earlier than years ending after June 30, 1980 (paragraph 154).
- Composite depreciation rates based on groupings of similar assets or classes of dissimilar assets are permitted (paragraph 163). See Exercise #1 in Appendix 4.

272. Q—How detailed should records of infrastructure assets be?

A—Detailed records of individual assets are not necessarily required. The level at which infrastructure assets are reported determines the minimum amount of detail. Infrastructure may be reported by major class, network, subsystem, or individual asset. Other factors, such as maintenance, insurance, and stewardship responsibilities, also influence the level of record keeping selected by a government.

273. *Q*—If a government reports all of its long-term debt in its government-wide statement of net assets prior to retroactively reporting its infrastructure assets, what could a government do to avoid reporting a negative balance of net assets?

A—The government may decide to record some or all of its networks at the transition date. During the transition period, the government should disclose a description of the infrastructure assets being reported and those that are not, as well as a description of any eligible infrastructure assets that the government has decided to report using the modified approach (paragraph 151).

274. *Q*—Could a government record capital assets, including infrastructure, in an amount equal to the balance of general long-term debt at the transition date?

A—Generally, no. Long-term debt is often issued to finance the purchase of capital assets, and the total amount of debt outstanding at a transition date may be a starting point for estimating the historical cost of those capital assets. The original issuance amount, rather than the balance outstanding at a transition date, may be a better estimate of original cost in certain cases.

275. *Q*—Paragraph 150 indicates that governments may report networks of infrastructure assets in stages during the transition period as information becomes available. If a government develops its historical cost information for infrastructure assets in a different manner, by year of acquisition or by individual asset, for instance, may such infrastructure assets be recorded during the transition period as information is available?

A—No. Transition capitalization should be on a network basis, not on a year-by-year basis.

276. *Q*—Although NCGA Statement 1 required land to be capitalized, some governments have never capitalized the land associated with infrastructure assets, such as a right of way for highways. Should it be classified as land or as infrastructure?

A—Land, including that associated with infrastructure, should be reported as “land” at cost, estimated cost, or estimated fair value at date of acquisition.

277. *Q*—Can general infrastructure assets acquired in years ended before June 30, 1980 be capitalized at transition?

A—Yes. The date is intended as a minimum starting point. Reporting general infrastructure acquired earlier is encouraged but not required.

Modified Approach for Reporting Infrastructure Assets

278. *Q*—Statement 34 requires at least one complete condition assessment before the modified approach is permitted. Can the condition assessment be performed in the same year as adoption of Statement 34?

A—Yes. The condition assessment need only be available and documented prior to reporting infrastructure assets using the modified approach.

279. Q—At transition, at least one condition assessment should be available when a government adopts the modified approach (paragraph 152). If a government's most recent condition assessment for an infrastructure asset was completed three years prior to the date at which Statement 34 is implemented, would this asset qualify for the modified approach?

A—Yes. Condition assessments should be completed within a three-year period.

280. Q—At its implementation date, a government has not completed its condition assessment of a particular network—it is two-thirds complete. May the government apply the modified approach?

A—No. At least one complete condition assessment should be available (paragraph 152).

281. Q—If a government decides at its implementation date to use the modified approach for a subsystem or network of general infrastructure assets, would it capitalize the assets at estimated cost, adjusted for price-level changes, less accumulated depreciation?

A—No. If a subsystem or network of infrastructure assets will be reported using the modified approach, the assets are recorded at full estimated historical cost. Accumulated depreciation from the acquisition date to the transition capitalization date is not recorded.

Determining Major General Infrastructure Assets

282. Q—What are the thresholds for determining major general infrastructure assets?

A—For networks, the threshold is 10 percent of general capital assets reported in the first fiscal year ending after June 15, 1999. For subsystems, the threshold is 5 percent of general capital assets reported in that period. Statement 34 does not specify whether the calculation is performed using historical cost or net book value of general capital assets. It should be noted that general capital assets do not include proprietary or fiduciary fund capital assets.

283. Q—Does the total cost of general capital assets that is used to calculate the threshold for major general infrastructure assets in paragraph 156 include the costs of infrastructure *to be capitalized*?

A—No. The threshold for determining major infrastructure assets is based upon the total reported cost of all general capital assets before any previously unrecorded infrastructure has been capitalized.

284. Q—May the determination of major infrastructure networks and subsystems be made using preliminary cost estimates?

A—Yes. Paragraph 156 indicates that the determination of major general infrastructure assets is made using costs or estimated costs. See Exercise #10 in Appendix 4.

285. *Q*—The determination of major general infrastructure assets is at the network or subsystem level. If only a portion of a network or subsystem was acquired since 1980 and no records are available to estimate the historical cost of the entire network or subsystem, how does one determine whether the asset is a major asset?

A—Only the preliminary estimate of the cost of the portion of the network or subsystem acquired or receiving major improvements in fiscal years ending after June 30, 1980 needs to be compared to the criteria for major general infrastructure assets. Retroactive reporting of assets or portions of assets acquired prior to that period is encouraged, but not required.

Establishing Capitalization at Transition

286. *Q*—A county constructed a road financed by issuance of county bonds and then turned the road over to the state for managing all future maintenance. Which government reports the road as an infrastructure asset?

A—When ownership is unclear, the government with primary responsibility for managing an infrastructure asset should report the asset. In this example, because the state is responsible for maintenance, it would report the asset.

287. *Q*—If both the state and a local government pay jointly toward the construction of a bridge, what should be capitalized by the locality?

A—The government with primary responsibility for managing the bridge should report it. If the local government was solely responsible for maintaining the bridge at the conclusion of its construction, for example, the local government would report the entire historical cost of the bridge.

288. *Q*—If determining historical cost of general infrastructure assets is not practical because of inadequate records, how may estimated historical cost be calculated using current replacement cost techniques?

A—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. See Exercise #8 in Appendix 4 for an example of estimating historical cost using deflated replacement cost.

289. *Q*—If determining the actual historical costs of general infrastructure assets is not practical because of inadequate records, what alternatives are there to establish initial capitalizations from existing information?

A—Potential sources of estimates of historical costs include bond documents, capital outlay and capital projects fund expenditures in prior financial reports, engineering documents, capital budgets, and evidence of contract awards, such as those found in minutes of the governing body's meetings.

290. *Q*—Paragraph 159 indicates that roads and highways may be capitalized at transition using lane-miles multiplied by a standard cost. May a similar approach be used for other infrastructure assets?

A—Yes. For example, sidewalks could be estimated using square footage, curbs using lineal footage or miles, or bridges using the span footage.

Appendix 1

STANDARDS SECTION FROM STATEMENT 34

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*

³[Footnote 3 was superseded by Statement No. 35, *Basic Financial Statements—and Management’s Discussion and Analysis—for Public Colleges and Universities*, to include public institutions in the scope of this Statement.]

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

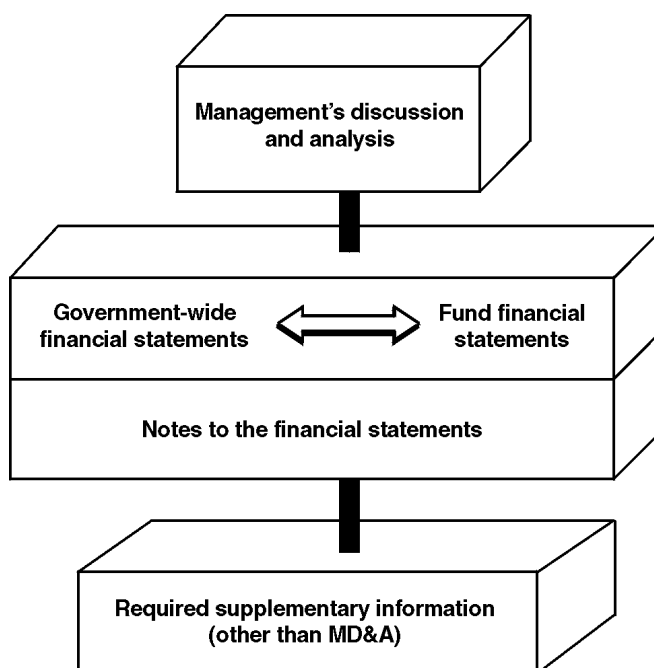
6. The minimum requirements for management’s discussion and analysis (MD&A), basic financial statements, and required supplementary information other than MD&A are:

- 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 government⁴ 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.)

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

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

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 known⁶ 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.

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

⁷If 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.

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 activity⁸ 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

⁸Paragraphs 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.

- (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 activities¹⁰ 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.

⁹See footnote 6.

¹⁰This 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.

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) Statements¹² and Interpretations
- b. Accounting Principles Board (APB) Opinions¹³
- 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. 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

¹¹In 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.

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

¹³Changes 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.

using the modified approach (paragraphs 23 through 25), should be reported separately if the government has a significant amount of these assets. Capital assets also may be reported in greater detail, such as by major class of asset (for example, infrastructure, buildings and improvements, vehicles, machinery and equipment). Required disclosures are discussed in paragraphs 116 and 117.

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

22. Depreciation expense should be reported in the statement of activities as discussed in paragraphs 44 and 45. Depreciation expense should be measured by allocating the net cost of depreciable assets (historical cost less estimated salvage value) over their estimated useful lives in a systematic and rational manner. It may be calculated for (a) a class of assets, (b) a network of assets,¹⁴ (c) a subsystem of a network,¹⁵ or (d) individual assets. (Composite methods may be used to calculate depreciation expense. See paragraphs 161 through 166 for a more complete discussion of depreciation.)

Modified approach

23. Infrastructure assets that are part of a network or subsystem of a network¹⁶ (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 assessments¹⁸ 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

¹⁴A 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.

¹⁵A 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.

¹⁶If 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.

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

¹⁸Condition 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.

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 level²⁰ established and disclosed by the government.

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

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

Reporting works of art and historical treasures

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

¹⁹Condition 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.

²⁰For 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.

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

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

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

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

Invested in Capital Assets, Net of Related Debt

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

Restricted Net Assets

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

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

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

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

Unrestricted Net Assets

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

²³Use 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.)

²⁴Because 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.

²⁵Enabling 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.

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. 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 approach²⁸ 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.

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

²⁷The 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.

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

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. *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 restricted²⁹ 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 accumulated resources* of a program are *legally restricted* to be used for that program, the net cost to be financed by the government's general revenues is reduced, and those investment earnings should be reported as program revenues.

General revenues

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

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

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

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 method³¹ for displaying the information required to be reported in the statement of activities:

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

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.

³¹See paragraph 136.

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

Eliminations and Reclassifications

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

Internal balances—statement of net assets

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

Internal activities—statement of activities

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

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

Intra-entity activity

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

Reporting Internal Service Fund Balances

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

Fund Financial Statements

Funds—Overview and Definitions

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

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

Governmental Funds

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

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

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

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.

³³These 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.

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

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/expenses³⁷ 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 *current financial resources measurement focus* and the *modified accrual basis of accounting*, as the terms are discussed in NCGA Statement 1, as amended.

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

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

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

Reporting general capital assets

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

Reporting general-long term liabilities

81. NCGA Statement 1, paragraph 32, provides that “a clear distinction should be made between . . . fund long-term liabilities and general long-term debt.” That Statement, as amended, requires recognition of *governmental fund liabilities* using the modified accrual basis of accounting. Paragraph 43 of that Statement states that “general long-term debt is the *unmatured principal* of bonds, warrants, notes, or other forms of noncurrent or long-term *general obligation* indebtedness. . . . General long-term debt is not limited to liabilities arising from debt issuances *per se*, but may also include noncurrent liabilities on lease-purchase agreements and other commitments that are not current liabilities properly recorded in governmental funds.” Subsequent NCGA and GASB pronouncements also define the noncurrent portion of capital leases, operating leases with scheduled rent increases, compensated absences, claims and judgments, pensions, special termination benefits, and landfill closure and postclosure care liabilities as general long-term liabilities. Liabilities arising from interfund activities (see paragraph 112) do not constitute general long-term liabilities and therefore should be reported in governmental funds.

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

Balance sheet

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

Separate display of reserved and unreserved fund balance

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

Required reconciliation

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

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

Statement of revenues, expenditures, and changes in fund balances

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

Revenues (detailed)
<u>Expenditures (detailed)</u>
Excess (deficiency) of revenues over expenditures
Other financing sources and uses, including transfers (detailed)
<u>Special and extraordinary items (detailed)</u>
Net change in fund balances
<u>Fund balances³⁸—beginning of period</u>
<u>Fund balances—end of period</u>

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

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

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 sheet³⁹
- b. Statement of revenues, expenses, and changes in fund net assets or fund equity⁴⁰
- 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*.

³⁹Either 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.

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

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 source⁴¹ and should identify revenues used as security for revenue bonds. This statement should also distinguish between operating and nonoperating revenues and expenses (as discussed in paragraph 102) and should present a separate subtotal for *operating revenues, operating expenses, and operating income*. Nonoperating revenues and expenses should be reported after operating income. Revenues from capital contributions and additions to the principal of permanent and term endowments, special and extraordinary items, and transfers should be reported separately, after nonoperating revenues and expenses as illustrated below.

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

Operating revenues (detailed)
Total operating revenues
<u>Operating expenses (detailed)</u>
Total operating expenses
Operating income (loss)
<u>Nonoperating revenues and expenses (detailed)</u>
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
<u>Net assets—beginning of period</u>
<u>Net assets—end of period</u>

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

Defining operating revenues and expenses

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

Reporting capital contributions and additions to permanent and term endowments

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

Required reconciliations

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

⁴²Revenue 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.

⁴³For 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.

private-purpose trusts, agency funds. Financial statements for individual pension plans and postemployment healthcare plans⁴⁴ should be presented in the notes to the financial statements of the primary government if separate, GAAP financial reports have not been issued. If separate, GAAP financial reports have been issued, the notes should include information about how to obtain those separate reports.

Measurement Focus and Basis of Accounting

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

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.

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

- (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.)

⁴⁵However, 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.

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

Required Note Disclosures about Capital Assets and Long-term Liabilities

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

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

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

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

119. Information about long-term liabilities should include both long-term debt (such as bonds, notes, loans, and leases payable) and other long-term liabilities⁴⁷ (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.

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

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 be 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.

⁴⁸Segment 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.

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 unit⁴⁹ in a separate column in the reporting entity’s statements of net assets and activities, (b) including combining statements of major component units⁵⁰ 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 activities⁵¹ 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.

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

⁵⁰Nonmajor 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.

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

⁵²See footnote 51.

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. Budgetary comparison schedules should be presented as RSI⁵³ 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

⁵³Governments 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.

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

⁵⁵NCGA 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.”

⁵⁶If 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.

Modified Approach for Reporting Infrastructure

132. Governments should present the following schedules, derived from asset management systems, as RSI for all eligible infrastructure assets⁵⁷ 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 expended (as discussed in paragraph 25) for each of the past five reporting periods.

133. The following disclosures⁵⁸ 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 units⁵⁹ 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 activities⁶¹ 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

⁵⁷If 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*.

⁵⁸Governments 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.

⁵⁹As 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.

⁶⁰As 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.

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

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 113–123).

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.

⁶²If 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.

⁶³See Statement 25, paragraphs 14 and 44.

⁶⁴As 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.

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

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

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

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

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

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

146. The requirements of APB Opinions No. 12, *Omnibus Opinion—1967*, and No. 21, *Interest on Receivables and Payables*, as amended, require deferral and amortization of debt issue premium or discount. These Opinions may be applied prospectively to governmental activities in the statement of net assets and the statement of activities, except for governmental activity debt that is deep-discount or zero-coupon debt.⁶⁵ Similarly, FASB Statement No. 34,

⁶⁵For 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.

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 assets⁶⁶ 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.

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.

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

⁶⁷For 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.

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.**

Appendix 2

ILLUSTRATIVE FINANCIAL STATEMENTS

The sample financial statements included in this appendix are presented to illustrate the display and disclosure requirements of Statement 34. They are illustrative only and are nonauthoritative. 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 A: Illustrative Financial Statements for a Municipal Government

Illustration B: Illustrative Financial Statements for an Independent School District

Illustration C: Illustrative Financial Statements for a State Government

Illustration A—Illustrative Financial Statements for a Municipal Government

This appendix illustrates the display and disclosure requirements of Statement 34. 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 financial statement preparers in understanding the requirements of Statement 34. **In some instances, amounts that may be considered immaterial are used to illustrate specific requirements or approaches.** *No inferences about determining materiality should be drawn from these illustrations.*

This appendix illustrates the minimum requirements for a "complete set" of financial statements in accordance with GAAP and required supplementary information. MD&A, a "typical" set of basic financial statements, and RSI other than MD&A are included. *In addition, certain supplementary information, not required by Statement 34, is presented.* Combining statements for nonmajor governmental funds and internal service funds are illustrated to provide underlying fund details that may be helpful in understanding certain aspects of the basic financial statements.

The illustrations in this appendix are based on the examples in Appendix C of Statement 34; however, some modifications have been made to better illustrate the requirements. Alternative approaches to some of the displays and disclosures in this appendix are presented in Appendix 3. Preparers should select alternatives, where appropriate, considering what is most relevant and useful, based on the requirements set forth in Statement 34 and the needs of their financial statement users.

The illustrative MD&A demonstrates 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 example meets the minimum requirements for MD&A and in some instances provides additional insights and analyses about required elements to demonstrate how a "basic" MD&A might be embellished to improve readability or to provide for a more complete understanding of the areas that are required to be addressed.

Illustration A—Illustrative Financial Statements for a Municipal Government

Exhibit Number		Page Number
	Management's Discussion and Analysis	109
	Basic Financial Statements	
1	Statement of Net Assets	121
2	Statement of Activities	123
3	Balance Sheet—Governmental Funds	125
4	Statement of Revenues, Expenditures, and Changes in Fund Balances—Governmental Funds..	126
5	Reconciliation of the Statement of Revenues, Expenditures, and Changes in Fund Balances of Governmental Funds to the Statement of Activities.....	127
6	Statement of Net Assets—Proprietary Funds.....	129
7	Statement of Revenues, Expenses, and Changes in Fund Net Assets—Proprietary Funds.....	130
8	Statement of Cash Flows—Proprietary Funds	131
9	Statement of Fiduciary Net Assets.....	133
10	Statement of Changes in Fiduciary Net Assets.....	134
11	Notes to the Financial Statements	135
	1 Information about Capital Assets	136
	2 Information about Long-term Liabilities	138
	3 Major Component Unit Information	139
	4 Explanation of Certain Differences between the Governmental Fund Balance Sheet and the Statement of Net Assets.....	140
	5 Explanation of Certain Differences between the Governmental Fund Statement of Revenues, Expenditures, and Changes in Fund Balances and the Statement of Activities.....	140
	6 Segment Information	141
	Required Supplementary Information	
12	Budgetary Comparison Schedule—General Fund.....	143
13	Budgetary Comparison Schedule—HUD Programs Fund (a major fund)	144
14	Note to RSI: Note A—Explanation of Differences between Budgetary Inflows and Outflows and GAAP Revenues and Expenditures.....	145
	Supplementary Information	
15	Combining Balance Sheet—Nonmajor Governmental Funds	147
16	Combining Statement of Revenues, Expenditures, and Changes in Fund Balances—Nonmajor Governmental Funds.....	148
17	Combining Statement of Net Assets—Internal Service Funds.....	149
18	Combining Statement of Revenues, Expenses, and Changes in Fund Net Assets—Internal Service Funds	150
19	Combining Statement of Cash Flows—Internal Service Funds	151

MANAGEMENT'S DISCUSSION AND ANALYSIS

This section of Sample City's annual financial report presents our discussion and analysis of the City's financial performance during the fiscal year that ended on December 31, 2002. Please read it in conjunction with the transmittal letter at the front of this report and the City's financial statements, which follow this section.

FINANCIAL HIGHLIGHTS

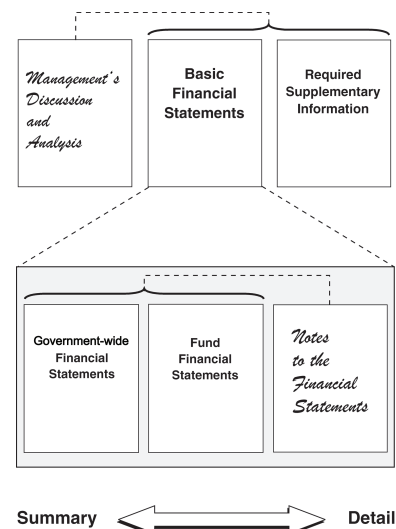
- The City's total net assets remained virtually unchanged over the course of this year's operations. However, while net assets of our business-type activities *increased* \$3.2 million (or nearly 4 percent), this was offset by a *decrease* of \$3.2 million (or 2.5 percent) in the net assets of our governmental activities.
- During the year, the City's expenses were \$6.4 million more than the \$99.5 million generated in taxes and other revenues for governmental programs (before special items). This is better than last year, when expenses exceeded revenues by \$8.9 million.
- In the City's business-type activities, revenues increased 5.6 percent to \$15 million while expenses decreased 1.7 percent.
- The total cost of the City's programs was virtually unchanged (increasing approximately \$900,000, or less than 1 percent), and no new programs were added this year.
- The general fund reported a deficit this year of \$1.3 million despite 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 midyear hiring and overtime freeze and our staff restructuring efforts.

OVERVIEW OF THE FINANCIAL STATEMENTS

This annual report consists of four parts—*management's discussion and analysis* (this section), the *basic financial statements*, *required supplementary information*, and an optional section that presents *combining statements* for nonmajor governmental funds and internal service funds. The basic financial statements include two kinds of statements that present different views of the City:

- The first two statements are *government-wide financial statements* that provide both *long-term* and *short-term* information about the City's *overall* financial status.
- The remaining statements are *fund financial statements* that focus on *individual parts* of the City government, reporting the City's operations in *more detail* than the government-wide statements.
 - The *governmental funds* statements tell how *general government* services like public safety were financed in the *short term* as well as what remains for future spending.
 - *Proprietary fund* statements offer *short- and long-term* financial information about the activities the government operates *like businesses*, such as the water and sewer system.
 - *Fiduciary fund* statements provide information about the financial relationships—like the retirement plan for the City's employees—in which the City acts solely as a *trustee or agent* for the benefit of others, to whom the resources in question belong.

Figure A-1
Required Components of
Sample City's Annual Financial Report



The financial statements also include *notes* that explain some of the information in the financial statements and provide more detailed data. The statements are followed by a section of *required supplementary information* that further explains and supports the information in the financial statements. Figure A-1 shows how the required parts of this annual report are arranged and relate to one another. In addition to these required elements, we have included a section with combining statements that provide details about our nonmajor governmental funds and internal service funds, each of which are added together and presented in single columns in the basic financial statements.

Figure A-2 summarizes the major features of the City’s financial statements, including the portion of the City government they cover and the types of information they contain. The remainder of this overview section of management’s discussion and analysis explains the structure and contents of each of the statements.

<p>Figure A-2 Major Features of Sample City’s Government-wide and Fund Financial Statements</p>				
	Government-wide Statements	Fund Statements		
		Governmental Funds	Proprietary Funds	Fiduciary Funds
Scope	Entire City government (except fiduciary funds) and the City’s component units	The activities of the City that are not proprietary or fiduciary, such as police, fire, and parks	Activities the City operates similar to private businesses: the water and sewer system, and the parking facilities	Instances in which the City is the trustee or agent for someone else’s resources, such as the retirement plan for City employees
Required financial statements	<ul style="list-style-type: none"> • Statement of net assets • Statement of activities 	<ul style="list-style-type: none"> • Balance sheet • Statement of revenues, expenditures, and changes in fund balances 	<ul style="list-style-type: none"> • Statement of net assets • Statement of revenues, expenses, and changes in net assets • Statement of cash flows 	<ul style="list-style-type: none"> • Statement of fiduciary net assets • Statement of changes in fiduciary net assets
Accounting basis and measurement focus	Accrual accounting and economic resources focus	Modified accrual accounting and current financial resources focus	Accrual accounting and economic resources focus	Accrual accounting and economic resources focus
Type of asset/liability information	All assets and liabilities, both financial and capital, and short-term and long-term	Only assets expected to be used up and liabilities that come due during the year or soon thereafter; no capital assets included	All assets and liabilities, both financial and capital, and short-term and long-term	All assets and liabilities, both short-term and long-term; the City’s funds do not currently contain capital assets, although they can
Type of inflow/outflow information	All revenues and expenses during year, regardless of when cash is received or paid	Revenues for which cash is received during or soon after the end of the year; expenditures when goods or services have been received and payment is due during the year or soon thereafter	All revenues and expenses during year, regardless of when cash is received or paid	All revenues and expenses during year, regardless of when cash is received or paid

Government-wide Statements

The government-wide statements report information about the City as a whole using accounting methods similar to those used by private-sector companies. The statement of net assets includes *all* of the government’s assets and liabilities. All of the current year’s revenues and expenses are accounted for in the statement of activities regardless of when cash is received or paid.

The two government-wide statements report the City’s *net assets* and how they have changed. Net assets—the difference between the City’s assets and liabilities—is one way to measure the City’s financial health, or *position*.

- Over time, increases or decreases in the City’s net assets are an indicator of whether its financial health is improving or deteriorating, respectively.
- To assess the overall health of the City you need to consider additional nonfinancial factors such as changes in the City’s property tax base and the condition of the City’s roads.

The government-wide financial statements of the City are divided into three categories:

- *Governmental activities*—Most of the City’s basic services are included here, such as the police, fire, public works, and parks departments, and general administration. Property taxes and state and federal grants finance most of these activities.
- *Business-type activities*—The City charges fees to customers to help it cover the costs of certain services it provides. The City’s water and sewer system and parking facilities are included here.
- *Component units*—The City includes two other entities in its report—the Sample City Public School District and the Sample City Landfill. Although legally separate, these “component units” are important because the City is financially accountable for them.

Fund Financial Statements

The fund financial statements provide more detailed information about the City’s most significant *funds*—not the City as a whole. Funds are accounting devices that the City uses to keep track of specific sources of funding and spending for particular purposes.

- Some funds are required by State law and by bond covenants.
- The City Council establishes other funds to control and manage money for particular purposes (like the Route 7 construction project) or to show that it is properly using certain taxes and grants (like aid from the U.S. Department of Housing and Urban Development).

The City has three kinds of funds:

- *Governmental funds*—Most of the City’s basic services are included in governmental funds, which focus on (1) how *cash and other financial assets* that can readily be converted to cash flow in and out and (2) the balances left at year-end that are available for spending. Consequently, the governmental funds statements provide a detailed *short-term* view that 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. Because this information does not encompass the additional long-term focus of the government-wide statements, we provide additional information at the bottom of the governmental funds statement, or on the subsequent page, that explains the relationship (or differences) between them.
- *Proprietary funds*—Services for which the City charges customers a fee are generally reported in proprietary funds. Proprietary funds, like the government-wide statements, provide both long- and short-term financial information.
 - In fact, the City’s *enterprise funds* (one type of proprietary fund) are the same as its business-type activities, but provide more detail and additional information, such as cash flows.
 - We use *internal service funds* (the other kind of proprietary fund) to report activities that provide supplies and services for the City’s other programs and activities—such as the City’s Telecommunications Fund.
- *Fiduciary funds*—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. The City is responsible for ensuring that the assets reported in these funds are used for their intended purposes. All of the City’s fiduciary activities are reported in a separate statement of fiduciary net assets and a statement of changes in fiduciary net assets. We exclude these activities from the City’s government-wide financial statements because the City cannot use these assets to finance its operations.

FINANCIAL ANALYSIS OF THE CITY AS A WHOLE

Net assets. The City's *combined* net assets were virtually unchanged between fiscal years 2001 and 2002—remaining at approximately \$208.6 million. (See Table A-1.) In comparison, last year net assets decreased \$6.2 million. Looking at the net assets and net expenses of governmental and business-type activities separately, however, two very different stories emerge.

Table A-1
Sample City's Net Assets
(in millions of dollars)

	Governmental Activities		Business-type Activities		Total		Total Percentage Change
	2001	2002	2001	2002	2001	2002	2001–2002
Current and other assets	\$ 48.4	\$ 54.5	\$ 15.8	\$ 14.0	\$ 64.2	\$ 68.5	6.7%
Capital assets	162.1	170.0	147.6	151.4	309.7	321.4	3.8%
Total assets	210.5	224.5	163.4	165.4	373.9	389.9	4.3%
Long-term debt outstanding	63.3	79.3	77.3	78.3	140.6	157.6	12.1%
Other liabilities	21.1	22.3	3.6	1.4	24.7	23.7	(4.0)%
Total liabilities	84.4	101.6	80.9	79.7	165.3	181.3	9.7%
Net assets							
Invested in capital assets, net of related debt	100.3	103.7	71.6	73.1	171.9	176.8	2.9%
Restricted	29.5	25.1	2.8	1.4	32.3	26.5	(18.0)%
Unrestricted	(3.7)	(5.9)	8.1	11.2	4.4	5.3	20.5%
Total net assets	\$126.1	\$122.9	\$ 82.5	\$ 85.7	\$208.6	\$208.6	0%

Net assets of the City's governmental activities decreased 2.5 percent to \$122.9 million. However, all of those net assets either are restricted as to the purposes they can be used for or are invested in capital assets (buildings, roads, bridges, and so on). Consequently, *unrestricted* net assets showed a \$5.9 million deficit at the end of this year. This deficit does not mean that the City does not have resources available to pay its bills next year. Rather, it is the result of having *long-term* commitments that are greater than currently available resources. Specifically, the City did not include in past annual budgets the full amounts needed to finance future liabilities arising from property and casualty claims and to pay for unused employee vacation and sick days. The City will include these amounts in future years' budgets as they come due.

In addition, the deficit in unrestricted governmental net assets was adversely affected by two particular features of the City's recent financial activity:

- During the past two years tax revenues and State grants fell short of expectations.
- The City Council used accumulated cash balances to avoid tax increases.

Although the net assets of our business-type activities increased by 3.9 percent to \$85.7 million, these resources cannot be used to make up for the net asset deficit in governmental activities. The City generally can only use these net assets to finance the continuing operations of the water, sewer, and parking operations.

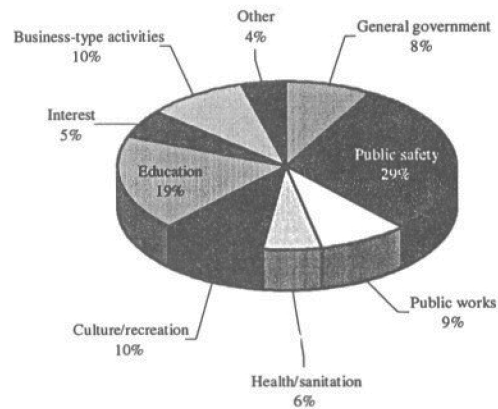
Changes in net assets. The City's total revenues (excluding special items) increased by 4 percent to \$114.5 million. (See Table A-2.) Virtually half of the City's revenue comes from property taxes, and 60 cents of every dollar raised comes from some type of tax. (See Figure A-3.) Another quarter comes from fees charged for services, and most of the rest is state and federal aid.

The total cost of all programs and services was virtually unchanged (increasing approximately \$900,000, or less than 1 percent). The City's expenses cover a range of services, with about half related to public safety and education. (See Figure A-4.)

Figure A-3
Sample City
Sources of Revenue for Fiscal Year 2002



Figure A-4
Sample City
Functional Expenses for Fiscal Year 2002



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 net assets deficit also were the primary reasons for this year's shortfall. Table A-2 and the narrative that follows consider the operations of governmental and business-type activities separately.

Governmental Activities

Revenues for the City's governmental activities (excluding the sale of park land) increased 3.8 percent, while total expenses increased only 1 percent. With the gain on the sale of the park land, the decrease in net assets for governmental activities was narrowed to \$3.2 million in 2002. This compares to a \$9.3 million decrease 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 a third reduced expenses:

- The City increased property tax rates an average of 5 percent. This increase, the first in four years, raised tax revenues \$2.8 million in 2002. Based on increases in property values, tax revenues are budgeted to increase an additional \$2.8 million next year.
- The City sold three parcels of park land for \$3.5 million, for a gain (net of the \$823,000 originally paid) 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 in the future are not expected to be at the same level as the City received this year by selling the land.
- The City imposed a hiring and overtime freeze (excluding the City's police, fire, and sanitation departments) in midyear that resulted in a \$2.2 million savings in wages and related benefits expenses 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.

Table A-2
Changes in Sample City's Net Assets
(in millions of dollars)

	Governmental Activities		Business-type Activities		Total		Total Percentage Change
	2001	2002	2001	2002	2001	2002	2001-2002
Revenues							
Program revenues							
Charges for services	\$ 14.6	\$ 15.9	\$11.9	\$12.8	\$ 26.5	\$ 28.7	8.3%
Federal grants	2.4	2.5	1.5	1.6	3.9	4.1	5.1%
State grants and entitlements	8.3	7.5	—	—	8.3	7.5	(9.6)%
General revenues							
Property taxes	53.6	56.4	—	—	53.6	56.4	5.2%
Other taxes	13.0	13.0	—	—	13.0	13.0	—
Federal entitlements	1.4	1.5	—	—	1.4	1.5	7.1%
Other	2.6	2.7	0.8	0.6	3.4	3.3	(2.9)%
Total revenues	95.9	99.5	14.2	15.0	110.1	114.5	4.0%
Expenses							
General government	9.3	9.7	—	—	9.3	9.7	4.3%
Public safety	33.8	34.8	—	—	33.8	34.8	3.0%
Public works	10.5	10.1	—	—	10.5	10.1	(3.8)%
Engineering services	1.4	1.3	—	—	1.4	1.3	(7.1)%
Health and sanitation	6.5	6.7	—	—	6.5	6.7	3.1%
Cemetery	0.5	0.7	—	—	0.5	0.7	40.0%
Culture and recreation	11.9	11.5	—	—	11.9	11.5	(3.4)%
Community development	3.3	3.0	—	—	3.3	3.0	(9.1)%
Education	21.3	21.9	—	—	21.3	21.9	2.8%
Interest on long-term debt	6.3	6.2	—	—	6.3	6.2	(1.6)%
Water	—	—	3.7	3.6	3.7	3.6	(2.7)%
Sewer	—	—	4.8	4.9	4.8	4.9	2.1%
Parking facilities	—	—	3.0	2.8	3.0	2.8	(6.7)%
Total expenses	104.8	105.9	11.5	11.3	116.3	117.2	0.8%
Excess (deficiency) before special items and transfers	(8.9)	(6.4)	2.7	3.7	(6.2)	(2.7)	(56.5)%
Special item: gain on park land sale	—	2.7	—	—	—	2.7	—
Transfers	(0.4)	0.5	0.4	(0.5)	—	—	—
Increase (decrease) in net assets	\$ (9.3)	\$ (3.2)	\$ 3.1	\$ 3.2	\$ (6.2)	\$ (0.0)	0%

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 final budget estimates. The fire at the State Street Mall affected many retail businesses in the City. In addition, grant revenues were lower than expected because of overall state cutbacks.

Table A-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 fees generated by the activities and intergovernmental aid). The net cost shows the financial burden that was placed on the City's taxpayers by each of these functions.

- The cost of all *governmental* activities this year was \$105.9 million.
- However, the amount that our taxpayers paid for these activities through City taxes was only \$80 million. Some of the cost was paid by:
 - Those who directly benefited from the programs (\$15.9 million), or
 - Other governments and organizations that subsidized certain programs with grants and contributions (\$10.0 million).
- The City paid for the \$80 million “public benefit” portion with \$69.4 million in taxes, and with other revenues such as the park land sale, interest, and unrestricted state aid.

Table A-3
Net Cost of Sample City's Governmental Activities
(in millions of dollars)

	Total Cost of Services		Percentage Change	Net Cost of Services		Percentage Change
	2001	2002		2001	2002	
Police department	\$ 19.7	\$ 20.3	3.0%	\$19.1	\$19.5	2.1%
Fire department	9.2	9.4	2.2%	8.4	8.7	3.6%
Public works	10.5	10.1	(3.8)%	7.3	7.0	(4.1)%
Education	21.3	21.9	2.8%	21.3	21.9	2.8%
Parks and recreation	9.7	9.9	2.1%	4.6	4.4	(4.3)%
Other	34.4	34.3	(0.3)%	18.3	18.5	1.1%
Total	\$104.8	\$105.9	1.0%	\$79.0	\$80.0	1.3%

Business-type Activities

Revenues of the City's business-type activities increased 5.6 percent to \$15 million, and expenses *decreased* 1.7 percent to \$11.3 million. (Refer to Table A-2.) Factors contributing to these results included:

- A 10 percent increase in water and sewer operating revenues (driven by growth in hook-ups of residential customers converting from septic systems); operating expenses rose only 4 percent. The high maintenance costs caused by the harsh winter months of 2001 did not occur this year.
- Continued operating deficits at City parking facilities—\$1.4 million this year versus \$1.3 million in 2001. In both years the deficit was 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.

FINANCIAL ANALYSIS OF THE CITY'S FUNDS

As the City completed the year, its governmental funds reported a *combined* fund balance of \$34.9 million, slightly below last year. 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 those highlighted in the analysis of governmental activities. In addition, these other changes in fund balances should be noted:

- The City spent \$11.3 million this year on the Route 7 construction project, reducing the beginning fund balance in that capital projects fund by the same amount. This reduction was expected because fund balance at the beginning of this year included the proceeds of federal and state highway grants received late last year to finance that project. Although these and other capital expenditures reduce available fund balances, they create new assets for the City in the statement of net assets (as discussed in Note 1 to the financial statements).
- In the same way, the fund balance of the Community Redevelopment Fund increased \$18 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 constructing housing units and \$2.3 million was transferred to the debt service fund. Overall, fund balance grew \$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 (including \$1.6 million accumulated previously) was used for 10 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:

- Amendments and supplemental appropriations approved shortly after the beginning of the year to reflect the actual beginning account balances (correcting the estimated amounts in the budget adopted in October 2001).
- Changes made in the third quarter to account for the midyear hiring and overtime freeze, some of the City's staff restructuring efforts, and the sale of an additional parcel of park land.
- Increases in appropriations to prevent budget overruns.

Even with these adjustments, actual expenditures were \$1.3 million below final budget amounts. The most significant positive variance (\$534,646) resulted from a 10 percent reduction of the general administration workforce due to the staff restructuring and hiring freeze.

On the other hand, resources available for appropriation were \$1.1 million below the final budgeted amount. As noted earlier:

- Property and other tax collections were less than expected.
- Reductions in state funding also affected grant resources available for appropriation.

These shortfalls were partially offset by a 15 percent increase in utility and cable television taxes approved by the City Council in the third quarter.

The City's general fund balance of \$1.7 million differs from the general fund's *budgetary* fund balance of \$1.4 million reported in the budgetary comparison schedule principally because *budgetary* fund balance excludes:

- Supplies inventories of \$182,821 that are reported as expenditures for budgetary purposes when they are purchased
- Encumbrances of \$40,292 reported as expenditures for budgetary purposes.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At the end of 2002, the City had invested \$321 million in a broad range of capital assets, including police and fire equipment, buildings, park facilities, roads, bridges, and water and sewer lines. (See Table A-4.) This amount represents a net increase (including additions and deductions) of \$12 million, or 3.8 percent, over last year.

Table A-4
Sample City's Capital Assets
(net of depreciation, in millions of dollars)

	Governmental Activities		Business-type Activities		Total		Total Percentage Change
	2001	2002	2001	2002	2001	2002	2001-2002
Land	\$ 29.4	\$ 27.1	\$ 3.7	\$ 3.8	\$ 33.1	\$ 30.9	(6.6)%
Buildings and improvements	30.5	30.1	101.2	103.1	131.7	133.2	1.1%
Equipment	22.9	21.3	8.4	8.5	31.3	29.8	(4.8)%
Infrastructure	76.4	90.2	29.3	33.4	105.7	123.6	16.9%
Construction in progress	2.9	1.3	5.0	2.6	7.9	3.9	(50.6)%
Total	\$162.1	\$170.0	\$147.6	\$151.4	\$309.7	\$321.4	3.8%

This year's major capital asset additions included (dollars in millions):

- Route 7 construction project, including completion of Phase 1, paid for with proceeds of federal and state highway grants received late last year—\$11.3
- Redevelopment housing property, acquired with proceeds of revenue bonds issued this year—\$2.0
- Completion of Reese Road culvert project, financed by federal and state grants—\$2.0
- Replacement of older segments of the wastewater collection system and treatment facilities, paid for with proceeds from a revenue note issued last year—\$3.2
- Water distribution mains, hydrants, and meters, constructed and contributed by developers—\$1.2

The City's fiscal year 2003 capital budget projects spending another \$16 million for capital projects, principally for the completion of the final phase of the Route 7 construction project and to create housing units in Finden Acres, 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.

Long-term Debt

At year-end the City had \$158 million in bonds and notes outstanding—an increase of 12 percent over last year—as shown in Table A-5. More detailed information about the City's long-term liabilities is presented in Note 2 to the financial statements.

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 two revenue bond issues by issuing refunding bonds. By refinancing the debt, the City will reduce its debt service payments by \$2.3 million over the next 15 years.

Bond Ratings

Since 1995 the City's general obligation bonds have been rated Q-2 (the fourth highest rating possible). The City's other debt—principally, revenue bonds and notes—carries the fifth highest rating, Q-3+.

Limitations on Debt

The state limits the amount of general obligation debt the City can issue to 3 percent of the assessed value of all taxable property within the City's corporate limits. Our outstanding debt is significantly below this limit—which is currently \$134 million.

Table A-5
Sample City's Outstanding Debt
(in millions of dollars)

	Governmental Activities		Business-type Activities		Total		Total Percentage Change
	2001	2002	2001	2002	2001	2002	2001–2002
General obligation bonds (backed by the City)	\$32.7	\$32.6	\$ —	\$ —	\$ 32.7	\$ 32.6	(0.3)%
Revenue bonds and notes (backed by specific tax and fee revenues)	30.6	46.7	77.3	78.3	107.9	125.0	15.8%
Total	\$63.3	\$79.3	\$77.3	\$78.3	\$140.6	\$157.6	12.1%

ECONOMIC FACTORS AND NEXT YEAR'S BUDGETS AND RATES

- Nonagricultural employment growth mirrored population growth during 1998–2002, averaging annual gains of 4.2 percent.
- Unemployment now stands at 3.9 percent versus 4.1 percent a year ago. This compares favorably with the state's 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 due in part to residential housing market and energy price increases.
 - City inflation was 3.2 percent for fiscal year 2002.
 - The average US city rate was 3 percent.
 - The national rate was 2.8 percent.

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 3.2 percent over the final 2002 budget of \$93.4 million. Property taxes (benefiting from the 2002 rate increases and increases in assessed valuations), public service taxes (with rate increases discussed above), 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 expected impact of inflation on program costs.

Budgeted expenditures are expected to rise nearly 4 percent to \$95.9 million. The largest increments are increased wages and cost-of-living adjustments of \$800,000 based on agreements reached with the police, fire, and sanitation department unions in 2002. 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 repeating the selling of capital assets or restructuring of long-term debt to alleviate cash flow pressures that occurred this 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 at the City-owned garages and 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 demonstrate the City's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Sample City Controller's Office, 6 Delmonico St., Sample City, ST 00000.

STATEMENT OF NET ASSETS

The statement of net assets should display information about the reporting government as a whole. It 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.

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 among major categories of restrictions); and *unrestricted*.

Requirements for the statement of net assets are discussed in paragraphs 30 through 37 of Statement 34. (See Appendix 1.)

Exhibit 1 (on the following page) illustrates the “net assets” format with assets and liabilities in order of relative liquidity. Exhibit 1 in Appendix 3 presents a statement of net assets using a classified “balance sheet” format. A classified approach could also be used in the net assets format.

There are two alternative approaches illustrated in Appendix 3 that may be useful for a government engaged in a single governmental activity with no component units. Exhibit 5 illustrates a statement of net assets using a single column. Exhibit 7 presents a combined governmental fund balance sheet/statement of net assets.

Sample City
Statement of Net Assets
December 31, 2002

Alternatively, the internal balances could be reported on separate lines as assets and liabilities. (See Appendix 3, Exhibit 1.)

ASSETS

	Primary Government			Component
	Governmental	Business-type	Total	Units
	Activities	Activities		
Cash and cash equivalents	\$ 13,597,899	\$ 10,516,820	\$ 24,114,719	\$ 303,935
Investments	27,365,221	64,575	27,429,796	7,428,952
Receivables (net)	12,833,132	3,609,615	16,442,747	4,042,290
Internal balances ←	313,768	(313,768)	—	—
Inventories	322,149	126,674	448,823	83,697
Capital assets (Note 1):				
Land, improvements, and construction in progress	28,435,025	6,408,150	34,843,175	751,239
Other capital assets, net of depreciation	141,587,735	144,980,601	286,568,336	36,993,547
Total capital assets	170,022,760	151,388,751	321,411,511	37,744,786
Total assets	224,454,929	165,392,667	389,847,596	49,603,660

LIABILITIES

Accounts payable and accrued expenses	7,538,543	786,842	8,325,385	1,803,332
Deferred revenue	1,435,599	—	1,435,599	38,911
Long-term 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	101,512,520	79,695,401	181,207,921	30,375,033

NET ASSETS (See Appendix 4, Exhibit 3A.)

Invested in capital assets, net of related debt	103,711,386	73,088,574	176,799,960	15,906,392
Restricted for:				
Capital projects	11,290,079	—	11,290,079	492,445
Debt service	3,076,829	1,451,996	4,528,825	—
Community development projects	6,886,663	—	6,886,663	—
Other purposes	3,874,736	—	3,874,736	—
Unrestricted (deficit)	(5,897,284)	11,156,696	5,259,412	2,829,790
Total net assets	\$122,942,409	\$ 85,697,266	\$208,639,675	\$19,228,627

Exercise #3 in Appendix 4 presents a schedule that shows how the net asset components were determined.

STATEMENT OF ACTIVITIES

The statement of activities should display information about the reporting government as a whole. It 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.

The operations of the reporting government should be presented in a format that reports the *net (expense) revenues* of its individual functions. General revenues, contributions to term and permanent endowments, contributions to permanent fund principal, special and extraordinary items, and transfers should be reported separately after the total net expenses of the government's functions, ultimately arriving at the "change in net assets" for the period.

Separate rows and columns should be used to distinguish between the governmental and business-type activities of the primary government and between the primary government and its discretely presented component units. A total column for the primary government should be presented. A total column for the reporting entity and comparative data from the prior year may be presented but are not required.

The detail presented for governmental activities in Exhibit 2 (on the next page) 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." Exhibit 3 in Appendix 3 presents expanded program details for the municipal government in this Illustration.

For most governments, the format illustrated on the following page 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.

Alternative approaches for the statement of activities are presented in Exhibits 2–4, 6, 8, and 9 of Appendix 3. Those alternatives may be used based on the nature, size, and complexity of the reporting government and the needs of its financial statement users.

Requirements for the statement of activities are discussed in paragraphs 38 through 62 of Statement 34. (See Appendix 1.)

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

Functions/Programs	Program Revenues				Net (Expense) Revenue and Changes in Net Assets		
	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Primary Government		Component Units
					Governmental Activities	Business-type Activities	
Primary government:							
Governmental activities:							
General government	\$ 9,709,509	\$ 3,333,265	\$ 843,617	\$ —	\$ (5,532,627)	\$ (5,532,627)	
Public safety	34,782,144	1,198,855	1,307,693	62,300	(32,213,296)	(32,213,296)	
Public works	10,131,928	850,000	—	2,252,615	(7,029,313)	(7,029,313)	
Engineering services	1,299,645	704,793	—	—	(594,852)	(594,852)	
Health and sanitation	6,705,675	5,612,267	575,000	—	(518,408)	(518,408)	
Cemetery	735,866	212,496	72,689	—	(450,681)	(450,681)	
Culture and recreation	11,534,045	3,995,199	2,450,000	—	(5,088,846)	(5,088,846)	
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	6,242,893	—	—	—	(6,242,893)	(6,242,893)	
Total governmental activities (See Note 1)	106,029,367	15,906,875	5,248,999	4,894,915	(79,978,578)	(79,978,578)	
Business-type activities:							
Water	3,643,315	4,159,350	—	1,159,909	—	\$ 1,675,944	1,675,944
Sewer	4,909,885	7,170,533	—	486,010	—	2,746,658	2,746,658
Parking facilities	2,824,368	1,449,012	—	—	—	(1,375,356)	(1,375,356)
Total business-type activities	11,377,568	12,778,895	—	1,645,919	—	3,047,246	3,047,246
Total primary government	\$117,406,935	\$28,685,770	\$5,248,999	\$6,540,834	(79,978,578)	(76,931,332)	
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	—	6,461,708
Unrestricted investment earnings					1,885,455	619,987	884,277
Miscellaneous					884,907	—	19,950
Special item—gain on sale of park land					2,653,488	—	—
Transfers					501,409	(501,409)	—
Total general revenues, special items, and transfers					76,828,288	118,578	29,259,208
Change in net assets					(3,150,290)	3,165,824	3,202,656
Net assets—beginning					126,092,699	82,531,442	16,025,971
Net assets—ending					\$122,942,409	\$85,697,266	\$ 19,228,627

The reference to Note 1 is intended to call the reader's attention to the disclosure of the amount of depreciation expense that is included in the individual programs.

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.

Explanations of the amounts in the reconciliations 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. Exhibit 10 in Appendix 3 illustrates two methods that preparers could use to provide additional explanations of the reconciling items in the notes.

Requirements for governmental fund reporting are discussed in paragraphs 78 through 90 of Statement 34. (See Appendix 1.)

Illustrations

- Exhibit 3: Balance sheet. 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 Appendix 3, Exhibit 7, 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.
- Exhibit 4: Statement of revenues, expenditures, and changes in fund balances. The reconciliation to the statement of activities is presented as a separate schedule in Exhibit 5. Again, some single-program governments may combine the presentation of this statement with the statement of activities, as illustrated in Appendix 3, Exhibits 8 and 9.
- Exhibit 5: Reconciliation in an accompanying schedule as a continuation of the financial statement. The explanation of the differences between the net change in fund balances of governmental funds in Exhibit 4 and the change in net assets in the statement of activities is presented on a separate page, rather than on the face of the statement as in Exhibit 3.

**Sample City
Balance Sheet
Governmental Funds
December 31, 2002**

See Exhibit 15 for an optional combining statement of nonmajor funds.

	General	HUD Programs	Community Redevelopment	Route 7 Construction	Other Governmental Funds	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	3,807,308	2,953,438	353,340	11,000	10,221	7,135,307
Due from other funds	1,370,757	—	—	—	—	1,370,757
Receivables from other governments	629,179	119,059	—	—	1,596,038	2,344,276
Liens receivable	—	3,195,745	—	—	—	3,195,745
Inventories	182,821	—	—	—	—	182,821
Total assets	<u>\$9,408,550</u>	<u>\$7,504,765</u>	<u>\$13,616,035</u>	<u>\$10,478,037</u>	<u>\$10,698,303</u>	<u>\$ 51,705,690</u>
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)	<u>7,753,184</u>	<u>6,428,389</u>	<u>440,548</u>	<u>1,115,632</u>	<u>1,074,831</u>	<u>16,812,584</u>
Fund balances:						
Reserved for:						
Inventories	182,821	—	—	—	—	182,821
Noncurrent receivables	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	640,327	1,035,342	13,056,173	3,569,818	—	18,301,660
Unreserved, reported in nonmajor:						
Special revenue funds	—	—	—	—	1,330,718	1,330,718
Capital projects funds	—	—	—	—	1,241,270	1,241,270
Total fund balances	<u>1,655,366</u>	<u>1,076,376</u>	<u>13,175,487</u>	<u>9,362,405</u>	<u>9,623,472</u>	<u>34,893,106</u>
Total liabilities and fund balances	<u>\$9,408,550</u>	<u>\$7,504,765</u>	<u>\$13,616,035</u>	<u>\$10,478,037</u>	<u>\$10,698,303</u>	

Amounts reported for *governmental activities* in the statement of net assets (Exhibit 1) are different because:

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 certain internal service funds are included in governmental activities in the statement of net assets. (See Appendix 4, Exhibit 4B.)

3,133,459

Some liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported in the funds (Note 4).

(85,515,740)

Net assets of governmental activities

\$122,942,409

The reference to Note 2 is intended to alert the reader to the disclosure about which governmental funds have liquidated certain noncurrent liabilities in the past.

The reconciliation could be presented on an accompanying page, as a continuation of the financial statement, rather than on the face of the statement. (See the separate reconciliation example in Exhibit 5.) For a more detailed explanation of the reconciliation process and the sources of the reconciling items, see Exercise #6 in Appendix 4.

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

See Exhibit 16 for an optional combining statement of nonmajor funds.

	General Fund	HUD Programs	Community Redevelopment	Route 7 Construction Fund	Other Governmental Funds	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	<u>86,022,165</u>	<u>2,731,473</u>	<u>549,489</u>	<u>273,100</u>	<u>7,906,240</u>	<u>97,482,467</u>
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	—	—	470,440	—	5,215,151	5,685,591
Capital outlay	—	—	2,246,671	11,281,769	3,190,209	16,718,649
Total expenditures	<u>88,717,173</u>	<u>2,954,389</u>	<u>3,134,925</u>	<u>11,298,469</u>	<u>15,697,954</u>	<u>121,802,910</u>
Excess (deficiency) of revenues over expenditures	<u>(2,695,008)</u>	<u>(222,916)</u>	<u>(2,585,436)</u>	<u>(11,025,369)</u>	<u>(7,791,714)</u>	<u>(24,320,443)</u>
OTHER FINANCING SOURCES (USES)						
Refunding bonds issued	—	—	—	—	38,045,000	38,045,000
Capital-related debt issued	—	—	18,000,000	—	1,300,000	19,300,000
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	<u>(2,034,436)</u>	<u>(348,046)</u>	<u>15,726,813</u>	<u>—</u>	<u>7,392,967</u>	<u>20,737,298</u>
SPECIAL ITEM						
Proceeds from sale of park land	3,476,488	—	—	—	—	3,476,488
Net change in fund balances (See Exhibit 5)	(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	<u>\$ 1,655,366</u>	<u>\$1,076,376</u>	<u>\$13,175,487</u>	<u>\$ 9,362,405</u>	<u>\$ 9,623,472</u>	<u>\$ 34,893,106</u>

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 on the following page (Exhibit 5).

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 (Exhibit 4)	\$ (106,657)
Amounts reported for <i>governmental activities</i> in the statement of activities (Exhibit 2) are different because:	
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 and reported as depreciation expense. This is the amount by which capital outlays (\$16,718,649) exceeded depreciation (\$2,678,932) in the current period.	14,039,717
In the statement of activities, only the <i>gain</i> 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 (Note 5).	(16,610,856)
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 (Note 5).	(950,084)
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 certain internal service funds is reported with governmental activities. (See Appendix 4, Exhibit 4A.)	(620,040)
Change in net assets of governmental activities (Exhibit 2)	<u>\$ (3,150,290)</u>

The reconciliation could be presented on the face of the statement, rather than on a separate page. (See Exhibit 3.) However, using a separate page as a continuation of the financial statement provides more space for the preparer to explain the reconciling items. Alternatively, detailed explanations could be provided in the notes to the financial statements, as illustrated in Appendix 3, Exhibit 10. For a more detailed explanation of the reconciliation process and the sources of the reconciling items, see Exercise #6 in Appendix 4.

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 through 105 of Statement 34. (See Appendix 1.)

Illustrations

- Exhibit 6: Statement of net assets (Illustrates the net assets format; the balance sheet format also may be used.)
- Exhibit 7: Statement of revenues, expenses, and changes in fund net assets
- Exhibit 8: Statement of cash flows, using the direct method for reporting cash flows from operating activities

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

See Exhibit 17 for an optional combining statement of internal service funds.

	Enterprise Funds			Internal Service Funds
	Water and Sewer	Parking Facilities	Total	
ASSETS				
Current assets:				
Cash and cash equivalents	\$ 8,416,653	\$ 369,168	\$ 8,785,821	\$ 3,573,776
Investments	—	—	—	214,812
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	<u>12,149,407</u>	<u>372,703</u>	<u>12,522,110</u>	<u>4,085,720</u>
Noncurrent assets:				
Restricted cash and cash equivalents	—	1,493,322	1,493,322	—
Capital assets:				
Land and improvements	813,513	3,021,637	3,835,150	—
Construction in progress	2,572,105	—	2,572,105	—
Distribution and collection systems	41,945,183	—	41,945,183	—
Buildings and equipment	101,122,561	23,029,166	124,151,727	14,721,786
Less accumulated depreciation	(15,328,911)	(5,786,503)	(21,115,414)	(5,781,734)
Total noncurrent assets	<u>131,124,451</u>	<u>21,757,622</u>	<u>152,882,073</u>	<u>8,940,052</u>
Total assets	<u>143,273,858</u>	<u>22,130,325</u>	<u>165,404,183</u>	<u>13,025,772</u>
LIABILITIES				
Current liabilities:				
Accounts payable	447,427	304,003	751,430	815,982
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	<u>4,679,886</u>	<u>672,830</u>	<u>5,352,716</u>	<u>4,161,341</u>
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	<u>54,902,948</u>	<u>19,579,325</u>	<u>74,482,273</u>	<u>5,602,900</u>
Total liabilities	<u>59,582,834</u>	<u>20,252,155</u>	<u>79,834,989</u>	<u>9,764,241</u>
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	(5,429,215)
Total net assets	<u>\$ 83,691,024</u>	<u>\$ 1,878,170</u>	<u>85,569,194</u>	<u>\$ 3,261,531</u>

Some amounts reported for *business-type activities* in the statement of net assets (Exhibit 1) are different because certain internal service fund assets and liabilities are included with business-type activities. (See Appendix 4, Exhibit 4B.)

	128,072
Net assets of business-type activities	<u>\$ 85,697,266</u>

Sample City
Statement of Revenues, Expenses, and Changes in Fund Net Assets
Proprietary Funds
For the Year Ended December 31, 2002

See Exhibit 18 for an optional combining statement of internal service funds.

	Enterprise Funds			Internal Service Funds
	Water and Sewer	Parking Facilities	Total	
OPERATING REVENUES				
Charges for services	\$ 11,329,883	\$ 1,340,261	\$12,670,144	\$16,735,178
Miscellaneous	—	3,826	3,826	1,066,761
Total operating revenues	<u>11,329,883</u>	<u>1,344,087</u>	<u>12,673,970</u>	<u>17,801,939</u>
OPERATING EXPENSES				
Personal services	3,400,559	762,348	4,162,907	5,349,082
Contractual services	344,422	96,032	440,454	584,396
Utilities	754,107	100,726	854,833	239,680
Repairs and maintenance	747,315	64,617	811,932	1,960,490
Other supplies and expenses	498,213	17,119	515,332	430,596
Insurance claims and expenses	—	—	—	8,004,286
Depreciation	1,163,140	542,049	1,705,189	1,707,872
Total operating expenses	<u>6,907,756</u>	<u>1,582,891</u>	<u>8,490,647</u>	<u>18,276,402</u>
Operating income (loss)	<u>4,422,127</u>	<u>(238,804)</u>	<u>4,183,323</u>	<u>(474,463)</u>
NONOPERATING REVENUES (EXPENSES)				
Interest and investment revenue	454,793	146,556	601,349	153,371
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)	<u>(1,146,037)</u>	<u>(961,911)</u>	<u>(2,107,948)</u>	<u>(43,393)</u>
Income (loss) before contributions and transfers	3,276,090	(1,200,715)	2,075,375	(517,856)
Capital contributions	1,645,919	—	1,645,919	18,788
Transfers in	—	—	—	9,008
Transfers out	(290,000)	(211,409)	(501,409)	(184,041)
Change in net assets	4,632,009	(1,412,124)	3,219,885	(674,101)
Total net assets—beginning	79,059,015	3,290,294		3,935,632
Total net assets—ending	<u>\$83,691,024</u>	<u>\$ 1,878,170</u>		<u>\$ 3,261,531</u>

Some amounts reported for *business-type activities* in the statement of activities (Exhibit 2) are different because the net revenue (expense) of certain internal service funds is reported with business-type activities. (See Appendix 4, Exhibit 4A.)

(54,061)

Change in net assets of business-type activities \$ 3,165,824

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

See Exhibit 19 for an optional combining statement of internal service funds.

	Enterprise Funds			Internal Service Funds
	Water and Sewer	Parking Facilities	Total	
CASH FLOWS FROM OPERATING ACTIVITIES				
Receipts from customers	\$11,400,200	\$ 1,345,292	\$ 12,745,492	\$16,805,357
Payments to suppliers	(2,725,349)	(365,137)	(3,090,486)	(3,025,956)
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)	(1,191,926)
Claims paid	—	—	—	(8,482,451)
Other receipts (payments)	(1,165,574)	—	(1,165,574)	1,061,118
Net cash provided by operating activities	<u>2,852,454</u>	<u>229,327</u>	<u>3,081,781</u>	<u>956,454</u>
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	486,010	—	486,010	—
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	<u>(3,324,902)</u>	<u>(1,526,310)</u>	<u>(4,851,212)</u>	<u>(1,264,423)</u>
CASH FLOWS FROM INVESTING ACTIVITIES				
Proceeds from sales and maturities of investments	—	—	—	15,684
Interest and dividends	454,793	143,747	598,540	148,188
Net cash provided by investing activities	<u>454,793</u>	<u>143,747</u>	<u>598,540</u>	<u>163,872</u>
Net (decrease) in cash and cash equivalents	(307,655)	(1,364,645)	(1,672,300)	(319,130)
Balances—beginning of the year	8,724,308	3,227,135	11,951,443	3,892,906
Balances—end of the year	<u>\$ 8,416,653</u>	<u>\$ 1,862,490</u>	<u>\$ 10,279,143</u>	<u>\$ 3,573,776</u>
Reconciliation of operating income (loss) to net cash provided by operating activities:				
Operating income (loss)	\$ 4,422,127	\$ (238,804)	\$ 4,183,323	\$ (474,463)
Adjustments to reconcile operating income to net cash provided 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)	40,475
Accrued expenses	(3,091,460)	11,520	(3,079,940)	(389,161)
Net cash provided by operating activities	<u>\$ 2,852,454</u>	<u>\$ 229,327</u>	<u>\$ 3,081,781</u>	<u>\$ 956,454</u>
Noncash capital financing activities:				
Capital assets of \$1,159,909 were acquired through contributions from developers.				

FIDUCIARY FUND 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.

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.

Requirements for fiduciary fund reporting are discussed in paragraphs 106 through 111 of Statement 34. (See Appendix 1.)

Illustrations

Exhibit 9: Statement of fiduciary net assets

Exhibit 10: Statement of changes in 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	<u>515,301</u>	<u>760</u>	<u>183,161</u>
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	<u>65,280,187</u>	<u>80,000</u>	<u>—</u>
Total assets	<u>65,797,461</u>	<u>82,010</u>	<u>\$228,050</u>
LIABILITIES			
Accounts payable	—	1,234	\$ —
Refunds payable and others	1,358	—	228,050
Total liabilities	<u>1,358</u>	<u>1,234</u>	<u>\$228,050</u>
NET ASSETS			
Held in trust for pension benefits and other purposes	<u>\$65,796,103</u>	<u>\$80,776</u>	

Sample City
Statement of Changes in Fiduciary Net Assets
Fiduciary Funds
For the Year Ended December 31, 2002

	<u>Employee Retirement Plan</u>	<u>Private-purpose Trusts</u>
ADDITIONS		
Contributions:		
Employer	\$ 2,721,341	
Plan members	1,421,233	
Total contributions	<u>4,142,574</u>	
Investment earnings:		
Net (decrease) in fair value of investments	(272,522)	\$ —
Interest	2,460,871	4,560
Dividends	1,445,273	—
Total investment earnings	<u>3,633,622</u>	<u>4,560</u>
Less investment expense	216,428	—
Net investment earnings	<u>3,417,194</u>	<u>4,560</u>
Total additions	<u>7,559,768</u>	<u>4,560</u>
DEDUCTIONS		
Benefits	2,453,047	3,800
Refunds of contributions	464,691	—
Administrative expenses	87,532	678
Total deductions	<u>3,005,270</u>	<u>4,478</u>
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	<u><u>\$65,796,103</u></u>	<u><u>\$80,776</u></u>

NOTES TO THE FINANCIAL STATEMENTS

These sample note disclosures are presented only to illustrate the specific disclosure requirements of Statement 34. Other disclosures such as the additional significant accounting policies that will result from implementing the Statement are not illustrated. NCGA Interpretation 6, as amended by Statement 34 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.

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 or 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.

There are many different ways to present the required disclosures—only one method has been illustrated. For example, some governments may find it more informative to reverse the columns and rows in the disclosure; that is, present the assets categories as column headings and explain the changes going down the page. More complete explanations could be provided using that approach.

Note 2: Information about long-term liabilities. This disclosure is required by paragraph 119. It presents the beginning and ending balances and increases and decreases for the year for each major type of long-term liability. In addition, paragraphs 119c and d require disclosure of the portion of each item that is due within one year, and which governmental funds have liquidated the long-term operating liabilities in the past. Other presentation techniques may be used.

Note 3: Major component unit information. Paragraph 51 of Statement 14 requires information about each major component unit to be included in the basic financial statements of the reporting entity. Paragraph 126 of Statement 34 explains how to implement that requirement in this model. This sample disclosure illustrates the minimum requirements; governments may provide more details than illustrated.

Notes 4 and 5: 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 6: Disclosure of segment information. This disclosure is required by paragraph 122. The segments in this illustrative note represent two departments (that meet the criteria as segments) reported in a single fund. If a segment is reported as a major fund, the required information is already presented; therefore, the disclosures illustrated here would not be required.

Note 1—Illustrative Disclosure of Information about Capital Assets

Capital asset activity for the year ended December 31, 2002 was as follows (in thousands):

	Primary Government			Ending Balance
	Beginning Balance	Increases	Decreases	
Governmental activities:				
Capital assets not being depreciated: [†]				
Land and improvements	\$ 29,484	\$ 2,020	\$ (4,358)	\$ 27,146
Construction in progress	2,915	13,220	(14,846)	1,289
Total capital assets not being depreciated	<u>32,399</u>	<u>15,240</u>	<u>(19,204)</u>	<u>28,435</u>
Other capital assets:				
Buildings and improvements	40,861	334	—	41,195
Equipment	32,110	1,544	(1,514)	32,140
Road network [†]	72,885	10,219	—	83,104
Bridge network [†]	18,775	4,627	—	23,402
Total other capital assets at historical cost	<u>164,631</u>	<u>16,724</u>	<u>(1,514)</u>	<u>179,841</u>
Less accumulated depreciation for:				
Buildings and improvements	(10,358)	(691)	—	(11,049)
Equipment	(9,247)	(2,676)	1,040	(10,883)
Road network [†]	(12,405)	(823)	—	(13,228)
Bridge network [†]	(2,896)	(197)	—	(3,093)
Total accumulated depreciation	<u>(34,906)</u>	<u>(4,387)*</u>	<u>1,040</u>	<u>(38,253)</u>
Other capital assets, net	<u>129,725</u>	<u>12,337</u>	<u>(474)</u>	<u>141,588</u>
Governmental activities capital assets, net	<u>\$162,124</u>	<u>\$27,577</u>	<u>\$(19,678)</u>	<u>\$170,023</u>

*Depreciation expense was charged to functions as follows:

Governmental activities:	
General government	\$ 275
Public safety	330
Public works, which includes the depreciation of road and bridge networks [†]	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 Exhibit 7) is charged to the various functions based on their usage of the assets.	<u>1,708</u>
Total governmental activities depreciation expense	<u>\$4,387</u>

Note 1 (continued)

	Primary Government			
	Beginning Balance	Increases	Decreases	Ending Balance
Business-type activities:				
Capital assets not being depreciated: [†]				
Land and improvements	\$ 3,691	\$ 145	\$ —	\$ 3,836
Construction in progress	5,013	767	(3,208)	2,572
Total capital assets not being depreciated	<u>8,704</u>	<u>912</u>	<u>(3,208)</u>	<u>6,408</u>
Other capital assets:				
Distribution and collection systems	37,806	4,968	(829)	41,945
Buildings and equipment	121,357	2,827	(32)	124,152
Total other capital assets at historical cost	<u>159,163</u>	<u>7,795</u>	<u>(861)</u>	<u>166,097</u>
Less accumulated depreciation for:				
Distribution and collection systems	(8,483)	(897)	829	(8,551)
Buildings and equipment	(11,789)	(808)	32	(12,565)
Total accumulated depreciation	<u>(20,272)</u>	<u>(1,705)*</u>	<u>861</u>	<u>(21,116)</u>
Other capital assets, net	<u>138,891</u>	<u>6,090</u>	<u>—</u>	<u>144,981</u>
Business-type activities capital assets, net	<u>\$147,595</u>	<u>\$ 7,002</u>	<u>\$(3,208)</u>	<u>\$151,389</u>

*Depreciation expense was charged to functions as follows:

Business-type activities:	
Water	\$ 550
Sewer	613
Parking facilities	542
Total business-type activities depreciation expense	<u>\$1,705</u>

[†]Capital assets that are not being depreciated, as discussed in paragraph 20, are reported separately in this note. In addition, if this government was using the modified approach for infrastructure assets there would be no accumulated depreciation expense for those assets.

Note: Disclosures similar to those above for component units' balances and changes would be made in accordance with the guidelines set forth in paragraph 63 of Statement 14, as amended.

Note 2—Illustrative Disclosure of Information about Long-term Liabilities

Long-term liability activity for the year ended December 31, 2002 was as follows (in thousands):

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance*</u>	<u>Amounts Due within One Year</u>
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
	<u>63,323</u>	<u>57,345</u>	<u>(38,279)</u>	<u>82,389</u>	<u>5,410</u>
Less deferred amount on refundings	—	(3,409)	341	(3,068)	—
Total bonds and notes payable	<u>63,323</u>	<u>53,936</u>	<u>(37,938)</u>	<u>79,321</u>	<u>5,410</u>
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	<u>13,607</u>	<u>5,413</u>	<u>(5,803)</u>	<u>13,217</u>	<u>3,826</u>
Governmental activities long-term liabilities	<u>\$76,930</u>	<u>\$59,349</u>	<u>\$(43,741)</u>	<u>\$92,538</u>	<u>\$9,236</u>

*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 primarily by the General Fund. In the past, approximately 85% has been paid by the General Fund, 10% by the HUD Programs Fund, and the remainder by various other governmental and internal service funds.

The claims and judgments liability will generally be liquidated through the city's Health, Life, and Casualty Insurance internal service fund. (See Note 4, also.) That 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.

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Amounts Due within One Year</u>
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
	<u>78,542</u>	<u>13,114</u>	<u>(11,073)</u>	<u>80,583</u>	<u>4,304</u>
Less deferred amount on refundings	(1,207)	(1,329)	254	(2,282)	—
Total bonds and notes payable	<u>77,335</u>	<u>11,785</u>	<u>(10,819)</u>	<u>78,301</u>	<u>4,304</u>
Compensated absences	<u>572</u>	<u>1,286</u>	<u>(1,250)</u>	<u>608</u>	<u>122</u>
Business-type activities long-term liabilities	<u>\$77,907</u>	<u>\$13,071</u>	<u>\$(12,069)</u>	<u>\$78,909</u>	<u>\$4,426</u>

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 a single amount is reported as long-term liabilities and 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.

Note 3—Illustrative Disclosure of Major Component Unit Information

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	<u>42,522,714</u>	<u>7,080,946</u>	<u>49,603,660</u>
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	<u>25,371,965</u>	<u>5,003,068</u>	<u>30,375,033</u>
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	<u>\$17,150,749</u>	<u>\$2,077,878</u>	<u>\$19,228,627</u>

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. A combining statement for major component units is illustrated in Appendix 3, Exhibit 11.

The statement of net assets and the statement of revenues, expenses, and changes in net assets for the Sample City Landfill are presented in Appendix 3, Exhibit 12.

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	Total
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	4,171,760	—	—		(4,171,760)		(4,171,760)
Total—Sample City School District	<u>31,186,498</u>	<u>705,765</u>	<u>3,937,083</u>		<u>(26,543,650)</u>		
Sample City Landfill							
Landfill operations	3,382,157	3,857,858	—	\$11,397		\$ 487,098	487,098
Total component units	<u>\$34,568,655</u>	<u>\$4,563,623</u>	<u>\$3,937,083</u>	<u>\$11,397</u>			<u>(26,056,552)</u>
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					<u>29,048,967</u>	<u>210,241</u>	<u>29,259,208</u>
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					<u>\$ 17,150,749</u>	<u>\$2,077,878</u>	<u>\$ 19,228,627</u>

Note 4—Explanation of Certain Differences between the Governmental Fund Balance Sheet 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. Interest on long-term debt is not accrued in governmental funds, but rather is recognized as an expenditure when due. 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)
Accrued interest	755,233
Compensated absences	5,104,433
Litigation settlement—general fund	584,304
Combined adjustment (Exhibit 3)	<u>\$85,515,740</u>

Note 5—Explanation of Certain Differences between the Governmental Fund Statement of Revenues, Expenditures, and Changes in Fund Balances and the Statement of Activities

Bond proceeds are reported as financing sources in governmental funds and thus contribute to the change in fund balance. In the statement of net assets, however, issuing debt increases long-term liabilities and does not affect the statement of activities. Similarly, repayment of principal is an expenditure in the governmental funds, but reduces the liability in the statement of net assets.

Debt issued:

Refunding general obligation bonds	\$ 22,205,000
Refunding revenue bonds	15,840,000
Redevelopment agency bonds	18,000,000
Special assessment bonds	1,300,000
Total proceeds	<u>57,345,000</u>

Repayments:

To paying agent:	
For bond principal	(33,875,000)
Additional amount—deferred interest	(3,409,144)
Total to the paying agent	<u>(37,284,144)</u>
To bondholders	(3,450,000)
Total repayments	<u>(40,734,144)</u>
Net adjustment (Exhibit 5)	<u>\$ 16,610,856</u>

This explanation and the one in Note 4 are examples of the disclosures that are required if the summarized reconciliation obscures the nature of the individual elements of a particular reconciling item.

Under the modified accrual basis of accounting used in the governmental funds, expenditures are not recognized for transactions that are not normally paid with expendable available financial resources. In the statement of activities, however, which is presented on the accrual basis, expenses and liabilities are reported regardless of when financial resources are available. In addition, interest on long-term debt is not recognized under the modified accrual basis of accounting until due, rather than as it accrues. This adjustment is a combination of four items:

Compensated absences	\$ 149,906
Claims and judgments	(584,304)
Amortization of advanced refunding difference	(340,914)
Accrued interest on bonds	(174,772)
Combined adjustment (Exhibit 5)	<u>\$(950,084)</u>

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.

	<u>Water Department</u>	<u>Sewer Department</u>
CONDENSED STATEMENT OF NET ASSETS		
Assets:		
Current assets	\$ 5,229,593	\$ 6,919,814
Capital assets	38,952,991	92,171,460
Total assets	<u>44,182,584</u>	<u>99,091,274</u>
Liabilities:		
Interfund payables	—	175,000
Other current liabilities	1,520,672	2,984,214
Noncurrent liabilities	5,476,120	49,426,828
Total liabilities	<u>6,996,792</u>	<u>52,586,042</u>
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	<u>\$37,185,792</u>	<u>\$46,505,232</u>
CONDENSED STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS		
Operating revenues (pledged against bonds)	\$ 4,159,350	\$ 7,170,533
Depreciation expense	(549,987)	(613,153)
Other operating expenses	(2,642,774)	(3,101,842)
Operating income	<u>966,589</u>	<u>3,455,538</u>
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	<u>1,940,904</u>	<u>2,691,105</u>
Beginning net assets	35,244,888	43,814,127
Ending net assets	<u>\$37,185,792</u>	<u>\$46,505,232</u>
CONDENSED STATEMENT OF CASH FLOWS		
Net cash provided (used) by:		
Operating activities	\$ 2,001,811	\$ 850,643
Noncapital financing activities	—	(290,000)
Capital and related financing activities	(1,683,785)	(1,641,117)
Investing activities	217,378	237,415
Net increase (decrease)	<u>535,404</u>	<u>(843,059)</u>
Beginning cash and cash equivalents	3,089,534	5,634,774
Ending cash and cash equivalents	<u>\$ 3,624,938</u>	<u>\$ 4,791,715</u>

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

- Exhibit 12: Budget-to-actual comparison schedule for the general fund in the budget document format. A budget-to-actual comparison schedule for the general fund in a revenues, expenditures, and changes in fund balances format is illustrated in Appendix 3, Exhibit 13.
- Exhibit 13: Budget-to-actual comparison schedule for a major special revenue fund, also in the budget document format.
- Exhibit 14: Budget-to-GAAP reconciliation for the comparison schedules in Exhibits 12 and 13. 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.

Required Supplementary Information
Sample City
Budgetary Comparison Schedule—General Fund
For the Year Ended December 31, 2002

This schedule is presented using the government's budget document format. An illustration of this schedule using the statement of revenues, expenditures, and changes in fund balances format is provided in Appendix 3, Exhibit 13. Either format may be used.

The variance column is optional.

	Budgeted Amounts		Actual Amounts (Budgetary Basis) (See Note A)	Variance with Final Budget— Positive (Negative)
	Original	Final		
Budgetary fund balance, January 1	\$ 3,528,750	\$ 2,742,799	\$ 2,742,799	\$ —
Resources (inflows):				
Property taxes	52,017,833	51,853,018	51,173,436	(679,582)
Franchise taxes	4,546,209	4,528,750	4,055,505	(473,245)
Public service taxes	8,295,000	8,307,274	8,969,887	662,613
Licenses and permits	2,126,600	2,126,600	2,287,794	161,194
Fines and forfeitures	718,800	718,800	606,946	(111,854)
Charges for services	12,392,972	11,202,150	11,374,460	172,310
Grants	6,905,898	6,571,360	6,119,938	(451,422)
Sale of land	1,355,250	3,500,000	3,476,488	(23,512)
Miscellaneous	3,024,292	1,220,991	881,874	(339,117)
Interest received	1,015,945	550,000	552,325	2,325
Transfers from other funds	939,525	130,000	129,323	(677)
Amounts available for appropriation	<u>96,867,074</u>	<u>93,451,742</u>	<u>92,370,775</u>	<u>(1,080,967)</u>
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 beaches	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	<u>22,000,000</u>	<u>22,000,000</u>	<u>21,893,273</u>	<u>106,727</u>
Total charges to appropriations	<u>93,910,551</u>	<u>92,205,681</u>	<u>90,938,522</u>	<u>1,267,159</u>
Budgetary fund balance, December 31	<u>\$ 2,956,523</u>	<u>\$ 1,246,061</u>	<u>\$ 1,432,253</u>	<u>\$ 186,192</u>

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

	Budgeted Amounts		Actual Amounts	Variance with
	Original	Final	(Budgetary Basis)	Final Budget—
			(See Note A)	Positive (Negative)
Budgetary fund balance, 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	<u>3,735,000</u>	<u>4,353,441</u>	<u>4,349,914</u>	<u>(3,527)</u>
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	<u>2,775,000</u>	<u>3,375,000</u>	<u>3,314,572</u>	<u>60,428</u>
Budgetary fund balance, December 31	<u>\$ 960,000</u>	<u>\$ 978,441</u>	<u>\$1,035,342</u>	<u>\$ 56,901</u>

Required Supplementary Information
Budgetary Comparison Schedule
Note to RSI

Note A—Explanation of Differences between Budgetary Inflows and Outflows and GAAP Revenues and Expenditures

	<u>General Fund</u>	<u>HUD Programs Fund</u>
Sources/inflows of resources		
Actual amounts (budgetary basis) “available for appropriation” from the budgetary comparison schedule (Exhibits 12 and 13)	\$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 <i>revenues</i> for financial reporting purposes.	(129,323)	—
The proceeds from the sale of the park land are budgetary resources but are regarded as a <i>special item</i> , 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 (Exhibit 4)	<u>\$86,022,165</u>	<u>\$ 2,731,473</u>
Uses/outflows of resources		
Actual amounts (budgetary basis) “total charges to appropriations” from the budgetary comparison schedule (Exhibits 12 and 13)	\$90,938,522	\$ 3,314,572
Differences—budget to GAAP:		
The city budgets for claims and compensated absences on the cash basis, rather than on the modified accrual basis.	129,100	3,900
Encumbrances for supplies and equipment ordered but not received are reported in the year the order is placed for <i>budgetary</i> purposes, but in the year the supplies are received for <i>financial reporting</i> purposes.	(186,690)	(16,037)
Transfers to other funds are outflows of budgetary resources but are not <i>expenditures</i> 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 (Exhibit 4)	<u>\$88,717,173</u>	<u>\$ 2,954,389</u>

This illustration includes examples of basis, timing, and perspective differences, as discussed in NCGA Interpretation 10, paragraphs 15–25. There are no “entity” differences 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.

SUPPLEMENTARY INFORMATION

The focus of governmental and proprietary fund financial statements is on major funds. Fund statements should present the financial information of each major fund in a separate column. Nonmajor funds should be aggregated and displayed in a single column. **Combining statements for nonmajor funds are not required, but may be presented as supplementary information.**

Illustrations

Exhibits 15 and 16: Optional combining statements for nonmajor governmental funds

Each illustration presents all nonmajor governmental funds, with fund-type subtotals, on a single page. In the previous model, separate combining statements were presented for each fund type. Statement 34 modifies that requirement only to exclude major funds from the combining statements, in recognition of the requirement to display them in the basic statements. These illustrations show all nonmajor governmental funds on a single page 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).

Exhibits 17, 18, and 19: Optional combining statements for internal service funds

Because internal service funds are exempt from the major fund reporting requirements, all funds are presented in these combining statements.

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

	Special Revenue Funds			Debt Service Funds			Capital Projects Fund Bridge	Permanent Fund Cemetery Care	Total Nonmajor Governmental Funds (See Exhibit 3)
	Impact Fees	Local Gas Tax	Historic District	Central City Development	Community Redevelopment	Total			
ASSETS									
Cash and cash equivalents	\$371,413	\$1,999,819	\$189,880	\$ 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
Receivable from other governments	—	129,883	4,836	—	—	—	1,461,319	—	1,596,038
Total assets	\$371,413	\$2,139,923	\$194,716	\$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	\$ 151,922	\$ —	\$ 151,922	\$ 686,293	\$ —	\$ 1,074,831
Total liabilities	61,165	170,615	4,836	151,922	—	151,922	686,293	—	1,074,831
Fund balances:									
Reserved for:									
Encumbrances	176,487	962,231	—	—	—	—	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	—	—	—	1,241,270	—	2,571,988
Total fund balances	310,248	1,969,308	189,880	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	\$1,618,653	\$2,365,331	\$3,983,984	\$2,602,967	\$1,405,300	\$10,698,303

Sample City
Combining Statement of Revenues, Expenditures, and Changes in Fund Balances
Nonmajor 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	Culvert Project	Bridge	Total	Cemetery Care	(See Exhibit 4)
REVENUES											
Property taxes	\$ —	\$ —	\$ —	\$ —	\$ 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	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	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	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
Interest and other charges	—	—	—	—	3,885,191	1,329,960	—	—	—	—	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	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)	(503,202)	(1,267,858)	(1,771,060)	72,689	(7,791,714)
OTHER FINANCING SOURCES (USES)											
Long-term debt issued	—	—	—	—	38,045,000	—	—	1,300,000	1,300,000	—	39,345,000
Payment to bond refunding escrow agent	—	—	—	—	(37,284,144)	—	—	—	—	—	(37,284,144)
Transfers in	—	—	177,000	177,000	1,604,149	2,387,149	—	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	(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	(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	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	\$ —	\$ 1,916,674	\$ 1,916,674	\$ 1,405,300	\$ 9,623,472

*In accordance with the provision in paragraph 51, the earnings from this permanent fund's investments are reported as program revenue (Operating Grants and Contributions) in the statement of activities.

Sample City
Combining Statement of Net Assets
Internal Service Funds
December 31, 2002

	Health, Life, and Casualty Insurance	Fleet Management	Utility Customer Services	Telecom- munications	Data Processing	Total (See Exhibit 6)
ASSETS						
Current assets:						
Cash and cash equivalents	\$ 1,060,406	\$1,845,325	\$237,677	\$ 6,645	\$ 423,723	\$ 3,573,776
Investments	—	—	64,575	—	150,237	214,812
Receivables, net	124,767	11,363	—	203	21,471	157,804
Inventories	—	127,140	—	—	12,188	139,328
Total current assets	<u>1,185,173</u>	<u>1,983,828</u>	<u>302,252</u>	<u>6,848</u>	<u>607,619</u>	<u>4,085,720</u>
Capital assets:						
Buildings and equipment, net	21,383	2,821,024	—	5,526,642	571,003	8,940,052
Total assets	<u>1,206,556</u>	<u>4,804,852</u>	<u>302,252</u>	<u>5,533,490</u>	<u>1,178,622</u>	<u>13,025,772</u>
LIABILITIES						
Current liabilities:						
Accounts payable	508,610	77,931	35,412	144,840	49,189	815,982
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	<u>2,207,708</u>	<u>147,645</u>	<u>35,412</u>	<u>1,461,847</u>	<u>308,729</u>	<u>4,161,341</u>
Noncurrent liabilities:						
Claims and judgments	5,602,900	—	—	—	—	5,602,900
Total liabilities	<u>7,810,608</u>	<u>147,645</u>	<u>35,412</u>	<u>1,461,847</u>	<u>308,729</u>	<u>9,764,241</u>
NET ASSETS						
Invested in capital assets, net of related debt	21,383	2,821,024	—	5,277,336	571,003	8,690,746
Unrestricted	(6,625,435)	1,836,183	266,840	(1,205,693)	298,890	(5,429,215)
Total net assets	<u><u>\$ (6,604,052)</u></u>	<u><u>\$ 4,657,207</u></u>	<u><u>\$ 266,840</u></u>	<u><u>\$ 4,071,643</u></u>	<u><u>\$ 869,893</u></u>	<u><u>\$ 3,261,531</u></u>

Sample City
Combining Statement of Revenues, Expenses,
and Changes in Fund Net Assets
Internal Service Funds
For the Year Ended December 31, 2002

	Health, Life, and Casualty Insurance	Fleet Management	Utility Customer Services	Telecom- munications	Data Processing	Total (See Exhibit 7)
OPERATING REVENUES						
Charges for services—internal	\$ 6,375,070	\$4,096,753	\$1,479,014	\$3,542,116	\$1,055,875	\$16,548,828
Charges for services—other	—	—	—	—	186,350	186,350
Miscellaneous	1,066,761	—	—	—	—	1,066,761
Total operating revenues	<u>7,441,831</u>	<u>4,096,753</u>	<u>1,479,014</u>	<u>3,542,116</u>	<u>1,242,225</u>	<u>17,801,939</u>
OPERATING EXPENSES						
Personal services	169,866	1,248,271	1,191,926	1,850,222	888,797	5,349,082
Contractual services	200,888	62,449	—	22,843	298,216	584,396
Utilities	—	2,616	24,868	212,196	—	239,680
Repairs and maintenance	2,497	1,523,774	—	389,132	45,087	1,960,490
Other supplies and expenses	55,041	23,656	196,151	89,252	66,496	430,596
Insurance claims and expenses	8,004,286	—	—	—	—	8,004,286
Depreciation	5,541	448,944	—	938,251	315,136	1,707,872
Total operating expenses	<u>8,438,119</u>	<u>3,309,710</u>	<u>1,412,945</u>	<u>3,501,896</u>	<u>1,613,732</u>	<u>18,276,402</u>
Operating income (loss)	<u>(996,288)</u>	<u>787,043</u>	<u>66,069</u>	<u>40,220</u>	<u>(371,507)</u>	<u>(474,463)</u>
NONOPERATING REVENUES (EXPENSES)						
Earnings on investments	58,908	52,925	18,638	—	22,900	153,371
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)	<u>53,504</u>	<u>13,867</u>	<u>18,638</u>	<u>(145,555)</u>	<u>16,153</u>	<u>(43,393)</u>
Income (loss) before contributions and transfers	<u>(942,784)</u>	<u>800,910</u>	<u>84,707</u>	<u>(105,335)</u>	<u>(355,354)</u>	<u>(517,856)</u>
Capital contributions	—	3,364	—	1,222	14,202	18,788
Transfers in	—	—	—	9,008	—	9,008
Transfers out	(40,319)	—	—	—	(143,722)	(184,041)
Change in net assets	<u>(983,103)</u>	<u>804,274</u>	<u>84,707</u>	<u>(95,105)</u>	<u>(484,874)</u>	<u>(674,101)</u>
Net assets—beginning	<u>(5,620,949)</u>	<u>3,852,933</u>	<u>182,133</u>	<u>4,166,748</u>	<u>1,354,767</u>	<u>3,935,632</u>
Net assets—ending	<u><u>\$ (6,604,052)</u></u>	<u><u>\$ 4,657,207</u></u>	<u><u>\$ 266,840</u></u>	<u><u>\$ 4,071,643</u></u>	<u><u>\$ 869,893</u></u>	<u><u>\$ 3,261,531</u></u>

Sample City
Combining Statement of Cash Flows
Internal Service Funds
For the Year Ended December 31, 2002

	Health, Life, and Casualty Insurance	Fleet Management	Utility Customer Services	Telecom- munications	Data Processing	Total (See Exhibit 8)
CASH FLOWS FROM OPERATING ACTIVITIES						
Receipts from customers (including other funds)	\$ 6,455,428	\$ 4,098,790	\$ 1,479,014	\$ 3,542,157	\$1,229,968	\$16,805,357
Payments to suppliers	(129,409)	(1,671,378)	(213,718)	(656,961)	(354,490)	(3,025,956)
Payments to employees	(166,729)	(1,236,855)	—	(1,910,948)	(895,156)	(4,209,688)
Internal activity—payments to other funds	—	—	(1,191,926)	—	—	(1,191,926)
Claims paid	(8,482,451)	—	—	—	—	(8,482,451)
Other receipts (payments)	1,042,359	—	—	—	18,759	1,061,118
Net cash provided (used) by operating activities	(1,280,802)	1,190,557	73,370	974,248	(919)	956,454
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES						
Operating subsidies and transfers from (to) other funds	(40,319)	—	—	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	58,908	47,742	18,638	—	22,900	148,188
Net cash provided by investing activities	58,908	47,742	18,638	—	38,584	163,872
Net increase (decrease) in cash and cash equivalents	(1,250,624)	962,187	92,008	6,645	(129,346)	(319,130)
Balances—beginning of the year	2,311,030	883,138	145,669	—	553,069	3,892,906
Balances—end of the year	\$ 1,060,406	\$ 1,845,325	\$ 237,677	\$ 6,645	\$ 423,723	\$ 3,573,776

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

Illustration B—Illustrative Financial Statements for an Independent School District

These illustrative statements provide examples of the basic financial statements (and a budgetary comparison schedule as RSI) for a hypothetical independent school district. They are illustrative only and should not be considered authoritative. Management's discussion and analysis (MD&A), notes to financial statements, and other required contents are not presented; thus, this set of statements does not meet the minimum requirements for GAAP financial statements and required supplementary information.

Exhibits 21 and 22 present alternative approaches for the level of detail displayed for governmental activities in the statement of activities. Exhibit 21 presents only the functional categories used in the fund financial statements. Exhibit 22 illustrates a higher level of program detail. Paragraph 40 in Statement 34 states: "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."

Illustration B—Illustrative Financial Statements for an Independent School District

Exhibit Number		Page Number
	Basic Financial Statements	
20	Statement of Net Assets	154
21	Statement of Activities (same level of detail as presented in the fund financial statements)	155
22	Statement of Activities (expanded level of detail)	156
23	Balance Sheet—Governmental Funds	157
24	Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Assets	158
25	Statement of Revenues, Expenditures, and Changes in Fund Balances—Governmental Funds..	159
26	Reconciliation of the Governmental Funds Statement of Revenues, Expenditures, and Changes in Fund Balances to the Statement of Activities.....	160
27	Statement of Net Assets—Proprietary Funds.....	161
28	Statement of Revenues, Expenses, and Changes in Fund Net Assets—Proprietary Funds.....	162
29	Statement of Cash Flows—Proprietary Funds	163
30	Statements of Fiduciary Net Assets and Changes in Fiduciary Net Assets.....	164
	Required Supplementary Information	
31	Budgetary Comparison Schedule—General Fund.....	165

Sample Independent School District
Statement of Net Assets
June 30, 2002

	Governmental Activities	Business-type Activities	Total
ASSETS			
Cash and cash equivalents	\$104,268,980	\$ 5,971,032	\$ 110,240,012
Property taxes receivable (net)	12,182,730	—	12,182,730
Due from other governments	19,968,336	1,268,411	21,236,747
Other receivables	2,252,919	3,783	2,256,702
Internal balances	442,539	(442,539)	—
Inventories and prepaid expenses	1,537,230	1,572,376	3,109,606
Capital assets:			
Land	21,823,682	—	21,823,682
Buildings	262,202,141	—	262,202,141
Furniture and equipment	130,675,133	11,549,456	142,224,589
Less accumulated depreciation	(98,176,725)	(9,016,026)	(107,192,751)
Total capital assets, net of depreciation	<u>316,524,231</u>	<u>2,533,430</u>	<u>319,057,661</u>
Total assets	<u>457,176,965</u>	<u>10,906,493</u>	<u>468,083,458</u>
LIABILITIES			
Accounts payable and other current liabilities	33,305,354	484,151	33,789,505
Deferred revenues	3,117,910	521,035	3,638,945
Long-term liabilities:			
Portion due or payable within one year:			
Bonds, capital leases, and contracts	13,446,974	—	13,446,974
Accrued interest	759,880	—	759,880
Special termination benefits and compensated absences	2,156,000	—	2,156,000
Claims and judgments	5,700,000	—	5,700,000
Portion due or payable after one year:			
Bonds, capital leases, and contracts	70,958,588	—	70,958,588
Accrued interest	16,014,649	—	16,014,649
Special termination benefits and compensated absences	15,460,789	—	15,460,789
Claims and judgments	5,866,721	—	5,866,721
Total liabilities	<u>166,786,865</u>	<u>1,005,186</u>	<u>167,792,051</u>
NET ASSETS (See Appendix 4, Exhibit 3B.)			
Invested in capital assets, net of related debt	216,104,020	2,533,430	218,637,450
Restricted for:			
Debt service	5,147,502	—	5,147,502
Campus activities	1,396,569	—	1,396,569
Unrestricted	67,742,009	7,367,877	75,109,886
Total net assets	<u>\$290,390,100</u>	<u>\$ 9,901,307</u>	<u>\$ 300,291,407</u>

**Sample Independent School District
Statement of Activities
For the Year Ended June 30, 2002**

Functions/Programs	Program Revenues			Net (Expense) Revenue and Changes in Net Assets			
	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities	Business-type Activities	Total
Governmental activities:							
Instruction and instruction-related services	\$234,074,862	\$ 5,336,661	\$27,631,301	\$ —	\$(201,106,900)		\$(201,106,900)
Instructional and school leadership	33,579,907	—	3,783,490	—	(29,796,417)		(29,796,417)
Support services—student-based	37,311,861	2,986,172	4,203,974	1,654,321	(28,467,394)		(28,467,394)
Administrative support services	9,365,149	—	1,055,183	—	(8,309,966)		(8,309,966)
Support services—non-student-based	57,379,902	—	5,465,065	700,145	(51,214,692)		(51,214,692)
Community services	2,753,346	—	131,297	—	(2,622,049)		(2,622,049)
Interest on long-term debt	5,969,465	—	—	—	(5,969,465)		(5,969,465)
Depreciation—unallocated*	6,555,053	—	—	—	(6,555,053)		(6,555,053)
Total governmental activities	386,989,545	8,322,833	42,270,310	2,354,466	(334,041,936)		(334,041,936)
Business-type activities:							
Food services	20,596,032	4,750,350	16,599,235	—	—	\$ 753,553	753,553
Total primary government	\$407,585,577	\$13,073,183	\$58,869,545	\$2,354,466	(334,041,936)	753,553	(333,288,383)
General revenues:							
Taxes:							
Property taxes, levied for general purposes					154,108,322	—	154,108,322
Property taxes, levied for debt service					16,860,557	—	16,860,557
State aid—formula grants					176,265,211	—	176,265,211
Unrestricted investment earnings					7,397,103	301,410	7,698,513
Special item—gain on sale of unimproved land					367,341	—	367,341
Total general revenues and special items					354,998,534	301,410	355,299,944
Change in net assets					20,956,598	1,054,963	22,011,561
Net assets—beginning					269,433,502	8,846,344	278,279,846
Net assets—ending					\$ 290,390,100	\$9,901,307	\$ 300,291,407

*This amount excludes the depreciation that is included in the direct expenses of the various programs.

This statement uses the functional categories for governmental activities that are used for governmental funds in Exhibit 25. Exhibit 22 illustrates this statement using expanded details for governmental activities.

**Sample Independent School District
Statement of Activities
For the Year Ended June 30, 2002**

See Exhibit 21 for an illustration of this statement using only the functional categories for governmental activities that are also presented in the fund financial statements in Exhibit 25.

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenue and Changes in Net Assets		
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities	Business-type Activities	Total
Governmental activities:							
Instruction	\$220,993,099	\$ 5,336,661	\$25,973,423	\$ —	\$(189,683,015)		\$(189,683,015)
Instructional resources and media services	6,421,372	—	690,782	—	(5,730,590)		(5,730,590)
Curriculum and staff development	6,660,391	—	967,096	—	(5,693,295)		(5,693,295)
Instructional leadership	9,630,019	—	2,648,443	—	(6,981,576)		(6,981,576)
School leadership	23,949,888	—	1,135,047	—	(22,814,841)		(22,814,841)
Guidance, counseling, and evaluation services	15,691,486	765,432	2,059,947	—	(12,866,107)		(12,866,107)
Social work services	1,357,181	—	420,397	—	(936,784)		(936,784)
Health services	4,074,485	—	630,596	—	(3,443,889)		(3,443,889)
Student transportation	10,591,675	568,733	1,093,034	1,654,321	(7,275,587)		(7,275,587)
Extracurricular activities	5,597,034	1,652,007	—	—	(3,945,027)		(3,945,027)
General administration	9,365,149	—	1,055,183	—	(8,309,966)		(8,309,966)
Plant maintenance and operations	49,841,126	—	3,825,545	—	(46,015,581)		(46,015,581)
Security and monitoring services	5,182,416	—	1,093,013	700,145	(3,389,258)		(3,389,258)
Data processing services	2,356,359	—	546,507	—	(1,809,852)		(1,809,852)
Community services	2,753,347	—	131,297	—	(2,622,050)		(2,622,050)
Interest on long-term debt	5,969,465	—	—	—	(5,969,465)		(5,969,465)
Depreciation—unallocated*	6,555,053	—	—	—	(6,555,053)		(6,555,053)
Total governmental activities	386,989,545	8,322,833	42,270,310	2,354,466	(334,041,936)		(334,041,936)
Business-type activities:							
Food services	20,596,032	4,750,350	16,599,235	—	—	\$ 753,553	753,553
Total primary government	\$407,585,577	\$13,073,183	\$58,869,545	\$2,354,466	(334,041,936)	753,553	(333,288,383)
General revenues:							
Taxes:							
Property taxes, levied for general purposes					154,108,322	—	154,108,322
Property taxes, levied for debt service					16,860,557	—	16,860,557
State aid—formula grants					176,265,211	—	176,265,211
Unrestricted investment earnings					7,397,103	301,410	7,698,513
Special item—gain on sale of unimproved land					367,341	—	367,341
Total general revenues and special items					354,998,534	301,410	355,299,944
Change in net assets					20,956,598	1,054,963	22,011,561
Net assets—beginning					269,433,502	8,846,344	278,279,846
Net assets—ending					\$ 290,390,100	\$9,901,307	\$ 300,291,407

*This amount excludes the depreciation that is included in the direct expenses of the various programs.

**Sample Independent School District
Balance Sheet
Governmental Funds
June 30, 2002**

	General Fund	Debt Service Fund	Other Funds	Total Governmental Funds
ASSETS				
Cash and cash equivalents	\$ 98,864,805	\$3,294,850	\$2,109,325	\$104,268,980
Property taxes receivable	15,179,756	2,702,625	—	17,882,381
Less allowance for uncollectible taxes	(4,838,244)	(861,407)	—	(5,699,651)
Due from other governments	15,105,826	—	4,862,510	19,968,336
Accrued interest	504,757	—	—	504,757
Due from other funds	4,997,421	759,359	1,852,454	7,609,234
Other receivables	1,218,640	20,695	508,827	1,748,162
Inventories—supplies and materials	1,412,121	—	—	1,412,121
Other current assets	125,109	—	—	125,109
Total assets	<u>\$132,570,191</u>	<u>\$5,916,122</u>	<u>\$9,333,116</u>	<u>\$147,819,429</u>
LIABILITIES AND FUND BALANCES				
Liabilities:				
Accounts payable and accrued liabilities	\$ 30,270,632	\$ 8,740	\$ 933,434	\$ 31,212,806
Due to other funds	20,845,752	—	5,503,492	26,349,244
Due to other governments and agencies	243,128	—	—	243,128
Due to student groups	—	—	256,183	256,183
Deferred revenue	12,283,000	1,774,202	1,243,438	15,300,640
Total liabilities	<u>63,642,512</u>	<u>1,782,942</u>	<u>7,936,547</u>	<u>73,362,001</u>
Fund balances:				
Reserved for:				
Inventories	1,412,121	—	—	1,412,121
Retirement of long-term debt	—	4,133,180	—	4,133,180
Encumbrances	4,744,173	—	—	4,744,173
Unreserved:				
Designated	21,347,665	—	—	21,347,665
Undesignated	41,423,720	—	—	41,423,720
Undesignated, reported in special revenue funds	—	—	1,396,569	1,396,569
Total fund balances	<u>68,927,679</u>	<u>4,133,180</u>	<u>1,396,569</u>	<u>74,457,428</u>
Total liabilities and fund balances	<u>\$132,570,191</u>	<u>\$5,916,122</u>	<u>\$9,333,116</u>	<u>\$147,819,429</u>

The Debt Service Fund does not meet the major fund percentage criteria in paragraph 76 and, therefore, is not *required* to be reported as a major fund. The School District voluntarily presents the fund separately as a major fund because of the public's interest in the debt service activity of the District.

**Sample Independent School District
Reconciliation of the Governmental Funds Balance Sheet to the
Statement of Net Assets**

Total fund balances—governmental funds (Exhibit 23) \$ 74,457,428

Amounts reported for governmental *activities* in the statement of net assets are different because:

Capital assets used in governmental activities are not financial resources and therefore are not reported as assets in governmental funds. The cost of the assets is \$414,700,956, and the accumulated depreciation is \$98,176,725. 316,524,231

Property taxes receivable will be collected this year, but are not available soon enough to pay for the current period's expenditures, and therefore are deferred in the funds. 12,182,730

An internal service fund is used by the district's management to charge the costs of workers' compensation and unemployment claims to the individual funds. The assets and liabilities of the internal service fund are included with governmental activities. (See Exhibit 27.) 6,022,591

Long-term liabilities, including bonds payable, are not due and payable in the current period and therefore are not reported as liabilities in the funds. Long-term liabilities at year-end consist of:

Bonds payable	\$80,575,118	
Accrued interest on the bonds	759,880	
Capital leases payable	1,062,861	
Contracts payable	2,767,583	
Compensated absences (sick pay and vacations)	1,125,503	
Special termination benefits payable	16,491,286	
In addition, in 1990, the district issued "capital appreciation" bonds. The accretion of interest on those bonds to date is:	16,014,649	(118,796,880)

Total net assets—governmental activities (Exhibit 20) \$ 290,390,100

**Sample Independent School District
Statement of Revenues, Expenditures, and
Changes in Fund Balances
Governmental Funds
For the Year Ended June 30, 2002**

	<u>General Fund</u>	<u>Debt Service Fund</u>	<u>Other Funds</u>	<u>Total Governmental Funds</u>
REVENUES				
Property taxes	\$153,862,367	\$16,589,425	\$ —	\$170,451,792
Tuition charges	1,110,720	—	4,225,941	5,336,661
Fees and charges	2,347,009	—	—	2,347,009
State aid	190,373,996	—	6,135,833	196,509,829
Federal aid	2,284,748	—	22,095,410	24,380,158
Earnings on investments	7,077,388	194,926	124,789	7,397,103
Miscellaneous	197,604	—	441,559	639,163
Total revenues	<u>357,253,832</u>	<u>16,784,351</u>	<u>33,023,532</u>	<u>407,061,715</u>
EXPENDITURES				
Current:				
Instruction and instruction-related services	206,958,475	—	25,236,202	232,194,677
Instructional and school leadership	31,485,279	—	1,825,705	33,310,984
Support services—student	34,010,001	—	3,003,049	37,013,050
Administrative support services	9,290,149	—	—	9,290,149
Support services—non-student-based	55,615,563	—	1,308,415	56,923,978
Community services	1,691,107	—	1,040,189	2,731,296
Debt service				
Principal	1,143,185	12,171,263	212,498	13,526,946
Interest	395,733	3,723,442	292,170	4,411,345
Capital outlay	3,277,003	—	708,327	3,985,330
Total expenditures	<u>343,866,495</u>	<u>15,894,705</u>	<u>33,626,555</u>	<u>393,387,755</u>
Excess (deficiency) of revenues over expenditures	<u>13,387,337</u>	<u>889,646</u>	<u>(603,023)</u>	<u>13,673,960</u>
OTHER FINANCING SOURCES (USES)				
Capital leases	—	—	692,245	692,245
SPECIAL ITEM				
Proceeds from sale of unimproved land	601,908	—	—	601,908
Net change in fund balances	13,989,245	889,646	89,222	14,968,113
Fund balances—July 1, 2001	54,938,434	3,243,534	1,307,347	59,489,315
Fund balances—June 30, 2002	<u>\$ 68,927,679</u>	<u>\$ 4,133,180</u>	<u>\$ 1,396,569</u>	<u>\$ 74,457,428</u>

**Sample Independent School District
Reconciliation of the Governmental Funds Statement of
Revenues, Expenditures, and Changes in Fund Balances
to the Statement of Activities**

Total net change in fund balances—governmental funds (Exhibit 25)	\$14,968,113
Amounts reported for governmental <i>activities</i> in the statement of activities are different because:	
Capital outlays are reported in governmental funds 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 depreciation expense (\$13,108,809) exceeds capital outlays (\$3,985,330) in the period.	(9,123,479)
Some of the capital assets acquired this year were financed with capital leases. The amount financed by the leases is reported in the governmental funds as a source of financing. On the other hand, the capital leases are not revenues in the statement of activities, but rather constitute long-term liabilities in the statement of net assets.	(692,245)
Repayment of bond principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets.	13,526,946
Because some property taxes will not be collected for several months after the district's fiscal year ends, they are not considered "available" revenues and are deferred in the governmental funds. Deferred tax revenues increased by this amount this year.	517,087
In the statement of activities, only the <i>gain</i> on the sale of the unimproved land is reported, whereas in the governmental funds, the entire proceeds from the sale increase financial resources. Thus, the change in net assets differs from the change in fund balances by the <i>cost</i> of the land sold.	(234,567)
In the statement of activities, certain operating expenses—compensated absences (sick pay and vacations) and special termination benefits (early retirement)—are measured by the amounts <i>earned</i> during the year. In the governmental funds, however, expenditures for these items are measured by the amount of financial resources used (essentially, the amounts actually <i>paid</i>). This year, vacation and sick leave earned (\$327,280) exceeded the amounts used (\$261,132) by \$66,148. Special termination benefits paid (\$10,300,426) exceeded the amounts earned (\$7,906,074) by \$2,394,352.	2,328,204
Interest on long-term debt in the statement of activities differs from the amount reported in the governmental funds because interest is recognized as an expenditure in the funds when it is due, and thus requires the use of current financial resources. In the statement of activities, however, interest expense is recognized as the interest accrues, regardless of when it is due. The additional interest reported in the statement of activities is the net result of two factors. First, accrued interest on bonds, leases, and contracts payable <i>decreased</i> by \$43,380, and second, \$1,601,500 of additional accumulated interest was accreted on the district's "capital appreciation" bonds.	(1,558,120)
An internal service fund is used by the district's management to charge the costs of workers' compensation and unemployment claims to the individual funds. The net revenue of the internal service fund is reported with governmental activities. (See Exhibit 28.)	1,224,659
Change in net assets of governmental activities (Exhibits 21 and 22)	<u><u>\$20,956,598</u></u>

**Sample Independent School District
Statement of Net Assets
Proprietary Funds
June 30, 2002**

	Enterprise Fund— Food Services	Internal Service Fund— Insurance
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 5,971,032	\$ —
Due from other governments	1,268,411	—
Due from other funds	—	17,589,312
Other receivables	3,783	—
Inventories—supplies and materials	1,572,376	—
Total current assets	<u>8,815,602</u>	<u>17,589,312</u>
Noncurrent assets:		
Furniture and equipment	11,549,456	—
Less accumulated depreciation	<u>(9,016,026)</u>	<u>—</u>
Total noncurrent assets	<u>2,533,430</u>	<u>—</u>
Total assets	<u>11,349,032</u>	<u>17,589,312</u>
LIABILITIES		
Current liabilities:		
Accounts payable and accrued liabilities	484,151	—
Claims payable	—	5,700,000
Due to other funds	442,539	—
Deferred revenue	521,035	—
Total current liabilities	<u>1,447,725</u>	<u>5,700,000</u>
Long-term liabilities:		
Claims payable	—	5,866,721
Total liabilities	<u>1,447,725</u>	<u>11,566,721</u>
NET ASSETS		
Invested in capital assets	2,533,430	—
Unrestricted	7,367,877	6,022,591
Total net assets	<u>\$ 9,901,307</u>	<u>\$ 6,022,591</u>

**Sample Independent School District
Statement of Revenues, Expenses, and
Changes in Fund Net Assets
Proprietary Funds
For the Year Ended June 30, 2002**

	Enterprise Fund— Food Services	Internal Service Fund— Insurance
OPERATING REVENUES		
Food service sales	\$ 4,750,350	\$ —
Charges to other funds	—	23,864,586
Total operating revenues	<u>4,750,350</u>	<u>23,864,586</u>
OPERATING EXPENSES		
Payroll costs	10,494,786	—
Professional and contract services	343,439	—
Supplies and materials	8,773,317	—
Depreciation	984,490	—
Other operating costs	—	22,639,927
Total operating expenses	<u>20,596,032</u>	<u>22,639,927</u>
Operating income (loss)	<u>(15,845,682)</u>	<u>1,224,659</u>
NONOPERATING REVENUES (EXPENSES)		
Interest income	301,410	—
State matching and other	292,448	—
Grants—child nutrition program	16,306,787	—
Total nonoperating revenue (expenses)	<u>16,900,645</u>	<u>—</u>
Change in net assets	1,054,963	1,224,659
Total net assets—July 1, 2001	8,846,344	4,797,932
Total net assets—June 30, 2002	<u>\$ 9,901,307</u>	<u>\$ 6,022,591</u>

Note: The district uses the internal service fund to charge its programs for workers' compensation and unemployment insurance. The Food Service enterprise fund is covered by the self-insurance program and is charged for its pro-rata share—approximately 3.8%—of the total cost of the program. Therefore, that percentage of the internal service fund's change in net assets should be allocated back to the enterprise fund so that the internal service fund "breaks even" with respect to internal charges. However, because the amount of this "look-back" adjustment for the enterprise fund is so small (less than one fourth of 1 percent of total expenses), no adjustment needs to be made and, consequently, no reconciliation is necessary. The entire amount of the change in net assets (\$1,224,659) is allocated back to the major programs reported as governmental activities.

**Sample Independent School District
Statement of Cash Flows
Proprietary Funds
For the Year Ended June 30, 2002**

	Enterprise Fund— Food Services	Internal Service Fund— Insurance
CASH FLOWS FROM OPERATING ACTIVITIES		
Received from user charges	\$ 4,851,104	\$ —
Received from assessments made to other funds	—	22,639,927
Payments to employees for services	(10,494,786)	—
Payments for workers' compensation and unemployment claims	—	(22,639,927)
Payments to suppliers for goods and services	(7,855,737)	—
Net cash used by operating activities	<u>(13,499,419)</u>	<u>0</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Nonoperating grants received	14,914,368	—
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Acquisition of capital assets	(122,918)	—
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest on investments	301,410	—
Net increase in cash and cash equivalents	1,590,848	—
Cash and cash equivalents—July 1, 2001	4,380,184	—
Cash and cash equivalents—June 30, 2002	<u>\$ 5,971,032</u>	<u>\$ 0</u>
Reconciliation of operating income (loss) to net cash used by operating activities:		
Operating income (loss)	\$(15,845,682)	\$ 1,224,659
Adjustments to reconcile operating income (loss) to net cash used by operating activities:		
Depreciation	984,490	—
Commodities used	1,684,867	—
Changes in assets and liabilities:		
Receivables	100,754	(2,549,089)
Inventories	210,239	—
Accrued liabilities	(371,455)	1,324,430
Deferred revenue	(262,632)	—
Net cash used by operating activities	<u>\$(13,499,419)</u>	<u>\$ 0</u>

Noncash noncapital financing activities:

During the year the district received \$1,684,867 of food commodities from the U.S. Department of Agriculture.

**Sample Independent School District
Statement of Fiduciary Net Assets
June 30, 2002**

	Private-purpose Trusts	Agency Funds
ASSETS		
Cash and cash equivalents	\$280,087	\$ 101,959
Due to other governments	—	100,242
Accrued interest	23,853	—
Due from other funds	321,026	1,272,211
Total assets	<u>624,966</u>	<u>\$1,474,412</u>
LIABILITIES		
Accounts payable	1,450	\$ 14,911
Due to student groups	—	1,239,739
Due to grantor agencies	—	219,762
Total liabilities	<u>1,450</u>	<u>\$1,474,412</u>
NET ASSETS		
Reserved for scholarships	585,221	
Unreserved	38,295	
Total net assets	<u>\$623,516</u>	

* * *

**Sample Independent School District
Statement of Changes in Fiduciary Net Assets
For the Year Ended June 30, 2002**

	Private-purpose Trusts
ADDITIONS	
Gifts and contributions	\$ 61,967
DEDUCTIONS	
Scholarships awarded	(36,644)
Change in net assets	25,323
Net assets—July 1, 2001	598,193
Net assets—June 30, 2002	<u>\$623,516</u>

Required Supplementary Information
Sample Independent School District
Budgetary Comparison Schedule
General Fund
For the Year Ended June 30, 2002

The variance column is optional.

This schedule is presented using the statement of revenues, expenditures, and changes in fund balances format. An illustration of a budgetary comparison schedule using a government's budget document format is provided in Illustration A, Exhibit 12. Either format may be used.

	Budgeted Amounts		Actual	Variance with
	Original	Final	(Budgetary Basis)	Final Budget— Positive (Negative)
REVENUES				
Local and intermediate sources	\$162,140,000	\$162,140,000	\$164,595,088	\$ 2,455,088
State program revenues	187,073,000	187,073,000	190,373,996	3,300,996
Federal program revenues	2,137,500	2,250,000	2,284,748	34,748
Total revenues	<u>351,350,500</u>	<u>351,463,000</u>	<u>357,253,832</u>	<u>5,790,832</u>
EXPENDITURES				
Current:				
Instruction and instruction-related services	206,410,523	208,495,478	206,958,475	1,537,003
Instructional and school leadership	32,706,983	32,065,670	31,485,279	580,391
Support services—student	34,694,864	34,694,864	34,010,001	684,863
Administrative support services	9,627,845	9,627,845	9,290,149	337,696
Support services—non-student-based	58,659,046	59,251,562	55,615,563	3,635,999
Community services	1,721,536	1,721,536	1,691,107	30,429
Debt service	1,531,812	1,531,812	1,538,918	(7,106)
Capital outlay	4,059,000	4,059,000	3,277,003	781,997
Total expenditures	<u>349,411,609</u>	<u>351,447,767</u>	<u>343,866,495</u>	<u>7,581,272</u>
Excess (deficiency) of revenues over expenditures	<u>1,938,891</u>	<u>15,233</u>	<u>13,387,337</u>	<u>13,372,104</u>
SPECIAL ITEM				
Proceeds from sale of unimproved land	610,000	610,000	601,908	(8,092)
Net change in fund balances	2,548,891	625,233	13,989,245	13,364,012
Fund balance—July 1, 2001	54,938,434	54,938,434	54,938,434	—
Fund balance—June 30, 2002	<u>\$ 57,487,325</u>	<u>\$ 55,563,667</u>	<u>\$ 68,927,679</u>	<u>\$13,364,012</u>

Illustration C—Illustrative Financial Statements for a State Government

These illustrative statements provide examples of the basic financial statements for a hypothetical state government. The statements are illustrative only and should not be considered authoritative. Management's discussion and analysis (MD&A), notes to financial statements, budgetary comparison schedules, and other required contents are not presented; thus, this set of statements does not meet the minimum requirements for GAAP financial statements and required supplementary information.

Illustration C—Illustrative Financial Statements for a State Government

Exhibit Number		Page Number
	Basic Financial Statements	
32	Statement of Net Assets	168
33	Statement of Activities	169
34	Balance Sheet—Governmental Funds	171
35	Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Assets	172
36	Statement of Revenues, Expenditures, and Changes in Fund Balances—Governmental Funds..	173
37	Reconciliation of the Change in Fund Balances of Governmental Funds to the Statement of Activities	174
38	Statement of Net Assets—Proprietary Funds.....	175
39	Statement of Revenues, Expenses, and Changes in Fund Net Assets—Proprietary Funds.....	176
40	Statement of Cash Flows—Proprietary Funds	177
41	Statement of Fiduciary Net Assets	178
42	Statement of Changes in Fiduciary Net Assets	179

Sample State Government
Statement of Net Assets
June 30, 2002
(in Thousands)

	Primary Government			
	Governmental Activities	Business-type Activities	Total	Component Units
ASSETS				
Current assets:				
Cash and cash equivalents	\$ 1,891,267	\$ 132,666	\$ 2,023,933	\$ 647,190
Taxes, interest, and penalties receivable	1,808,587	144,836	1,953,423	—
Due from the state	—	—	—	8,126
Other receivables	1,740,116	18,341	1,758,457	393,665
Investments	205,501	1,953,980	2,159,481	475,224
Inventories	54,662	32,462	87,124	15,477
Other current assets	508,319	60,169	568,488	337,525
Total current assets	6,208,452	2,342,454	8,550,906	1,877,207
Noncurrent assets:				
Taxes, interest, and penalties receivable	64,576	—	64,576	—
Other receivables	186,633	—	186,633	1,079,363
Mortgages and loans receivable	—	—	—	2,206,144
Investments	122,334	869,433	991,767	1,669,091
Investment in joint venture	32,356	—	32,356	—
Other noncurrent assets	95,670	—	95,670	88,694
Capital assets:				
Land	263,208	98	263,306	141,516
Infrastructure	7,604,600	—	7,604,600	—
Property, plant, and equipment	3,036,336	21,193	3,057,529	1,812,202
Less accumulated depreciation	(3,313,645)	(15,715)	(3,329,360)	(650,588)
Total capital assets, net of depreciation	7,590,499	5,576	7,596,075	1,303,130
Total noncurrent assets	8,092,068	875,009	8,967,077	6,346,422
Total assets	14,300,520	3,217,463	17,517,983	8,223,629
LIABILITIES				
Current liabilities:				
Accounts payable and other current liabilities	2,390,961	248,884	2,639,845	163,075
Income tax refunds payable	393,722	—	393,722	—
Internal balances	156	(156)	—	—
Due to component units	8,126	—	8,126	—
Bonds, notes, and leases payable	517,661	—	517,661	525,842
Claims, judgments, and compensated absences	176,143	—	176,143	—
Accrued interest	426,250	—	426,250	121,352
Deferred revenue	80,202	1,370	81,572	50,911
Total current liabilities	3,993,221	250,098	4,243,319	861,180
Long-term liabilities:				
Lottery prize awards payable	—	900,486	900,486	—
Bonds, notes, and leases payable	3,309,191	—	3,309,191	3,914,475
Claims, judgments, and compensated absences	1,158,391	5,463	1,163,854	1,017,242
Total long-term liabilities	4,467,582	905,949	5,373,531	4,931,717
Total liabilities	8,460,803	1,156,047	9,616,850	5,792,897
NET ASSETS (See Appendix 4, Exhibit 3C.)				
Invested in capital assets, net of related debt	3,763,647	5,576	3,769,223	1,415,794
Restricted for:				
Transportation programs	553,174	—	553,174	—
Elementary and secondary education	127,848	—	127,848	—
Conservation and recreation	413,116	—	413,116	—
Unemployment compensation	—	2,049,712	2,049,712	—
Other purposes	596,563	—	596,563	168,385
Unrestricted	385,369	6,128	391,497	846,553
Total net assets	\$ 5,839,717	\$2,061,416	\$ 7,901,133	\$2,430,732

Sample State Government
Statement of Activities
June 30, 2002
(in Thousands)

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenue (Exhibit 33b)
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	
Primary government:					
Governmental activities:					
General government	\$ 1,159,715	\$ 104,277	\$ 377,434	\$ —	\$ (678,004)
Education—elementary and secondary	9,790,623	13,509	712,171	—	(9,064,943)
Education—state aid to the universities	567,538	—	—	—	(567,538)
Health and welfare	8,636,008	102,242	5,872,725	—	(2,661,041)
Public safety and corrections	1,611,415	34,753	14,770	85,000	(1,476,892)
Conservation, recreation, and agriculture	519,223	109,142	154,105	—	(255,976)
Labor, commerce, and regulatory	568,428	127,705	396,081	—	(44,642)
Mental health	1,519,549	42,047	333,541	123,321	(1,020,640)
Transportation	901,335	165,133	42,351	481,128	(212,723)
Intergovernmental—grants and revenue sharing	1,941,999	—	—	—	(1,941,999)
Depreciation expense*	217,275	—	—	—	(217,275)
Interest expense	214,623	—	—	—	(214,623)
Total governmental activities	<u>27,647,731</u>	<u>698,808</u>	<u>7,903,178</u>	<u>689,449</u>	<u>(18,356,296)</u>
Business-type activities: <					
Lottery	987,014	1,456,251	—	—	469,237
Unemployment insurance	1,174,657	1,250,997	165,964	—	242,304
Liquor control	370,430	482,306	160	—	112,036
Other	7,302	5,896	—	—	(1,406)
Total business-type activities	<u>2,539,403</u>	<u>3,195,450</u>	<u>166,124</u>	<u>—</u>	<u>822,171</u>
Total primary government	<u>\$30,187,134</u>	<u>\$3,894,258</u>	<u>\$8,069,302</u>	<u>\$689,449</u>	<u>\$(17,534,125)</u>
Component units:					
State universities	\$ 1,451,857	\$ 710,148	\$ 274,528	\$ 48,010	(419,171)
Higher education financial assistance programs	174,007	32,258	68,642	—	(73,107)
Other component units	347,904	52,304	9,543	54,469	(231,588)
Total component units	<u>\$ 1,973,768</u>	<u>\$ 794,710</u>	<u>\$ 352,713</u>	<u>\$102,479</u>	<u>\$ (723,866)</u>

Note: The state has no business-type activities that meet the definition of a segment in paragraph 122. The three programs presented were selected by the state based on significance and user interest.

(The statement of activities continues on the following page.)

*This amount does not include depreciation that is reported in the direct expenses of the various programs.

Sample State Government
Statement of Activities (continued)
June 30, 2002
(in Thousands)

	Primary Government			Component Units
	Governmental Activities	Business-type Activities	Total	
Changes in net assets:				
Net (expense) revenue (Exhibit 33a)	<u>\$(18,356,296)</u>	<u>\$ 822,171</u>	<u>\$(17,534,125)</u>	<u>\$ (723,866)</u>
General revenues:				
Taxes:				
Personal and corporate income	7,068,167	—	7,068,167	—
Sales and use	2,047,291	—	2,047,291	—
Others	825,577	—	825,577	—
Restricted for educational purposes:				
Sales and use	5,463,610	—	5,463,610	—
Personal and corporate income	918,182	—	918,182	—
Others	475,566	—	475,566	—
Restricted for transportation purposes:				
Motor fuel taxes	1,334,349	—	1,334,349	—
Others	58,187	—	58,187	—
Total taxes	<u>18,190,929</u>	<u>—</u>	<u>18,190,929</u>	<u>—</u>
Unrestricted investment earnings	172,119	195,482	367,601	393,407
State aid	—	—	—	567,538
Transfers—internal activities	650,732	(650,732)	—	—
Total general revenues and transfers	<u>19,013,780</u>	<u>(455,250)</u>	<u>18,558,530</u>	<u>960,945</u>
Change in net assets	<u>657,484</u>	<u>366,921</u>	<u>1,024,405</u>	<u>237,079</u>
Net assets—beginning	5,182,233	1,694,495	6,876,728	2,193,653
Net assets—ending	<u>\$ 5,839,717</u>	<u>\$2,061,416</u>	<u>\$ 7,901,133</u>	<u>\$2,430,732</u>

**Sample State Government
Balance Sheet
Governmental Funds
June 30, 2002
(in Thousands)**

	General Fund	Transportation Fund	Rainy-day Fund	School Aid Fund	Other Funds	Total
ASSETS						
Cash and cash equivalents	\$ 37,032	\$ 573,238	\$ 488,738	\$ 46	\$ 605,565	\$1,704,619
Taxes, interest, and penalties receivable	1,187,449	69,206	—	613,612	2,896	1,873,163
Receivable from:						
Other funds	608,100	98,587	684,674	—	161,006	1,552,367
Component units	3,254	369	—	—	1,132	4,755
Federal agencies	1,120,253	184,916	—	4,688	1,969	1,311,826
Local governments	462,846	81,455	—	45,270	25,354	614,925
Investments	—	—	—	—	327,836	327,836
Inventories	28,586	7,487	—	—	30	36,103
Other assets	481,819	19,051	10,000	9	13,851	524,730
Total assets	<u>\$3,929,339</u>	<u>\$1,034,309</u>	<u>\$1,183,412</u>	<u>\$663,625</u>	<u>\$1,139,639</u>	<u>\$7,950,324</u>
LIABILITIES AND FUND BALANCES						
Liabilities:						
Accounts payable and other liabilities	\$1,671,975	\$ 367,718	\$ —	\$ 71,564	\$ 159,008	\$2,270,265
Income tax refunds payable	393,722	—	—	—	—	393,722
Payable to:						
Other funds	698,989	103,484	29,850	464,213	264,038	1,560,574
Pension trust funds	28,787	—	—	—	—	28,787
Component units	3,382	—	—	—	9,499	12,881
Matured bonds and notes payable	—	—	—	—	321,561	321,561
Deferred revenue	311,357	9,933	—	7,598	702	329,590
Total liabilities	<u>3,108,212</u>	<u>481,135</u>	<u>29,850</u>	<u>543,375</u>	<u>754,808</u>	<u>4,917,380</u>
Fund balances:						
Reserved for:						
Encumbrances	69,319	42,615	—	—	2,354	114,288
Restricted purposes	436,200	102,770	—	—	35,426	574,396
Multiyear projects	54,400	193,975	—	—	120,725	369,100
Noncurrent assets	131,500	50,763	10,000	1,095	2,042	195,400
Unreserved	129,708	163,051	1,143,562	119,155	—	1,555,476
Unreserved, reported in:						
Nonmajor special revenue funds	—	—	—	—	224,284	224,284
Total fund balances	<u>821,127</u>	<u>553,174</u>	<u>1,153,562</u>	<u>120,250</u>	<u>384,831</u>	<u>3,032,944</u>
Total liabilities and fund balances	<u>\$3,929,339</u>	<u>\$1,034,309</u>	<u>\$1,183,412</u>	<u>\$663,625</u>	<u>\$1,139,639</u>	<u>\$7,950,324</u>

Sample State Government
Reconciliation of the Governmental Funds Balance Sheet
to the Statement of Net Assets
June 30, 2002
(in Thousands)

Total fund balances—governmental funds (Exhibit 34) \$ 3,032,944

Amounts reported for governmental activities in the statement of net assets are different because:

Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds. These assets consist of:

Land	\$ 263,208	
Infrastructure assets	7,604,600	
Other capital assets	2,860,246	
Accumulated depreciation	<u>(3,249,771)</u>	
Total capital assets		7,478,283

The state has an equity interest in a joint venture. This investment is not a current financial resource and therefore is not reported in the funds. 32,356

Some of the state's revenues will be collected after year-end but are not available soon enough to pay for the current period's expenditures and therefore are deferred in the funds. 249,812

Internal service funds are used by management to charge the costs of certain activities to individual funds. The assets and liabilities of the internal service funds are included in governmental activities in the statement of net assets. (See Exhibit 38.) 210,863

Some liabilities are not due and payable in the current period and therefore are not reported in the funds. Those liabilities consist of:

Bonds and notes payable	(3,285,277)	
Accrued interest on bonds	(426,250)	
Capital leases	(220,014)	
Compensated absences	(451,700)	
Claims and judgments	<u>(781,300)</u>	
Total long-term liabilities		<u>(5,164,541)</u>

Net assets of governmental activities (Exhibit 32) \$ 5,839,717

Sample State Government
Statement of Revenues, Expenditures, and Changes in Fund Balances
Governmental Funds
June 30, 2002
(in Thousands)

	<u>General Fund</u>	<u>Transportation Fund</u>	<u>Rainy-day Fund</u>	<u>School Aid Fund</u>	<u>Other Funds</u>	<u>Total</u>
REVENUES						
Taxes:						
Personal and corporate income	\$ 7,049,432	\$ —	\$ —	\$ 918,182	\$ —	\$ 7,967,614
Sales and use	2,041,046	—	—	5,451,119	—	7,492,165
Tobacco and liquor	312,559	—	—	394,064	—	706,623
Motor fuels	36,776	1,334,349	—	—	—	1,371,125
Others	355,039	58,187	—	81,502	121,203	615,931
From federal agencies:						
Health and human services	4,648,284	—	—	—	—	4,648,284
Agriculture	1,169,833	—	—	—	—	1,169,833
Education	521,235	—	—	69,691	—	590,926
Transportation	8,787	509,941	—	—	—	518,728
Labor	115,492	106,373	—	—	—	221,865
Others	191,234	—	—	—	4,118	195,352
From local governments	134,769	90,248	—	23	—	225,040
Charges for services	119,229	1,186	—	—	—	120,415
Licenses and permits	189,979	73,700	—	—	89,588	353,267
Special Medicaid reimbursements	598,654	—	—	—	—	598,654
Miscellaneous	512,410	72,386	59,205	5,176	172,013	821,190
Total revenues	<u>18,004,758</u>	<u>2,246,370</u>	<u>59,205</u>	<u>6,919,757</u>	<u>386,922</u>	<u>27,617,012</u>
EXPENDITURES						
Current:						
General government	1,060,940	—	—	—	2,039	1,062,979
Education	1,340,042	—	—	8,312,033	134,838	9,786,913
State aid to universities	567,538	—	—	—	—	567,538
Health and welfare	8,617,712	—	—	—	1,382	8,619,094
Public safety and corrections	1,580,342	—	—	—	3,276	1,583,618
Conservation, recreation, and agriculture	247,168	—	—	—	264,291	511,459
Labor, commerce, and regulatory	560,807	—	—	—	33	560,840
Mental health	1,501,080	—	—	—	—	1,501,080
Transportation	—	877,986	—	—	—	877,986
Intergovernmental—grants and revenue sharing	1,281,089	660,910	—	—	—	1,941,999
Debt service:						
Bond principal retirement	—	—	—	—	145,587	145,587
Bond interest and fiscal charges	—	—	—	—	164,394	164,394
Capital lease principal payments	19,202	200	—	—	—	19,402
Interest on capital leases	24,789	11	—	—	—	24,800
Capital outlay	129,958	553,065	—	—	116,495	799,518
Total expenditures	<u>16,930,667</u>	<u>2,092,172</u>	<u>—</u>	<u>8,312,033</u>	<u>832,335</u>	<u>28,167,207</u>
Excess (deficiency) of revenues over expenditures	<u>1,074,091</u>	<u>154,198</u>	<u>59,205</u>	<u>(1,392,276)</u>	<u>(445,413)</u>	<u>(550,195)</u>
OTHER FINANCING SOURCES (USES)						
Bonds and bond anticipation notes issued	—	—	—	—	109,900	109,900
Refunding bonds issued	—	—	—	—	216,600	216,600
Premiums on bonds issued	—	—	—	—	11,014	11,014
Payment to refunding bond escrow account	—	—	—	—	(206,718)	(206,718)
Capital leases	71,746	63	—	—	—	71,809
Transfers in	327,061	651,359	91,334	1,169,288	938,418	3,177,460
Transfers out	(1,409,292)	(849,100)	—	(19,616)	(248,027)	(2,526,035)
Total other financing sources and uses	<u>(1,010,485)</u>	<u>(197,678)</u>	<u>91,334</u>	<u>1,149,672</u>	<u>821,187</u>	<u>854,030</u>
Net change in fund balances	<u>63,606</u>	<u>(43,480)</u>	<u>150,539</u>	<u>(242,604)</u>	<u>375,774</u>	<u>303,835</u>
Fund balances—beginning	757,521	596,654	1,003,023	362,854	9,057	2,729,109
Fund balances—ending	<u>\$ 821,127</u>	<u>\$ 553,174</u>	<u>\$1,153,562</u>	<u>\$ 120,250</u>	<u>\$ 384,831</u>	<u>\$ 3,032,944</u>

Sample State Government
Reconciliation of the Change in Fund Balances of Governmental Funds
to the Statement of Activities
June 30, 2002
(in Thousands)

Net change in fund balances—total governmental funds (Exhibit 36)		\$ 303,835
Amounts reported for governmental activities in the statement of activities are different because:		
Capital outlays are reported as expenditures in governmental funds. However, in the statement of activities, the cost of capital assets is allocated over their estimated useful lives as depreciation expense. In the current period, these amounts are:		
Capital outlay	\$ 799,518	
Depreciation expense	<u>(373,501)</u>	
Excess of capital outlay over depreciation expense		426,017
Bond proceeds provide current financial resources to governmental funds; however, issuing debt increases long-term liabilities in the statement of net assets. In the current period, proceeds were received from:		
Bonds and bond anticipation notes issued, including a premium of \$2,828	(112,728)	
Refunding bonds issued, including a premium of \$8,186	<u>(224,786)</u>	
Total bond proceeds		(337,514)
Some capital additions were financed through capital leases. In governmental funds, a capital lease arrangement is considered a source of financing, but in the statement of net assets, the lease obligation is reported as a liability.		
		(71,809)
Repayment of long-term debt is reported as an expenditure in governmental funds, but the repayment reduces long-term liabilities in the statement of net assets. In the current year, these amounts consist of:		
Bond principal retirement	145,587	
Capital lease payments	19,402	
Payments to the bond refunding agent	<u>206,718</u>	
Total long-term debt repayment		371,707
Internal service funds are used by management to charge the costs of certain activities to individual funds. The net revenue of the internal service funds is reported with governmental activities. (See Exhibit 39.)		
		9,108
Because some revenues will not be collected for several months after the state's fiscal year ends, they are not considered "available" revenues and are deferred in the governmental funds. Deferred revenues increased by this amount this year.		
		37,471
Some items 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. These activities consist of:		
Net increase in accrued interest	(14,500)	
Interest accreted on capital appreciation debt	(10,500)	
Increase in compensated absences	(3,126)	
Increase in claims and judgments	<u>(53,205)</u>	
Total additional expenditures		<u>(81,331)</u>
Change in net assets of governmental activities (Exhibit 33b)		<u><u>\$ 657,484</u></u>

Sample State Government
Statement of Net Assets
Proprietary Funds
June 30, 2002
(in Thousands)

	Enterprise Funds				
	Lottery Fund	Unemployment Compensation Fund	Other Enterprise Funds	Total	Internal Service Funds
ASSETS					
Current assets:					
Cash and cash equivalents	\$ 27,503	\$ 87,653	\$17,510	\$ 132,666	\$186,648
Assessments, interest, and penalties receivable	—	144,836	—	144,836	—
Investments	111,102	1,842,878	—	1,953,980	—
Due from other funds	—	2,716	—	2,716	82,796
Due from federal agencies	—	2,601	—	2,601	—
Due from local units	—	15,740	—	15,740	—
Inventories	3,496	—	28,966	32,462	18,560
Other current assets	43,274	16,477	418	60,169	13,434
Total current assets	<u>185,375</u>	<u>2,112,901</u>	<u>46,894</u>	<u>2,345,170</u>	<u>301,438</u>
Noncurrent assets:					
Investments	869,433	—	—	869,433	—
Capital assets:					
Land	—	—	98	98	—
Buildings and equipment	10,685	—	10,508	21,193	176,090
Less accumulated depreciation	(8,633)	—	(7,082)	(15,715)	(63,874)
Other noncurrent assets	—	—	—	—	65,821
Total noncurrent assets	<u>871,485</u>	<u>—</u>	<u>3,524</u>	<u>875,009</u>	<u>178,037</u>
Total assets	<u>1,056,860</u>	<u>2,112,901</u>	<u>50,418</u>	<u>3,220,179</u>	<u>479,475</u>
LIABILITIES					
Current liabilities:					
Accounts payable and other liabilities	154,562	59,631	34,691	248,884	91,909
Due to other funds	123	2,188	249	2,560	74,745
Deferred revenue	—	1,370	—	1,370	424
Total current liabilities	<u>154,685</u>	<u>63,189</u>	<u>34,940</u>	<u>252,814</u>	<u>167,078</u>
Noncurrent liabilities:					
Prize awards payable	900,486	—	—	900,486	—
Other noncurrent liabilities	1,689	—	3,774	5,463	101,534
Total noncurrent liabilities	<u>902,175</u>	<u>—</u>	<u>3,774</u>	<u>905,949</u>	<u>101,534</u>
Total liabilities	<u>1,056,860</u>	<u>63,189</u>	<u>38,714</u>	<u>1,158,763</u>	<u>268,612</u>
NET ASSETS					
Invested in capital assets	2,052	—	3,524	5,576	112,216
Restricted for unemployment compensation	—	2,049,712	—	2,049,712	—
Unrestricted (deficit)	(2,052)	—	8,180	6,128	98,647
Total net assets	<u>\$ 0</u>	<u>\$2,049,712</u>	<u>\$11,704</u>	<u>\$2,061,416</u>	<u>\$210,863</u>

Sample State Government
Statement of Revenues, Expenses, and
Changes in Fund Net Assets
Proprietary Funds
June 30, 2002
(in Thousands)

	Enterprise Funds				Internal Service Funds
	Lottery Fund	Unemployment Compensation Fund	Other Enterprise Funds	Total	
OPERATING REVENUES					
Sales and charges for services	\$1,456,251	\$ —	\$480,020	\$1,936,271	\$774,926
Assessments	—	1,231,245	—	1,231,245	—
From federal agencies	—	165,964	—	165,964	—
From local agencies	—	1,301	—	1,301	—
Miscellaneous	—	18,451	—	18,451	—
Total revenue	<u>1,456,251</u>	<u>1,416,961</u>	<u>480,020</u>	<u>3,353,232</u>	<u>774,926</u>
OPERATING EXPENSES					
Salaries, wages, and administrative expenses	159,716	—	35,652	195,368	120,433
Depreciation	851	—	1,171	2,022	10,895
Unemployment compensation	—	1,174,657	—	1,174,657	—
Purchases for resale	—	—	340,106	340,106	52,963
Lottery prize awards	826,447	—	—	826,447	—
Premiums and claims	—	—	—	—	547,129
Other operating expenses	—	—	—	—	33,446
Total operating expenses	<u>987,014</u>	<u>1,174,657</u>	<u>376,929</u>	<u>2,538,600</u>	<u>764,866</u>
Operating income	<u>469,237</u>	<u>242,304</u>	<u>103,091</u>	<u>814,632</u>	<u>10,060</u>
NONOPERATING REVENUES (EXPENSES)					
Alcoholic beverage taxes	—	—	8,182	8,182	—
Interest and dividends	4,625	115,173	—	119,798	—
Net increase in fair value of investments	75,684	—	—	75,684	—
Other nonoperating revenue	—	—	160	160	170
Interest expense	—	—	(803)	(803)	(429)
Total nonoperating revenues (expenses)	<u>80,309</u>	<u>115,173</u>	<u>7,539</u>	<u>203,021</u>	<u>(259)</u>
Income before transfers	<u>549,546</u>	<u>357,477</u>	<u>110,630</u>	<u>1,017,653</u>	<u>9,801</u>
Transfer to other funds	(549,546)	(18,528)	(98,402)	(666,476)	(693)
Transfer from other funds	—	15,744	—	15,744	—
Change in net assets	—	354,693	12,228	366,921	9,108
Total net assets—beginning	—	1,695,019	(524)	1,694,495	201,755
Total net assets—ending	<u>\$ 0</u>	<u>\$2,049,712</u>	<u>\$ 11,704</u>	<u>\$2,061,416</u>	<u>\$210,863</u>

**Sample State Government
Statement of Cash Flows
Proprietary Funds
June 30, 2002
(in Thousands)**

	Enterprise Funds				
	Lottery Fund	Unemployment Compensation Fund	Other Enterprise Funds	Total	Internal Service Funds
CASH FLOWS FROM OPERATING ACTIVITIES					
Cash received from assessments	\$ —	\$ 1,239,640	\$ —	\$ 1,239,640	\$ —
Cash received from federal and local agencies	—	164,896	—	164,896	—
Cash received from customers	1,456,251	—	480,020	1,936,271	—
Cash received from other funds	—	—	—	—	737,765
Payments to employees	(122,658)	—	(31,791)	(154,449)	(112,989)
Payments to suppliers	(28,199)	—	(348,335)	(376,534)	(96,909)
Payments to prize winners	(781,102)	—	—	(781,102)	—
Claims paid	—	(1,177,535)	—	(1,177,535)	(547,129)
Other receipts (payments)	—	18,451	(3,912)	14,539	4,208
Net cash provided (used) by operating activities	<u>524,292</u>	<u>245,452</u>	<u>95,982</u>	<u>865,726</u>	<u>(15,054)</u>
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES					
Interest paid	—	—	(803)	(803)	(429)
Interfund loan or loan repayments received	—	1,991	10,765	12,756	47,541
Interfund loans made or repaid	—	(4,001)	(10,831)	(14,832)	(38,261)
Alcoholic beverage taxes	—	—	8,182	8,182	—
Net transfers to other funds	(549,546)	(2,784)	(98,402)	(650,732)	(693)
Net cash provided (used) by noncapital financing activities	<u>(549,546)</u>	<u>(4,794)</u>	<u>(91,089)</u>	<u>(645,429)</u>	<u>8,158</u>
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES					
Acquisition and construction of capital assets	(665)	—	(136)	(801)	(48,683)
Capital lease payments (and interest)	—	—	—	—	(169)
Proceeds from sale of property, plant, and equipment	—	—	1,935	1,935	1,816
Net cash provided (used) by capital and related financing activities	<u>(665)</u>	<u>—</u>	<u>1,799</u>	<u>1,134</u>	<u>(47,036)</u>
CASH FLOWS FROM INVESTING ACTIVITIES					
Purchase of investments	(64,007)	(363,719)	—	(427,726)	—
Proceeds from sale and maturities of investments	63,401	—	—	63,401	—
Interest and dividends on investments	4,625	115,173	—	119,798	—
Net cash provided (used) by investing activities	<u>4,019</u>	<u>(248,546)</u>	<u>—</u>	<u>(244,527)</u>	<u>—</u>
Net increase (decrease) in cash	(21,900)	(7,888)	6,692	(23,096)	(53,932)
Cash and cash equivalents—beginning	49,403	95,541	10,818	155,762	240,580
Cash and cash equivalents—ending	<u>\$ 27,503</u>	<u>\$ 87,653</u>	<u>\$ 17,510</u>	<u>\$ 132,666</u>	<u>\$ 186,648</u>
Reconciliation of operating income to net cash provided (used) by operating activities:					
Operating income	\$ 469,237	\$ 242,304	\$ 103,091	\$ 814,632	\$ 10,060
Adjustments to reconcile operating income to net cash provided (used) by operating activities:					
Depreciation	851	—	1,171	2,022	10,895
Net changes in assets and liabilities:					
Inventories	(718)	—	(1,984)	(2,702)	—
Other assets	681	6,026	180	6,887	(45,843)
Current liabilities	8,859	(2,878)	(6,476)	(495)	20,838
Prize awards payable	45,345	—	—	45,345	—
Other liabilities	37	—	—	37	(11,004)
Net cash provided (used) by operating activities	<u>\$ 524,292</u>	<u>\$ 245,452</u>	<u>\$ 95,982</u>	<u>\$ 865,726</u>	<u>\$ (15,054)</u>
Noncash investing activities					

The net increase in the fair value of investments in the Lottery Fund was \$75,684 for the year.

Sample State Government
Statement of Fiduciary Net Assets
Fiduciary Funds
June 30, 2002
(in Thousands)

	Pension Trust Funds	Private-purpose Trust Funds	Investment Trust Funds	Agency Funds
ASSETS				
Cash and cash equivalents	\$ 155,564	\$104,747	\$ —	\$ 87,788
Receivables:				
Employee	2,123	—	—	—
Employer	83,004	—	—	—
Interest and dividends	175,402	—	12,166	—
From other funds	28,787	—	—	—
From federal agencies	—	—	—	858
From local units	—	—	—	17
From sale of investments	30,879	—	—	—
Total receivables	<u>320,195</u>	<u>—</u>	<u>12,166</u>	<u>875</u>
Investments at fair value:				
Short-term investments	2,268,960	61,591	241,645	1,811,384
Bonds, notes, mortgages, and preferred stock	14,115,391	187,650	804,576	—
Common stock	20,742,440	520,196	497,848	—
Real estate	3,408,145	—	—	—
International investments	1,723,951	—	342,845	—
Mutual funds	72,315	—	178,046	—
Pooled investment funds	23,128	—	—	—
Total investments	<u>42,354,330</u>	<u>769,437</u>	<u>2,064,960</u>	<u>1,811,384</u>
Securities lending collateral	1,746,544	—	—	—
Other assets	13,519	81,157	181	394,910
Total assets	<u>44,590,152</u>	<u>955,341</u>	<u>2,077,307</u>	<u>2,294,957</u>
LIABILITIES				
Accounts payable and other liabilities	130,846	61,447	1,361	2,294,957
Obligations under securities lending	1,746,544	—	—	—
Other long-term liabilities	1,617	7,870	—	—
Total liabilities	<u>1,879,007</u>	<u>69,317</u>	<u>1,361</u>	<u>2,294,957</u>
NET ASSETS				
Held in trust for:				
Employees' pension benefits	29,897,802	—	—	—
Employees' postemployment healthcare benefits	12,813,343	—	—	—
Individuals, organizations, and other governments	—	886,024	2,075,946	—
Total net assets	<u>\$42,711,145</u>	<u>\$886,024</u>	<u>\$2,075,946</u>	<u>\$ 0</u>

Sample State Government
Statement of Changes in Fiduciary Net Assets
Fiduciary Funds
June 30, 2002
(in Thousands)

	Pension Trust Funds	Private-purpose Trust Funds	Investment Trust Funds
ADDITIONS			
Contributions:			
Members	\$ 297,846	\$ —	\$ —
Employers	1,259,384	—	—
Other plans	148,792	—	—
Gifts, bequests, and endowments	—	72,132	—
Total contributions	<u>1,706,022</u>	<u>72,132</u>	<u>—</u>
Investment income:			
Net increase in fair value of investments	1,852,408	98,765	84,663
Interest, dividends, and other	1,416,448	90,378	73,465
Securities lending income	76,075	—	—
Total investment income	<u>3,344,931</u>	<u>189,143</u>	<u>158,128</u>
Less investment expense:			
Investment activity expense	32,281	—	50,236
Securities lending expense	73,642	—	—
Net investment income	<u>3,239,008</u>	<u>189,143</u>	<u>107,892</u>
Capital share and individual account transactions:			
Shares sold	—	—	2,817,210
Reinvested distributions	—	—	96,525
Shares redeemed	—	—	(2,811,843)
Net capital share and individual account transactions	<u>—</u>	<u>—</u>	<u>101,892</u>
Miscellaneous	1,130	—	—
Total additions	<u>4,946,160</u>	<u>261,275</u>	<u>209,784</u>
DEDUCTIONS			
Benefits paid to participants or beneficiaries	1,963,047	—	—
Medical, dental, and life insurance for retirees	536,027	—	—
Refunds and transfers to other systems	170,514	—	—
Administrative expense	19,920	—	—
Payments in accordance with trust agreements	—	211,222	—
Distributions to shareholders	—	—	96,525
Total deductions	<u>2,689,508</u>	<u>211,222</u>	<u>96,525</u>
Change in net assets held in trust for:			
Employees' pension benefits	2,280,555	—	—
Employees' postemployment healthcare benefits	(23,903)	—	—
Individuals, organizations, and other governments	—	50,053	113,259
Net assets—beginning	<u>40,454,493</u>	<u>835,971</u>	<u>1,962,687</u>
Net assets—ending	<u><u>\$42,711,145</u></u>	<u><u>\$886,024</u></u>	<u><u>\$ 2,075,946</u></u>

Appendix 3

ALTERNATIVE APPROACHES FOR CERTAIN DISPLAY AND DISCLOSURE REQUIREMENTS

This appendix presents alternative approaches to certain display and disclosures illustrated in Appendix 2, Illustration A. Some of the alternatives presented in this appendix could be used by any government—for example, Exhibit 1 illustrates a “classified” statement of net assets. Other alternatives are available only to certain types of governments—for example, Exhibits 5 through 9 are appropriate only for single-program governments.

Preparers should evaluate these alternative approaches in light of what is most appropriate and useful, based on the requirements set forth in Statement 34 and the needs of their financial statement users.

Alternative Approaches for Certain Display and Disclosure Requirements

	Page Number
Statement of Net Assets Using a Classified Format	183
Exhibit 1—Statement of Net Assets.....	184
Statement of Activities with a Separate Column to Display the Allocation of Indirect Expenses.....	185
Exhibit 2—Statement of Activities.....	186
Statement of Activities Using the Two-page Approach	187
Exhibit 3—Statement of Activities.....	188
Statement of Activities Displaying Functions in Columns.....	190
Exhibit 4—Statement of Activities.....	191
Single-column Government-wide Financial Statements for a Single-program Government	192
Exhibit 5—Statement of Net Assets.....	193
Exhibit 6—Statement of Activities.....	194
Combined Government-wide and Fund Financial Statements for a Single-program Government	195
Exhibit 7—Statement of Net Assets and Governmental Funds Balance Sheet.....	196
Exhibit 8—Statement of Activities and Governmental Fund Revenues, Expenditures, and Changes in Fund Balances	197
Exhibit 9—Statement of Activities and Governmental Fund Revenues, Expenditures, and Changes in Fund Balances	198
Illustrations of Notes That Provide Additional Details for the Reconciliations of Fund Financial Statements to Government-wide Statements	199
Exhibit 10 (Note 4a)—Explanation of Differences between the Governmental Funds Balance Sheet and the Statement of Net Assets	200
Exhibit 10 (Note 5a)—Explanation of Differences between Governmental Fund Operating Statements and the Statement of Activities	201
Exhibit 10 (Note 5b)—Explanation of Differences between Governmental Fund Operating Statements and the Statement of Activities	203
Combining Statements for Major Component Units.....	204
Exhibit 11A—Statement of Net Assets	205
Exhibit 11B—Statement of Activities.....	206
Special-purpose Government Engaged Only in Business-type Activities: Selected Government-wide Financial Statements for the Landfill Component Unit in Appendix 2, Illustration A	207
Exhibit 12A—Statement of Net Assets.....	208
Exhibit 12B—Statement of Revenues, Expenses, and Changes in Net Assets	209
Budget-to-Actual Comparison Statement Using the Operating Statement Format	210
Exhibit 13—Schedule of Revenues, Expenditures, and Changes in Fund Balances—Budget and Actual.....	211
Illustration of Required Supplementary Information for Governments That Use the Modified Approach for Infrastructure Assets	212
Exhibit 14—Illustration of Required Supplementary Information for Governments That Use the Modified Approach for Infrastructure Assets.....	213

STATEMENT OF NET ASSETS USING A CLASSIFIED FORMAT

Exhibit 1 illustrates a classified approach within the balance sheet format for the government-wide statement of net assets. Also within the balance sheet format presented in this exhibit, assets and liabilities may be presented in order of relative liquidity (as illustrated in Exhibit 1 in Appendix 2).

Also 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).

Internal balances are reported on separate lines for governmental (receivable) and business-type (payable) activities and are not included in the primary government totals.

Sample City
Statement of Net Assets
December 31, 2002

Alternatively, the internal balances could be reported on the same line as offsetting positive and negative balances. (See Appendix 2, Exhibit 1.)

	Primary Government			Component Units
	Governmental Activities	Business-type Activities	Total	
ASSETS				
Current assets:				
Cash and cash equivalents	\$ 13,597,899	\$ 9,023,498	\$ 22,621,397	\$ 303,935
Investments	27,365,221	64,575	27,429,796	7,428,952
Receivables (net)	12,833,132	3,609,615	16,442,747	4,042,290
Internal balances	313,768	—	—	—
Inventories	322,149	126,674	448,823	83,697
Total current assets	<u>54,432,169</u>	<u>12,824,362</u>	<u>66,942,763</u>	<u>11,858,874</u>
Noncurrent assets:				
Restricted cash and cash equivalents	—	1,493,322	1,493,322	—
Capital assets (Note 1):				
Land, infrastructure, and other assets not being depreciated	118,620,361	34,788,333	153,408,694	751,239
Buildings and equipment, net of depreciation	51,402,399	116,600,418	168,002,817	36,993,547
Total noncurrent assets	<u>170,022,760</u>	<u>152,882,073</u>	<u>322,904,833</u>	<u>37,744,786</u>
Total assets	<u>\$224,454,929</u>	<u>\$165,706,435</u>	<u>\$389,847,596</u>	<u>\$49,603,660</u>
LIABILITIES				
Current liabilities:				
Accounts payable and accrued expenses	\$ 7,538,543	\$ 786,842	\$ 8,325,385	\$ 1,803,332
Internal balances	—	313,768	—	—
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	<u>18,210,142</u>	<u>5,526,896</u>	<u>23,423,270</u>	<u>3,268,882</u>
Noncurrent liabilities:				
Noncurrent portion of long-term obligations (Note 2)	83,302,378	74,482,273	157,784,651	27,106,151
Total liabilities	<u>101,512,520</u>	<u>80,009,169</u>	<u>181,207,921</u>	<u>30,375,033</u>
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	11,290,079	—	11,290,079	492,445
Debt service	3,076,829	1,451,996	4,528,825	—
Community development projects	6,886,663	—	6,886,663	—
Other purposes	3,874,736	—	3,874,736	—
Unrestricted (deficit)	(5,897,284)	11,156,696	5,259,412	2,829,790
Total net assets	<u>122,942,409</u>	<u>85,697,266</u>	<u>208,639,675</u>	<u>19,228,627</u>
Total liabilities and net assets	<u>\$224,454,929</u>	<u>\$165,706,435</u>	<u>\$389,847,596</u>	<u>\$49,603,660</u>

**STATEMENT OF ACTIVITIES WITH A SEPARATE COLUMN TO DISPLAY
THE ALLOCATION OF INDIRECT EXPENSES**

Exhibit 2 is a modification of Exhibit 2 in Appendix 2. It illustrates the use of an additional column in the statement of activities to display the allocation of indirect expenses (from the general government and interest on long-term debt functions) to the various functions and programs. 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.

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

Functions/Programs	Expenses	Indirect Expenses Allocation	Program Revenues			Net (Expense) Revenue and Changes in Net Assets		
			Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Primary Government		Component Units
						Governmental Activities	Business-type Activities	
Primary government:								
Governmental activities:								
General government	\$ 9,709,509	\$ (5,532,627)	\$ 3,333,265	\$ 843,617	\$ —	\$ —	\$ —	
Public safety	34,782,144	4,011,622	1,198,855	1,307,693	62,300	(36,224,918)	(36,224,918)	
Public works	10,131,928	3,439,152	850,000	—	2,252,615	(10,468,465)	(10,468,465)	
Engineering services	1,299,645	111,618	704,793	—	—	(706,470)	(706,470)	
Health and sanitation	6,705,675	558,088	5,612,267	575,000	—	(1,076,496)	(1,076,496)	
Cemetery	735,866	55,809	212,496	72,689	—	(506,490)	(506,490)	
Culture and recreation	11,534,045	1,858,966	3,995,199	2,450,000	—	(6,947,812)	(6,947,812)	
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	6,242,893	(6,242,893)	—	—	—	—	—	
Total governmental activities	106,029,367	\$ —	15,906,875	5,248,999	4,894,915	(79,978,578)	(79,978,578)	
Business-type activities:								
Water	3,643,315		4,159,350	—	1,159,909	—	\$ 1,675,944	1,675,944
Sewer	4,909,885		7,170,533	—	486,010	—	2,746,658	2,746,658
Parking facilities	2,824,368		1,449,012	—	—	—	(1,375,356)	(1,375,356)
Total business-type activities	11,377,568		12,778,895	—	1,645,919	—	3,047,246	3,047,246
Total primary government	\$117,406,935		\$28,685,770	\$5,248,999	\$6,540,834	(79,978,578)	(76,931,332)	
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)	(26,543,650)
Total component units	\$ 34,568,655		\$ 4,563,623	\$3,937,083	\$ 11,397	—	(26,056,552)	(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
Unrestricted investment earnings						1,885,455	619,987	2,505,442
Miscellaneous						884,907	—	884,277
Special item—gain on sale of park land						2,653,488	—	19,950
Transfers						501,409	(501,409)	—
Total general revenues, special items, and transfers						76,828,288	118,578	76,946,866
Change in net assets						(3,150,290)	3,165,824	15,534
Net assets—beginning						126,092,699	82,531,442	208,624,141
Net assets—ending						\$122,942,409	\$85,697,266	\$19,228,627

STATEMENT OF ACTIVITIES USING THE TWO-PAGE APPROACH

This illustration presents the statement of activities for the municipal government in Appendix 2, Exhibit 2 using a two-page approach. The first page (Exhibit 3a) presents the expanded details for expenses and program revenues. The second page (Exhibit 3b) begins with totals from 3a (shaded) and then presents the general revenues and changes in net assets information. This approach allows the government to present a far greater number of functions, or to further break down the program expenses into natural classifications. (See Exhibit 4 in this appendix.) 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 (Exhibit 2 in Appendix 2). The added space on the second page (3b) also allows governments to provide more details of general revenues.

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

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenue (Exhibit 3b)
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	
Primary government:					
Governmental activities:					
General government:					
Planning and economic development	\$ 2,177,831	\$ 562,333	\$ 843,617	\$ —	\$ (771,881)
Other general government	7,531,678	2,770,932	—	—	(4,760,746)
Public safety:					
Police	20,834,504	123,456	1,307,693	—	(19,403,355)
Fire	9,843,347	—	—	62,300	(9,781,047)
Emergency medical services	2,539,096	619,834	—	—	(1,919,262)
Inspections	1,565,197	455,565	—	—	(1,109,632)
Public works:					
Street maintenance	6,587,540	566,543	—	2,252,615	(3,768,382)
Other public works	3,544,388	283,457	—	—	(3,260,931)
Engineering services	1,299,645	704,793	—	—	(594,852)
Health and sanitation	6,705,675	5,612,267	575,000	—	(518,408)
Cemetery	735,866	212,496	72,689	—	(450,681)
Culture and recreation:					
Parks and beaches	9,991,335	3,649,521	2,350,000	—	(3,991,814)
Library and others	1,542,710	345,678	100,000	—	(1,097,032)
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	6,242,893	—	—	—	(6,242,893)
Total governmental activities	<u>106,029,367</u>	<u>15,906,875</u>	<u>5,248,999</u>	<u>4,894,915</u>	<u>(79,978,578)</u>
Business-type activities:					
Water	3,643,315	4,159,350	—	1,159,909	1,675,944
Sewer	4,909,885	7,170,533	—	486,010	2,746,658
Parking facilities	2,824,368	1,449,012	—	—	(1,375,356)
Total business-type activities	<u>11,377,568</u>	<u>12,778,895</u>	<u>—</u>	<u>1,645,919</u>	<u>3,047,246</u>
Total primary government	<u>\$ 117,406,935</u>	<u>\$ 28,685,770</u>	<u>\$ 5,248,999</u>	<u>\$ 6,540,834</u>	<u>\$(76,931,332)</u>
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	<u>\$ 34,568,655</u>	<u>\$ 4,563,623</u>	<u>\$ 3,937,083</u>	<u>\$ 11,397</u>	<u>\$(26,056,552)</u>

(The statement of activities continues on the following page.)

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

	Primary Government			Component Units
	Governmental Activities	Business-type Activities	Total	
Changes in net assets:				
Net (expense) revenue (from Exhibit 3a)	\$ (79,978,578)	\$ 3,047,246	\$ (76,931,332)	\$(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
Unrestricted investment earnings	1,885,455	619,987	2,505,442	884,277
Miscellaneous	884,907	—	884,907	19,950
<i>Special item</i> —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	76,828,288	118,578	76,946,866	29,259,208
Change in net assets	(3,150,290)	3,165,824	15,534	3,202,656
Net assets—beginning	126,092,699	82,531,442	208,624,141	16,025,971
Net assets—ending	<u>\$122,942,409</u>	<u>\$85,697,266</u>	<u>\$208,639,675</u>	<u>\$ 19,228,627</u>

STATEMENT OF ACTIVITIES DISPLAYING FUNCTIONS IN COLUMNS

Exhibit 4 illustrates a display technique that may be useful for governments that have only a few governmental functions or programs and no component units. Other governments with more individual functions and programs within both the business-type and governmental activity categories may not find this approach to be a viable alternative to the standard format illustrated in Exhibit 2 in Appendix 2. For example, if the township government in this example 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).

This method 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 addition, the “Total” column is presented as the first column, allowing all the descriptions to follow consecutively in a single column.

The minimum requirement for level of detail to be reported in the statement of activities is to report direct expenses for each function (paragraph 41). The additional details shown here (natural classifications) are not required, but are presented to demonstrate how this modified format can accommodate more information.

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

		Functions/Programs			
	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				
Unrestricted 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				

**SINGLE-COLUMN GOVERNMENT-WIDE FINANCIAL STATEMENTS
FOR A SINGLE-PROGRAM GOVERNMENT**

Exhibits 5 and 6 present a statement of net assets and a statement of activities for a single-program government that engages in only governmental activities and has no component units. **Governmental fund financial statements and the reconciliation to the government-wide statements would also be required.**

The level of detail about capital assets and long-term liabilities displayed in the statement of net assets is not required to be presented on the face of the statement. The details can be displayed, as shown here, or disclosed in the notes. (See Notes 1 and 2 in Exhibit 11 of Appendix 2.) For long-term liabilities, only the *total* amounts due within one year and those due beyond one year are required to be displayed.

The natural classifications of expenses displayed in the statement of activities are not required. Paragraph 41 requires only that the total program expense (\$11,203,213) be presented. Nevertheless, for single-program governments, or those that have only a few programs (see Exhibit 4 in this appendix), the usefulness of the statement of activities is enhanced with the additional expense details. Similarly, more details of the general revenues also could be presented.

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

ASSETS

Cash and investments	\$ 7,716,749
Taxes receivable	1,480,536
Other receivables	574,481
Prepaid expenses	7,763
Inventories	197,308
Capital assets, net of accumulated depreciation, where applicable:	
Land	301,576
Buildings and improvements	3,398,394
Fire apparatus—automotive	907,482
Furniture, fixtures, and equipment	911,754
Total capital assets, net	<u>5,519,206</u>
Total assets	<u>15,496,043</u>

LIABILITIES

Accounts payable	106,999
Salaries and benefits payable	273,367
Accrued interest payable	1,511
Deferred revenues	273,746
Compensated absences:	
Expected to be paid within one year	200,601
Expected to be paid after one year	401,202
Bonds and notes payable:	
Portion due within one year	235,453
Portion due after one year	3,195,905
Total liabilities	<u>4,688,784</u>

NET ASSETS

Invested in capital assets, net of related debt	2,087,848
Restricted for debt service	510,741
Unrestricted	8,208,670
Total net assets	<u><u>\$10,807,259</u></u>

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

Expenses:	
Public safety—fire protection:	
Personal services	\$ 9,440,023
Materials and services	1,250,788
Depreciation	306,623
Interest	205,779
Total program expenses	<u>11,203,213</u>
Program revenues:	
Charges for services	622,590
Net program expense	<u>10,580,623</u>
General revenues:	
Property taxes	11,412,154
Investment earnings	597,661
Miscellaneous	29,245
Total general revenues	<u>12,039,060</u>
Increase in net assets	1,458,437
Net assets—beginning of the year	<u>9,348,822</u>
Net assets—end of the year	<u><u>\$10,807,259</u></u>

COMBINED GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS FOR A SINGLE-PROGRAM GOVERNMENT

Paragraph 136 states that governments engaged in a single governmental program may combine their fund financial statements with their government-wide statements by using a columnar format that reconciles individual line items of fund financial data to government-wide data in a separate column.

Exhibit 7 presents the combined governmental fund balance sheet/statement of net assets. Exhibits 8 and 9 illustrate two different approaches for the combined statement of governmental fund revenues, expenditures, and changes in fund balances/statement of activities. If the explanations for the reconciliation items in the “Adjustments” column 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.

Using a combination approach for the statement of activities requires the reporting government to reformat either the statement of revenues, expenditures, and changes in fund balances or the statement of activities. In Exhibit 8 the governmental fund statement is modified to align with the statement of activities. Exhibit 9 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 of Exhibit 9 might provide more useful information. On the other hand, significant program revenues may support using the net cost format illustrated in Exhibit 8.)

Preparers should also consider that there is a difference in the “message” communicated to the users depending on the format used. In Exhibit 8 the message might be interpreted as “this is how we paid for the cost of the program”; the message from the approach in Exhibit 9 could be “this is what we did with the revenues we raised.”

Sample County Fire Protection District
Statement of Net Assets and
Governmental Funds Balance Sheet
June 30, 2002

	<u>General Fund</u>	<u>Other Funds</u>	<u>Total</u>	<u>Adjustments (Note C)*</u>	<u>Statement of Net Assets</u>
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
Land	—	—	—	301,507	301,507
Other capital assets, net of accumulated depreciation	—	—	—	5,217,699	5,217,699
Total assets	<u>\$8,706,120</u>	<u>\$1,283,010</u>	<u>\$9,989,130</u>	<u>5,506,913</u>	<u>15,496,043</u>
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:					
Due within one year	—	—	—	436,054	436,054
Due after one year	—	—	—	3,597,107	3,597,107
Total liabilities	<u>1,893,809</u>	<u>77,256</u>	<u>1,971,065</u>	<u>2,717,719</u>	<u>4,688,784</u>
FUND BALANCES/NET ASSETS					
Fund balances:					
Reserved for inventories	197,308	—	197,308	(197,308)	—
Unreserved	6,615,003	—	6,615,003	(6,615,003)	—
Unreserved, reported in:					
Debt service funds	—	468,167	468,167	(468,167)	—
Capital projects funds	—	737,587	737,587	(737,587)	—
Total fund balances	<u>6,812,311</u>	<u>1,205,754</u>	<u>8,018,065</u>	<u>(8,018,065)</u>	<u>—</u>
Total liabilities and fund balances	<u>\$8,706,120</u>	<u>\$1,283,010</u>	<u>\$9,989,130</u>		
Net assets:					
Invested in capital assets, net of related debt				2,087,848	2,087,848
Restricted for debt service				510,741	510,741
Unrestricted				8,208,670	8,208,670
Total net assets				<u>\$10,807,259</u>	<u>\$10,807,259</u>

*Note C would provide the details for the main components of the adjustments. (See Exhibit 10 in this appendix for examples.)

Sample County Fire Protection District
Statement of Activities and
Governmental Fund Revenues, Expenditures, and
Changes in Fund Balances
For the Year Ended June 30, 2002

	<u>General Fund</u>	<u>Other Funds</u>	<u>Total</u>	<u>Adjustments (Note Y)*</u>	<u>Statement of Activities</u>
Expenditures/expenses:					
Fire protection—operations	\$10,684,793	\$ —	\$10,684,793	\$ 312,641	\$10,997,434
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	<u>10,767,869</u>	<u>643,203</u>	<u>11,411,072</u>	<u>(207,859)</u>	<u>11,203,213</u>
Program revenues:					
Charges for services	<u>622,590</u>	<u>—</u>	<u>622,590</u>	<u>—</u>	<u>622,590</u>
Net program expense					<u>10,580,623</u>
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	<u>10,805,435</u>	<u>963,024</u>	<u>11,768,459</u>	<u>270,601</u>	<u>12,039,060</u>
Excess of revenues and transfers in over expenditures and transfers out	660,156	319,821	979,977	(979,977)	—
Change in net assets	—	—	—	1,458,437	1,458,437
Fund balance/net assets:					
Beginning of the year	<u>6,152,155</u>	<u>885,933</u>	<u>7,038,088</u>	<u>2,310,734</u>	<u>9,348,822</u>
End of the year	<u>\$ 6,812,311</u>	<u>\$1,205,754</u>	<u>\$ 8,018,065</u>	<u>\$2,789,194</u>	<u>\$10,807,259</u>

*Note Y would provide the details for the main components of the adjustments. (See Exhibit 10 in this appendix for examples.)

Sample County Fire Protection District
Statement of Activities and
Governmental Fund Revenues, Expenditures, and
Changes in Fund Balances
For the Year Ended June 30, 2002

	<u>General Fund</u>	<u>Other Funds</u>	<u>Total</u>	<u>Adjustments (Note Y)*</u>	<u>Statement of Activities</u>
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	<u>11,928,025</u>	<u>463,024</u>	<u>12,391,049</u>	<u>270,601</u>	<u>12,661,650</u>
Expenditures/expenses:					
Fire protection:					
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	<u>10,767,869</u>	<u>643,203</u>	<u>11,411,072</u>	<u>(207,859)</u>	<u>11,203,213</u>
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	2,310,734	9,348,822
End of the year	<u>\$ 6,812,311</u>	<u>\$ 1,205,754</u>	<u>\$ 8,018,065</u>	<u>\$ 2,789,194</u>	<u>\$ 10,807,259</u>

*Note Y would provide the details for the main components of the adjustments. (See Exhibit 10 in this appendix for examples.)

ILLUSTRATIONS OF NOTES THAT PROVIDE ADDITIONAL DETAILS FOR THE RECONCILIATIONS OF FUND FINANCIAL STATEMENTS TO GOVERNMENT-WIDE STATEMENTS

The reconciling items presented on the face of the fund financial statements should be aggregated and the descriptions of them should be brief. The requirement in paragraph 77 for additional explanations in the notes (when the aggregated information in the summary reconciliation obscures the nature of the individual elements of a particular item) acknowledges that, in some cases, the unavoidable complexity of an explanation takes precedence over the need to keep the explanation highly aggregated. Preparers will have to exercise judgment in balancing the characteristics of *highly aggregated* with *sufficiently descriptive*.

The illustrative disclosures in Exhibit 10 demonstrate two styles that could be used to provide additional explanations for items in the reconciliation. Other approaches that provide additional explanations in an understandable fashion could also be used. The *minimum* disclosure requirements from paragraph 77 are illustrated in Notes 4 and 5 in Exhibit 11 of Appendix 2. Notes 4a and 5a in this exhibit provide a *line item-by-line item* display of differences between the fund financial statements and the government-wide statements. Detailed explanations of the reconciling items are also provided. Note 5b in this exhibit presents similarly detailed explanations of the reconciling items, but does not include the line item details in the schedule in Note 5a.

Note 4a—Explanation of Differences between the Governmental Funds Balance Sheet and the Statement of Net Assets

“Total fund balances” of the city’s governmental funds (\$34,893,106) in Appendix 2, Exhibit 3, differs from “net assets” of governmental activities (\$122,942,409) reported in the statement of net assets in Appendix 2, Exhibit 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	7,135,307	—	157,804	5,540,021	12,833,132
Due from other funds	1,370,757	—	138,768	(1,195,757)	313,768
Due from other governments	2,344,276	—	—	(2,344,276)	—
Liens receivable	3,195,745	—	—	(3,195,745)	—
Inventories	182,821	—	139,328	—	322,149
Capital assets	—	161,082,708	8,940,052	—	170,022,760
Total assets	<u>\$51,705,690</u>	<u>\$161,082,708</u>	<u>\$12,862,288</u>	<u>\$(1,195,757)</u>	<u>\$224,454,929</u>
LIABILITIES					
Accounts payable	\$ 5,908,666	\$ —	\$ 780,570	\$ 94,074	\$ 6,783,310
Accrued interest	—	755,233	—	—	755,233
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	<u>16,812,584</u>	<u>76,166,864</u>	<u>9,728,829</u>	<u>(1,195,757)</u>	<u>101,512,520</u>
FUND BALANCES/NET ASSETS					
Total fund balances/net assets	34,893,106	84,915,844	3,133,459	—	122,942,409
Total liabilities and fund balances/net assets	<u>\$51,705,690</u>	<u>\$161,082,708</u>	<u>\$12,862,288</u>	<u>\$(1,195,757)</u>	<u>\$224,454,929</u>

- (1) When capital assets (land, buildings, equipment) that are to be used in governmental activities are purchased or constructed, the costs 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)
	<u>\$161,082,708</u>

Interest on long-term debt is not accrued in governmental funds, but rather is recognized as an expenditure when due.

\$ 755,233

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 revenues in the governmental funds and thus are not included in fund balance.

Adjustment of deferred revenue	<u>\$ 9,348,876</u>
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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
	<u>\$ 84,760,507</u>

- (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 certain internal service funds are included in governmental activities in the statement of net assets. (See Appendix 4, Exhibit 4B.)

Note 5a—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 Appendix 2, Exhibit 4 differs from the “change in net assets” for governmental activities (–\$3,150,290) reported in the statement of activities in Appendix 2, Exhibit 2. 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	—	—	—	—	2,287,794
Intergovernmental	11,529,045	—	—	—	—	11,529,045
Charges for services	11,405,168	1,354,441	—	186,350	—	12,945,959
Interest	1,823,411	—	—	134,733	—	1,958,144
Miscellaneous	951,083	—	—	—	—	951,083
Other sources:						
Bonds issued	57,345,000	—	—	—	(57,345,000)	—
Sale of park land	3,476,488	—	(823,000)	—	—	2,653,488
Total	<u>158,303,955</u>	<u>1,920,630</u>	<u>(823,000)</u>	<u>321,083</u>	<u>(57,345,000)</u>	<u>102,377,668</u>
EXPENDITURES/EXPENSES						
Current:						
General government	9,186,401	(25,369)	275,000	273,477	—	9,709,509
Public safety	33,729,623	514,368	330,000	208,153	—	34,782,144
Public works	8,697,317	(19,201)	1,315,044	138,768	—	10,131,928
Engineering services	1,299,645	—	—	—	—	1,299,645
Health and sanitation	6,070,032	(24,049)	625,000	34,692	—	6,705,675
Cemetery	706,305	673	28,888	—	—	735,866
Culture and recreation	11,411,685	(12,024)	65,000	69,384	—	11,534,045
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	5,685,591	515,686	—	41,616	—	6,242,893
Capital outlay	16,718,649	—	(16,718,649)	—	—	—
Total expenditures/expenses	<u>121,802,910</u>	<u>950,084</u>	<u>(14,039,717)</u>	<u>766,090</u>	<u>(3,450,000)</u>	<u>106,029,367</u>
Other financing uses/changes in net assets:						
Net transfers to (from) other funds	(676,442)	—	—	175,033	—	(501,409)
Payment to bond refunding escrow agent	37,284,144	—	—	—	(37,284,144)	—
Total	<u>158,410,612</u>	<u>950,084</u>	<u>(14,039,717)</u>	<u>941,123</u>	<u>(40,734,144)</u>	<u>105,527,958</u>
Net change for the year	<u>\$ (106,657)</u>	<u>\$ 970,546</u>	<u>\$ 13,216,717</u>	<u>\$ (620,040)</u>	<u>\$ (16,610,856)</u>	<u>\$ (3,150,290)</u>

- (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, other revenues are not currently available at year-end and are not reported as revenue in the governmental funds.

Property taxes	\$ 566,189
Other revenues	1,354,441
	<u>1,920,630</u>

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	<u>434,398</u>
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Interest expense in the statement of activities differs from the amount reported in governmental funds for two reasons. Additional accrued interest was calculated for bonds and notes payable, and the difference arising from the advance refunding mentioned in Note 4a(1) is being amortized (added to interest expense for the year).

Accrued interest	174,772
Advance refunding difference	340,914
Total interest adjustment	<u>515,686</u>
Total expenditure adjustment	<u>\$ 950,084</u>

- (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 sales 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	<u>\$ 823,000</u>
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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 decrease by the amount of depreciation expense charged for the year.

Capital outlay	\$16,718,649
Depreciation expense	(2,678,932)
Difference	<u>\$14,039,717</u>

- (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 "close" those funds by charging additional amounts to participating governmental activities to completely cover the internal service funds' costs for the year. (See Appendix 4, Exhibit 4A.)

- (6) Bond proceeds are reported as financing sources in governmental funds and thus contribute to the change in fund balance. In the government-wide statements, however, issuing debt increases long-term liabilities in the statement of net assets and does not affect the statement of activities. Proceeds were received from:

Refunding general obligation bonds	\$22,205,000
Refunding revenue bonds	15,840,000
Redevelopment agency bonds	18,000,000
Special assessment bonds	1,300,000
	<u>\$57,345,000</u>

Repayment of bond principal is reported as an expenditure in governmental funds and, thus, has the effect of reducing fund balance because current financial resources have been used. For the city as a whole, however, the principal payments reduce the liabilities in the statement of net assets and do not result in an expense in the statement of activities. The city's bonded debt was reduced in two ways—principal payments were made to bond holders and resources were sent to the bond paying agent for the advance refunding of outstanding bonds.

Transferred to the paying agent:	
For bond principal	\$33,875,000
Additional amount—deferred interest	3,409,144
Total to the paying agent	<u>37,284,144</u>
Principal payments made	3,450,000
	<u>\$40,734,144</u>

Note 5b—Explanation of Differences between Governmental Fund Operating Statements and the Statement of Activities

Total revenues and other financing sources (\$158,980,397) in the governmental funds differs from total revenues for governmental activities (\$102,879,077) 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 (Appendix 2, Exhibit 4) is composed of:

Revenues	\$ 97,482,467
Proceeds of refunding bonds	38,045,000
Proceeds of long-term capital debt	19,300,000
Proceeds from sale of park land	3,476,488
Transfers in (net)	676,442
Total revenues and other sources—governmental funds	<u>158,980,397</u>

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 other 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. Sales to entities outside the city (\$186,350), investment earnings (\$134,733) of the internal service funds, and the net interfund transfers (–\$175,033) are reported with governmental activities. (See Appendix 4, Exhibit 4A.)

146,050

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 were:

(57,345,000)

Total revenues of governmental activities in the statement of activities (Appendix 2, Exhibit 2) comprise:

Charges for services	\$15,906,875
Operating grants and contributions	5,248,999
Capital grants and contributions	4,894,915
General revenues, special items, and transfers	<u>76,828,288</u>
Total revenues of governmental activities	<u>\$102,879,077</u>

Total expenditures (\$121,802,910) and other financing uses (\$37,284,144) of the governmental funds (Appendix 2, Exhibit 4) differ from total expenses of governmental activities (\$106,029,367) reported in the statement of activities in Appendix 2, Exhibit 2. 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. Total expenditures and other financing sources for the year were:

\$159,087,054

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. Additional accrued interest (\$174,772) was calculated for bonds and notes payable, and the difference arising from the advance refunding (\$340,914 per year), noted below, is being amortized (added to interest expense).

950,084

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 Appendix 4, Exhibit 4A and the net adjustment of \$146,050 above.)

766,090

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 (see above) in the statement of activities over the remaining life of the refunded debt (ten years).

(40,734,144)

Total expenses of governmental activities \$106,029,367

COMBINING STATEMENTS FOR MAJOR COMPONENT UNITS

Exhibit 11A is a combining statement of net assets for major component units using the net assets format. Exhibit 11B presents a combining statement of activities for major component units in a standard net cost format. Nonmajor component units, if any, would be presented in the aggregate on each statement. Combining statements for nonmajor component units are not required, but may be presented as supplementary information.

These statements would be part of the basic statements but are not required if the government presents each major component unit in a separate column in the reporting entity's government-wide statements, or presents condensed financial statements for each major component unit in the notes. The level of detail in the statement of activities in Exhibit 11B is consistent with the minimum requirements established in paragraph 127 for condensed financial statement *disclosures*.

An illustration of the condensed financial statement disclosures is presented in Note 3 in Exhibit 11 of Appendix 2.

**Sample City
Statement of Net Assets
Component Units
December 31, 2002**

	<u>Sample City School District</u>	<u>Sample City Landfill</u>	<u>Total</u>
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
Land	223,210	528,029	751,239
Other capital assets, net of depreciation	<u>34,536,776</u>	<u>2,456,771</u>	<u>36,993,547</u>
Total assets	<u>42,522,714</u>	<u>7,080,946</u>	<u>49,603,660</u>
LIABILITIES			
Accounts payable	1,469,066	334,266	1,803,332
Deposits and deferred revenue	38,911	—	38,911
Long-term liabilities:			
Due within one year	1,426,639	—	1,426,639
Due in more than one year	<u>22,437,349</u>	<u>4,668,802</u>	<u>27,106,151</u>
Total liabilities	<u>25,371,965</u>	<u>5,003,068</u>	<u>30,375,033</u>
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	<u>3,736,712</u>	<u>(906,922)</u>	<u>2,829,790</u>
Total net assets	<u>\$17,150,749</u>	<u>\$2,077,878</u>	<u>\$19,228,627</u>

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

		Program Revenues			Net (Expense) Revenue and Changes in Net Assets		
		Charges for	Operating	Capital	School	Landfill	Total
	Expenses	Services	Grants and Contributions	Grants and Contributions	District		
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	4,171,760	—	—		(4,171,760)		(4,171,760)
Total—Sample City School District	<u>31,186,498</u>	<u>705,765</u>	<u>3,937,083</u>		<u>(26,543,650)</u>		
Sample City Landfill							
Landfill operations	3,382,157	3,857,858	—	\$11,397		\$ 487,098	487,098
Total component units	<u>\$34,568,655</u>	<u>\$4,563,623</u>	<u>\$3,937,083</u>	<u>\$11,397</u>			<u>(26,056,552)</u>
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
Unrestricted investment earnings					674,036	210,241	884,277
Miscellaneous					19,950	—	19,950
Total general revenues					<u>29,048,967</u>	<u>210,241</u>	<u>29,259,208</u>
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					<u>\$ 17,150,749</u>	<u>\$2,077,878</u>	<u>\$ 19,228,627</u>

**SPECIAL-PURPOSE GOVERNMENT ENGAGED ONLY IN BUSINESS-TYPE ACTIVITIES:
SELECTED GOVERNMENT-WIDE FINANCIAL STATEMENTS FOR
THE LANDFILL COMPONENT UNIT IN APPENDIX 2, ILLUSTRATION A**

This section presents the financial statements from the separately issued reports of Sample City Landfill, one of the two component units of the municipal government in Appendix 2, Illustration A. The selected statements presented contain the data included in the Sample City reporting entity's financial statements. (See Appendix 2, Exhibits 1 and 2.) The landfill is a special-purpose government engaged only in business-type activities (see paragraph 138). Governments engaged only in business-type activities should present only the financial statements required for enterprise funds. (See paragraphs 91–105.)

The statements in this exhibit are not required to be included in Sample City's financial statements, but are presented here to illustrate the "special-purpose government" provisions of Statement 34 and to demonstrate the articulation between the primary government's financial statements and those of its discretely presented component units.

Illustrations

Exhibits 12A and 12B present selected financial statements (excluding the statement of cash flows) from the separately issued report of the landfill component unit. The landfill's MD&A, notes to financial statements, and other required information are not included in this illustration. The landfill's separately issued financial report should include:

- 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 and 133).

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	<u>2,096,146</u>

Noncurrent assets:

Restricted assets—landfill closure	2,000,000
Capital assets:	
Land	528,029
Buildings and equipment	4,144,575
Less accumulated depreciation	<u>(1,687,804)</u>
Total noncurrent assets	<u>4,984,800</u>
Total assets	<u>7,080,946</u>

LIABILITIES

Current liabilities:

Accounts payable	334,266
------------------	---------

Noncurrent liabilities:

Landfill closure and postclosure care	<u>4,668,802</u>
Total liabilities	<u>5,003,068</u>

NET ASSETS

Invested in capital assets	2,984,800
Unrestricted (deficit)	<u>(906,922)</u>
Total net assets	<u><u>\$ 2,077,878</u></u>

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

OPERATING REVENUES

Charges for sales and services	\$3,853,903
Miscellaneous	3,955
Total operating revenues	<u>3,857,858</u>

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	<u>3,382,157</u>
Operating income	475,701

NONOPERATING REVENUES (EXPENSES)

Investment earnings	210,241
State grant	11,397
Total nonoperating revenues	<u>221,638</u>
Change in net assets	697,339
Net assets—beginning of the year	1,380,539
Net assets—end of the year	<u><u>\$2,077,878</u></u>

These two amounts are reported separately as program revenues in the reporting entity's statement of activities (Appendix 2, Exhibit 2).

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).

BUDGET-TO-ACTUAL COMPARISON STATEMENT USING THE OPERATING STATEMENT FORMAT

Exhibit 13 presents a budget-to-actual comparison schedule for the general fund of the municipal government in Appendix 2, Illustration A, in a revenues, expenditures, and changes in fund balances format. Note that the GAAP reconciliation presented separately in Exhibit 14 of Appendix 2 is presented in a separate column in this illustration. Also, an optional “variance” column used in Exhibits 12 and 13 of Appendix 2 is not presented.

Sample City
Schedule of Revenues, Expenditures, and
Changes in Fund Balances—Budget and Actual
General Fund
For the Year Ended December 31, 2002

	Budgeted Amounts		Actual Amounts, Budgetary Basis	Budget to GAAP Differences	Actual Amounts, GAAP Basis
	Original	Final			
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	<u>91,043,549</u>	<u>87,078,943</u>	<u>86,022,165</u>	<u>—</u>	<u>86,022,165</u>
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	<u>90,940,295</u>	<u>90,041,922</u>	<u>88,774,763</u>	<u>57,590</u>	<u>88,717,173</u>
Excess (deficiency) of revenues over expenditures	<u>103,254</u>	<u>(2,962,979)</u>	<u>(2,752,598)</u>	<u>57,590</u>	<u>(2,695,008)</u>
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	<u>(2,030,731)</u>	<u>(2,033,759)</u>	<u>(2,034,436)</u>	<u>—</u>	<u>(2,034,436)</u>
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	<u>(572,227)</u>	<u>(1,496,738)</u>	<u>(1,310,546)</u>	<u>57,590</u>	<u>(1,252,956)</u>
Fund balances—beginning	3,528,750	2,742,799	2,742,799	(2) 165,523	2,908,322
Fund balances—ending	<u>\$ 2,956,523</u>	<u>\$ 1,246,061</u>	<u>\$ 1,432,253</u>	<u>\$ 223,113</u>	<u>\$ 1,655,366</u>

Explanation of differences:

- (1) The city budgets for claims and compensated absences on the cash basis, 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 (Appendix 2, Exhibit 4) because of the cumulative effect of transactions such as those described above.

ILLUSTRATION OF REQUIRED SUPPLEMENTARY INFORMATION FOR GOVERNMENTS THAT USE THE MODIFIED APPROACH FOR INFRASTRUCTURE ASSETS

Governments that use the modified approach for eligible infrastructure assets are required to present information about those assets in MD&A, as discussed in paragraph 11g. An illustration of MD&A for a bridge network is presented below:

The State manages its bridge network using its Bridge Management and Inspection Program and accounts for them using the modified approach. The bridge condition rating is a numerical condition scale ranging from 1 (impaired or load restricted) to 7 (new). A bridge is considered “deficient”—that is, needs maintenance or preservation—when its condition falls below 5. A bridge is unsafe—impaired or load restricted—when it falls below condition level 2. It is the State’s policy to keep the number and square footage of deck area of unsafe bridges below 1 percent. The most recent condition assessment shows that the condition of the State’s bridges is in accordance with the State’s policy. Actual maintenance and preservation costs were less than estimated by approximately 12 percent. Due to an unusually mild winter in the previous year, less maintenance and preservation efforts were necessary to keep the State’s bridges at or above the established condition level.

Governments should also present the information in the following schedules, derived from the asset management system, as required supplementary information for all eligible infrastructure assets that are reported using the modified approach.

**Illustration of Required Supplementary Information for
Governments That Use the Modified Approach for
Infrastructure Assets**

BMIP Condition Rating		Number of Bridges					
		2002		2000		1998	
		Number	%	Number	%	Number	%
Acceptable	5.0–7.0	15,582	89.8%	15,182	87.5%	14,835	85.5%
Marginally deficient	4.0–4.9	1,232	7.1	1,544	8.9	1,666	9.6
Moderately deficient	2.0–3.9	504	2.9	538	3.1	781	4.5
Severely deficient	1.0–1.9	33	0.2	87	0.5	69	0.4
Total		17,351	100.0%	17,351	100.0%	17,351	100.0%

		Square Feet of Deck Area (1,000s of square feet)					
		2002		2000		1998	
		Square Feet	%	Square Feet	%	Square Feet	%
BMIP Condition	Rating						
Acceptable	5.0–7.0	124,656	85.8%	127,102	87.5%	125,649	86.5%
Marginally deficient	4.0–4.9	9,856	6.8	8,570	5.9	11,040	7.6
Moderately deficient	2.0–3.9	10,452	7.2	8,570	5.9	7,408	5.1
Severely deficient	1.0–1.9	295	0.2	1,017	0.7	1,162	0.8
Total		145,259	100.0%	145,259	100.0%	145,259	100.0%

Comparison of Estimated-to-Actual Maintenance/Preservation (in Thousands)

	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>	<u>1998</u>
Estimated	\$2,650	\$2,798	\$2,541	\$2,487	\$2,301
Actual	2,322	2,623	2,765	2,245	2,105

The condition of the State's bridges is determined using its Bridge Management and Inspection Program (BMIP). The bridge condition rating, which is a weighted average of an assessment of the ability of individual components to function structurally, uses a numerical condition scale ranging from 1.0 (impaired or load restricted) to 7.0 (new). It is the State's policy to keep the number and square footage of deck area of bridges with a condition rating of 1.0 to 1.9 below 1 percent. All bridges are inspected every two years.

Appendix 4

EXERCISES

This appendix presents a variety of “how to” exercises to help with the implementation of certain requirements of Statement 34. The guidance provided here is illustrative only and is not authoritative. The purpose of these exercises is to demonstrate practical ways in which preparers can apply specific provisions of the standard. These are only *suggested* approaches—preparers may discover that other methods work better in their particular situations. The exercises are intended to be as comprehensive as possible, and therefore may include issues and complications that many governments will not need to face on a regular basis.

CONTENTS

Exercise Number		Page Number
1	Calculating Composite Depreciation Rates	216
2	Applying Group Depreciation to Infrastructure Assets at Transition and in Subsequent Years.....	218
3	Calculating Net Asset Balances for Governmental Activities	220
4	Reporting Internal Service Fund Balances and Results	224
5	Determining Major Funds	232
6	Reconciling Fund Financial Statements to Government-wide Financial Statements	234
7	Indirectly Determining Direct-method Cash Flows	241
8	Estimating Historical Cost Using Current Replacement Cost	244
9	Calculating Weighted-average Age for General Infrastructure Assets Recorded at Transition	246
10	Determining Major General Infrastructure Assets	247

Exercise #1—Calculating Composite Depreciation Rates

In order to minimize the cost of implementing the infrastructure provisions of Statement 34, the Board specifically addressed the use of composite depreciation in paragraphs 163 and 164 as follows:

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. . . . 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.

* * *

The purpose of this example is to illustrate the calculation of a composite depreciation rate using an unweighted-average and a weighted-average estimate of useful lives of assets.

Summary of Facts

Sample City applies the composite depreciation method to its transportation infrastructure network. The network consists of the following components:

<u>Component</u>	<u>Estimated Useful Life*</u>	<u>Estimated Cost</u>
Bridges	50	\$ 2,000,000
Roadways	25	10,000,000
Curbs/gutters	15	1,000,000
Street lights	15	750,000
Traffic signals	18	750,000
Street signs	10	250,000
		<u>\$14,750,000</u>

Unweighted-average Method

The *average estimated life* of components is: $(50 + 25 + 15 + 15 + 18 + 10) \div 6 = 22.17$ years. The composite depreciation rate using the average life is: $1 \div 22.17$ years = 4.5% per year.

*Used for purposes of illustration only. Refer to Questions 47–50 for guidance on estimating useful lives.

Weighted-average Method

The composite rate is calculated by weighting estimated useful lives by the depreciable cost of the asset.

Estimated Useful Life	Estimated Cost	Salvage Value	Depreciable Cost	Depreciable Cost × Estimated Useful Life
50	\$ 2,000,000	\$ —	\$ 2,000,000	\$100,000,000
25	10,000,000	—	10,000,000	250,000,000
15	1,000,000	—	1,000,000	15,000,000
15	750,000	750	749,250	11,238,750
18	750,000	—	750,000	13,500,000
10	250,000	250	249,750	2,497,500
	<u>\$14,750,000</u>	<u>\$1,000</u>	<u>\$14,749,000</u>	<u>\$392,236,250</u>

The *weighted-average estimated life* of components is: $\$392,236,250 \div \$14,750,000 = 26.59$ years. The composite depreciation rate using the weighted-average life is: $1 \div 26.59 \text{ years} = 3.8\%$ per year. Neither method of computing a composite depreciation rate is recommended over the other. Governments should consider their own facts and circumstances including the costs of obtaining the information needed by the alternative methods.

In the same manner that computing an average life and composite depreciation rate can simplify the computation of annual depreciation expense, the use of an average age of assets can simplify computing accumulated depreciation and recording general infrastructure assets at transition. See Exercise #8 for an illustration of recording general infrastructure assets at transition, and see Exercise #9 for examples of calculating weighted-average age.

Exercise #2—Applying Group Depreciation to Infrastructure Assets at Transition and in Subsequent Years

This example illustrates the entries to record infrastructure assets at transition, to calculate depreciation using a group method, and to record the subsequent removal and replacement of a portion of the infrastructure.

Summary of Facts

Sample City is adopting Statement 34 and retroactively recording its infrastructure for the fiscal year ending June 30, 2002. During the period July 1, 1980 through June 30, 2001, the city made improvements to 855 lane-miles of secondary roads in accordance with its biennial capital budget as listed below. The city plans to account for these improvements as a group and to apply the straight-line method of depreciation. The city engineer estimates that roads have a useful life of 25 years* and no salvage value.

Historical cost has been estimated as follows:

<u>Project Year</u>	<u>Total Project Budget</u>	<u>Lane-miles</u>
2001	\$ 40,125,000	75
1999	36,075,000	65
1997	53,675,000	95
1995	55,500,000	100
1993	22,000,000	40
1991	35,425,000	65
1989	54,000,000	100
1987	34,775,000	65
1985	50,350,000	95
1983	39,375,000	75
1981	42,000,000	80
	<u>\$463,300,000</u>	<u>855</u>

The next project to be completed is the removal and replacement of 80 lane-miles of secondary roads at a cost of \$45,600,000 on June 30, 2003.

Recording Assets at Transition

In order to record the secondary roads at transition, the accumulated depreciation at July 1, 2001—the beginning of the transition year—should be computed. Using the straight-line method, the annual depreciation rate is determined directly from the estimated useful life as follows: $1 \div 25 = .04$ per year.

The city assumes each project was completed at the end of the project year and, therefore, no depreciation is recognized in that year.

*Used for purposes of illustration only. Refer to Questions 47 through 50 for guidance on estimating useful lives.

Project Year	Estimated Cost	Years of Accumulated Depreciation	Depreciation Rate	Total Accumulated Depreciation
2001	\$ 40,125,000	0	0.04	\$ —
1999	36,075,000	2	0.04	2,886,000
1997	53,675,000	4	0.04	8,588,000
1995	55,500,000	6	0.04	13,320,000
1993	22,000,000	8	0.04	7,040,000
1991	35,425,000	10	0.04	14,170,000
1989	54,000,000	12	0.04	25,920,000
1987	34,775,000	14	0.04	19,474,000
1985	50,350,000	16	0.04	32,224,000
1983	39,375,000	18	0.04	28,350,000
1981	42,000,000	20	0.04	33,600,000
	<u>\$463,300,000</u>			<u>\$185,572,000</u>

The entry to record historical cost and accumulated depreciation of secondary roads at transition would be:

Infrastructure—secondary roads	463,300,000	
Accumulated depreciation		185,572,000
Net assets—invested in capital assets		277,728,000

Recording Depreciation Expense for the Transition Year

The entry to record depreciation for the year ended June 30, 2002 would be:

Depreciation expense (463,300,000 × 0.04)	18,532,000	
Accumulated depreciation		18,532,000

Recording the Replacement of 80 Lane-miles of Road

Using group or composite methods, no gain or loss is recorded upon the retirement of assets within the group. Accordingly, cost (in this example, average cost) is removed from the asset account and charged to the accumulated depreciation account. (See Questions 51 and 52 for a discussion of composite methods.) The entry to record the replacement of 80 lane-miles of secondary roads at June 30, 2003 would be:

Accumulated depreciation (80 lane-miles × [463,300,000 ÷ 855] average cost)	43,349,708	
Infrastructure—secondary roads		43,349,708
Infrastructure—secondary roads	45,600,000	
Cash		45,600,000

Computing Annual Depreciation Expense in Future Years

Depreciation expense in future years would be computed by applying the annual depreciation rate to the current balance of secondary road account as follows:

Beginning balance of infrastructure—secondary roads	\$463,300,000
Retirements	(43,349,708)
Additions	45,600,000
	<u>465,550,292</u>
Depreciation rate	0.04
Depreciation expense	<u>\$ 18,622,012</u>

Exercise #3—Calculating Net Asset Balances for Governmental Activities

Paragraph 32 requires governments to display three components of net assets in the government-wide statement of net assets—*invested in capital assets, net of related debt*; *restricted* (distinguishing between major categories of restrictions); and *unrestricted*. For business-type activities, the same net asset components are required in the enterprise fund financial statements, and generally the amounts from the fund statements will also be presented in the government-wide statements. The required components of net assets for *governmental activities*, however, are not displayed in the governmental fund financial statements.

* * *

The purpose of this exercise is to illustrate how *fund balances* in governmental funds are converted to the required components of *net assets* in the government-wide statements. Exhibit 3A is the net assets calculation for the municipal government in Appendix 2, Illustration A. Exhibit 3B presents the information for the net asset components for the independent school district in Appendix 2, Illustration B. Exhibit 3C calculates the net asset balances for the state government in Appendix 2, Illustration C.

As mentioned above, paragraph 32 requires restricted net assets to be displayed in detail by major categories of restrictions. Restricted net assets are defined and discussed in paragraph 34.

The process of calculating net asset balances is clarified if the objective of the reporting requirement is understood. What information is intended to be communicated by reporting a restricted net asset component? A restricted net asset balance is *not* intended to represent an accumulated program balance. Rather, the amount displayed is intended to report, by major category, restricted assets on the accrual basis reduced by liabilities that relate to those specific assets. A liability “relates to” restricted assets if the asset results from incurring the liability or if the liability will be liquidated with the restricted assets. No category of restricted net assets can be negative—that is, if liabilities that relate to restricted assets exceed those assets, no balance should be reported; the negative amount should be reported as a reduction of unrestricted net assets.

The first step in converting fund balances to net assets is to determine the major categories of restrictions that will be separately reported. In these illustrations it is assumed that special revenue funds are used only for restricted assets, except for the state government’s Rainy Day Fund in Appendix 2, Illustration C. Similarly, it is assumed that each government’s general fund does not include restricted resources, except as indicated for the state government in Appendix 2, Exhibit 34. The restricted categories for each government are presented as column headings on the worksheets. Columns for unrestricted net assets and for invested in capital assets (net of related debt) should also be included.

Next, the fund balances of the governmental funds should be spread across the various restricted categories, as appropriate, and “unrestricted” amounts should be entered in the *unrestricted* column.

The final phase is to allocate the items in the reconciliation to the appropriate categories and make any other adjustments that may be necessary. Note that this procedure is not intended to convert funds to the accrual basis—categories of restrictions are not equivalent to *funds*.

Sample City—Calculation of Net Asset Balances

	Restricted for:				Unrestricted	Invested in Capital Assets, Net of Related Debt	Total
	Capital Projects	Debt Service	Community Development	Other Purposes			
Fund balances (Appendix 2, Exhibits 3 and 15):							
General fund	\$ —	\$ —	\$ —	\$ —	\$ 1,655,366	\$ —	\$ 1,655,366
HUD programs	—	—	1,076,376	—	—	—	1,076,376
Community development	—	—	13,175,487	—	—	—	13,175,487
Route 7 construction	9,362,405	—	—	—	—	—	9,362,405
Nonmajor special revenue funds	—	—	—	2,469,436	—	—	2,469,436
Debt service funds	—	3,832,062	—	—	—	—	3,832,062
Nonmajor capital project funds	1,916,674	—	—	—	—	—	1,916,674
Permanent fund	—	—	—	1,405,300	—	—	1,405,300
Total fund balances	11,279,079	3,832,062	14,251,863	3,874,736	1,655,366	—	34,893,106
Adjustments (See the reconciliation in Appendix 2, Exhibit 3):							
A Additional accrued interest	—	(755,233)	—	—	—	—	(755,233)
B Deferred revenues	11,000	—	6,132,156	—	3,205,720	—	9,348,876
C Compensated absences	—	—	(487,654)	—	(4,616,779)	—	(5,104,433)
D Internal service funds	—	—	—	—	(5,557,287)	8,690,746	3,133,459
E Litigation settlement	—	—	—	—	(584,304)	—	(584,304)
F Capital assets net of depreciation	—	—	—	—	—	161,082,708	161,082,708
G Bonds and notes payable, less deferred amount	—	—	—	—	—	(79,071,770)	(79,071,770)
Reclassifications:							
H Debt related to unspent proceeds	—	—	(13,009,702)	—	—	13,009,702	—
Net asset balances (Appendix 2, Exhibit 1)	\$11,290,079	\$3,076,829	\$ 6,886,663	\$3,874,736	\$ (5,897,284)	\$103,711,386	\$122,942,409

Explanations:

- A Accrued interest is a current liability that will be paid from the debt service funds. Therefore, the liability should reduce the “restricted for debt service” net assets balance.
- B The deferred revenue adjustment adds to net assets the “unavailable” revenues that were excluded from fund balances on the modified accrual basis of accounting.
- C Generally, compensated absences will reduce unrestricted net assets. In this case, however, the city has applied for or received federal grant reimbursements for compensated absence accruals charged against federal grant programs. In accordance with program guidelines, compensated absences are reimbursable expenses when earned. Thus, a portion of the compensated absence liability relates to the restricted assets.
- D Assets in the internal service funds are not restricted; therefore, the balance should be allocated to the unrestricted and capital assets components, as appropriate.
- E The city has determined that the settlement will be paid from the general fund. There are no restricted assets related to this liability.
- F Capital assets, net of depreciation, is a key element of the *invested in capital assets, net of related debt* component.
- G Because all of the city’s long-term debt is “capital-related,” it is included in the calculation of the *invested in capital assets, net of related debt* component.
- H As required by paragraph 33, the “unspent” portion of capital debt should reduce the net asset balance of the component that includes the unspent cash. In this illustration, the cash is “restricted for community development.” This is the amount that the city has determined is “unspent.”

Independent School District—Calculation of Net Asset Balances

	Restricted for:		Invested in Capital Assets, Net of Related Debt		Total
	Debt Service	Campus Activities	Unrestricted	Related Debt	
Fund balances (Appendix 2, Exhibit 23):					
General fund	\$ —	\$ —	\$ 68,927,679	\$ —	\$ 68,927,679
Debt service fund	4,133,180	—	—	—	4,133,180
Other funds	—	1,396,569	—	—	1,396,569
Total fund balances	4,133,180	1,396,569	68,927,679	—	74,457,428
Adjustments (See the reconciliation in Appendix 2, Exhibit 24):					
A Capital assets, net of depreciation	—	—	—	316,524,231	316,524,231
B Deferred revenue	1,774,202	—	10,408,528	—	12,182,730
C Internal service funds	—	—	6,022,591	—	6,022,591
D Bonds payable	—	—	—	(80,575,118)	(80,575,118)
E Accrued interest on bonds	(759,880)	—	—	—	(759,880)
F Capital leases	—	—	—	(1,062,861)	(1,062,861)
G Contracts payable	—	—	—	(2,767,583)	(2,767,583)
H Compensated absences	—	—	(1,125,503)	—	(1,125,503)
I Special termination benefits payable	—	—	(16,491,286)	—	(16,491,286)
J Capital appreciation bonds interest accrual	—	—	—	(16,014,649)	(16,014,649)
Net asset balances (Appendix 2, Exhibit 20)	\$5,147,502	\$1,396,569	\$ 67,742,009	\$216,104,020	\$290,390,100

Explanations:

- A Capital assets, net of depreciation, is a key element of the *invested in capital assets, net of related debt* component.
- B The deferred revenue adjustment adds to net assets the “unavailable” revenues that were excluded from fund balances on the modified accrual basis of accounting.
- C Assets in the internal service funds are not restricted, and there are no capital assets; therefore, the entire balance should be allocated to the unrestricted net assets component.
- D Because all of the district’s long-term debt is “capital-related,” it is included in the calculation of the *invested in capital assets, net of related debt* component.
- E Accrued interest is a current liability that will be paid from the debt service funds. Therefore, the liability should reduce the “restricted for debt service” net assets balance.
- F Capital leases are “capital-related” debt and therefore should be included in the calculation of the *invested in capital assets, net of related debt* component.
- G These equipment contracts are “capital-related” debt and therefore should be included in the calculation of the *invested in capital assets, net of related debt* component.
- H The entire balance of the compensated absence liability is allocated to unrestricted net assets because none of the restricted assets resulted from incurring the liability and none of the restricted assets will be used to liquidate the liability.
- I The entire balance of the special termination benefits liability is allocated to unrestricted net assets because there are no restricted assets to pay the benefits and no restricted assets resulted from incurring the liability.
- J The long-term liability for accretion of interest on deep-discount (capital appreciation) debt (issued for capital purposes) reduces the *invested in capital assets, net of related debt* component unless the government has funded the liability and has set aside restricted assets to pay the interest on the bonds at maturity. If a sinking fund is established, the accrued interest would be included in the same restricted component of net assets as the sinking fund assets.

Sample State Government—Calculation of Net Asset Balances

	Restricted for:					Unrestricted	Invested in Capital Assets, Net of Related Debt	Total
	Transportation	Education	Conservation and Recreation	Debt Service	Capital Projects	Other Purposes		
Fund balances (Appendix 2, Exhibit 34):								
General fund	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 436,200	\$ —	\$ 821,127
Major funds:								
Transportation	553,174	—	—	—	—	—	—	553,174
Rainy day fund	—	—	—	—	—	—	—	1,153,562
School aid	—	120,250	—	—	—	—	—	120,250
Nonmajor funds (combining statement not illustrated in Appendix 2, Illustration C)								
Total fund balances	553,174	120,250	413,116	203,477	(392,125)	160,363	—	384,831
			413,116	203,477	(392,125)	596,563	—	3,032,944
Adjustments (See the reconciliation in Appendix 2, Exhibit 35):								
A Equity in joint venture	—	—	—	—	—	—	—	32,356
B Deferred revenues	—	7,598	—	—	—	—	—	249,812
C Accrued interest	—	—	—	(426,250)	—	—	—	(426,250)
D Internal service funds	—	—	—	—	—	—	112,216	210,863
E Compensated absences	—	—	—	—	—	—	—	(451,700)
F Claims and judgments	—	—	—	—	—	—	—	(781,300)
G Capital assets, net of depreciation	—	—	—	—	—	—	7,478,283	7,478,283
H Bonds and notes payable	—	—	—	—	—	—	(3,285,277)	(3,285,277)
I Capital leases	—	—	—	—	—	—	(220,014)	(220,014)
Reclassifications:								
J Capital-related debt (matured)	—	—	—	—	—	—	(321,561)	—
K Reclassify negative balances	—	—	—	222,773	392,125	—	—	—
Net asset balances (Appendix 2, Exhibit 32)	553,174	\$127,848	\$413,116	\$ —	\$ —	\$596,563	\$ 3,763,647	\$ 5,839,717

Explanations:

- A An equity interest in a joint venture is not restricted, nor is it a "capital" asset, even though it may represent equity primarily in capital assets of the joint venture.
- B The deferred revenue adjustment adds to net assets the "unavailable" revenues that were excluded from fund balances on the modified accrual basis of accounting.
- C Accrued interest is a current liability that will be paid from the debt service funds. Therefore, the liability should reduce the "restricted for debt service" net assets balance.
- D Assets in the internal service funds are not restricted; therefore, the balance should be allocated to the unrestricted and capital assets components, as appropriate.
- E The entire balance of the compensated absence liability is allocated to unrestricted net assets because none of the restricted assets resulted from incurring the liability and none of the restricted assets will be used to liquidate the liability.
- F The entire balance of the claims and judgments liability is allocated to unrestricted net assets because there are no restricted assets to pay the claims and no restricted assets resulted from incurring the liability.
- G Capital assets, net of depreciation, is a key element of the invested in capital assets, net of related debt component.
- H Because all of the state's long-term debt is "capital-related," it is included in the calculation of the *invested in capital assets, net of related debt* component.
- I Capital leases are "capital-related" debt and therefore should be included in the calculation of the *invested in capital assets, net of related debt* component.
- J Matured long-term capital debt that is reported as a fund liability should be reclassified as *invested in capital assets, net of related debt*.
- K If liabilities related to restricted assets exceed the assets, the excess should be reclassified as unrestricted.

Exercise #4—Reporting Internal Service Fund Balances and Results

Paragraphs 59 and 62 discuss eliminating the “effect” of internal service fund activity in the statement of activities and reporting internal service fund balances in the statement of net assets.

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.

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.

Paragraph 314 in the Basis for Conclusions explains what is meant by eliminating the “effect” of internal service fund activity.

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.

* * *

This exercise presents a comprehensive set of internal service funds and is intended to illustrate most of the allocation issues that governments might encounter. As a result, it portrays a more complex scenario and works through a more complicated solution than will likely be the case for most governments. **In addition, some amounts that could be considered immaterial may be used in this exercise to illustrate the types of adjustments that may be needed to allocate internal service fund results and balances.** *No inferences about materiality should be drawn from this exercise.* For many governments, the internal service funds’ change in net assets for the year will not be significant, and it will likely be sufficient to allocate any excess or deficiency to only the most active program(s) within the governmental activities category. Similarly, in many instances the amounts of interest income, expense, and outside transactions will be negligible and can be included in the “look-back” adjustments to the individual functions and programs.

The basic philosophy that internal service funds should break even—at least with regard to internal activity involving the separately reported functions and programs—guides the adjustment process. The overriding objective in “eliminating the effects of internal service fund activity” is to adjust the internal charges to cause a break-even result. For example, if a data-processing internal service fund reports a “net income” of \$1,000, the participating programs’ direct expenses for data processing are overstated by that amount. The look-back adjustment “refunds” the overpayments to the programs.

Sometimes an internal service fund operation includes revenues and expenses that are not “internal,” or that deal with elements that are reported separately in the statement of activities. For example, investment income is generally reported separately in the general revenues section of the statement of activities; therefore, if an internal service fund has significant investment income, that amount should be included with investment income, rather than allocated

among the various participating functions or programs. Similarly, interest expense is generally reported as a separate expense category in the statement of activities. Therefore, if an internal service fund has significant interest expense, that amount should be allocated to the interest expense line item, rather than the various functions or programs. In addition, significant revenues and expenses pertaining to transactions with outsiders are not part of the internal “break-even” initiative and would be reported as program revenues (charges for services) and direct expenses of the appropriate function or program.

Illustration

This exercise illustrates the application of the requirements in paragraph 59 to eliminate the “effect” of internal service fund activity and similar internal events for the statement of activities. It also demonstrates how governments should report the assets and liabilities of internal service funds in the government-wide statement of net assets as discussed in paragraph 62.

In one case, enterprise funds are the only participants, whereas the other funds serve *both* enterprise and governmental funds. In addition, one of the funds conducts business with customers outside the reporting government.

Summary of Facts

- The city uses five internal service funds. The fund financial statements presented in Exhibits 17 and 18 in Appendix 2 are reproduced here as Exhibits 4C and 4D, with additional subtotal columns to make it easier to trace numbers in the exercise.
- The Utility Customer Services Fund accounts for customer services, including accounts receivable billing, provided by the finance department to the Water and Sewer and the Parking Facilities enterprise funds. Each fund is billed for its share of the estimated expenses of the internal service fund. The amounts billed are determined by each department or fund’s approximate percentage of operating revenues. Percentages were: Water Department 33%, Sewer Department 57%, and Parking Facilities Fund 10%.
- All other funds provide services to *both* governmental and enterprise funds. The amounts actually charged across the various functional categories in the statement of activities were in the following approximate percentages.

Governmental activities:	Business-type activities:
General government 15%	Water services 10%
Public safety 30%	Sewer services 5%
Public works 20%	Parking facilities 5%
Health and sanitation 5%	
Culture and recreation 10%	

- The Data Processing Fund also provides services to others outside the reporting government. It is the city’s policy to charge for those services at cost plus 10%.

* * *

Reporting Internal Service Funds in Government-wide Statements

Utility Customer Services Fund

Because the Utility Customer Services Fund provides services only to the enterprise funds, its net results and balances should be included with business-type activities in the statements of activities and net assets. The fund’s investment earnings (\$18,638) do not result from internal activity and thus should not affect the adjustment needed

to “break even” on internal activity. Rather, the investment earnings should be combined with other investment earnings of business-type activities. Operating income (\$66,069, which results entirely from internal activity) should be allocated back to the three departments in the appropriate percentages. The fund’s assets and liabilities should be combined with those of the total enterprise funds.

Other internal service funds

- a. Investment earnings of all other internal service funds (\$134,733) should be included with the investment earnings of other governmental activities in the statement of activities. Also, the amount of the net decrease attributable to interest expense (\$41,616) is not “allocated” to individual functions, but instead is reported with other interest on long-term debt of governmental activities. Net transfers will be combined with the net transfers of governmental funds. The remaining net decrease in net assets (except as explained in b) should be allocated back to the participating funds (by functional category) in the appropriate percentages.
- b. The sales to “outsiders” by the Data Processing Fund is reported in the “charges for services—external” line item. The revenue and expenses related to outside activity should not be allocated to participating funds or functions, but rather should be reported in the *general government* functional category in the statement of activities. In this illustration, the data processing department is included in the general government functional category. The revenue (\$186,350) should be included with *charges for services* (program revenue), and the expenses (sales less the 10% markup = \$169,400) should be included with the direct expenses of the general government category.
- c. Because all the internal service funds except the Utility Customer Services Fund are reported as governmental activities, the amounts allocated back to the enterprise functions (business-type activities) affect the internal balances. In this case, the amount undercharged to the enterprise utility funds (\$138,768) is reported as an increase in the amount due from business-type activities to governmental activities.

Exhibits 4A and 4B illustrate the allocation of the results and balances. Exhibits 4C and 4D display the internal service fund financial statements.

* * *

Exhibit 4A illustrates a schedule that can be used to calculate the elimination of internal service fund (ISF) activity.

Part 1

A separate column is established for each fund or group of funds that has a different set of allocation percentages to participating functions. In this exercise, the Utility Customer Services Fund uses a different allocation scheme than the other internal service funds. Thus, two columns are used. Completing the schedule involves the following steps:

- ① Enter the change in net assets for the ISFs from Exhibit 4D.
- ② Enter the effects (add back expenses, deduct revenues) of transactions that correspond to nonprogram lines displayed on the statement of activities. These amounts are also from Exhibit 4D.
 - The other ISFs had interest expense of \$41,616 on long-term debt.
 - The Utility Customer Services Fund had investment earnings of \$18,638, and the other ISFs had \$134,733.
 - The other ISFs had net interfund transfers out of \$175,033.
- ③ Adjust the step 1 amount by the step 2 items. This subtotal is the amount that must be assigned to the functions and programs reported on the statement of activities.
- ④ Enter any other revenues and expenses from external activity. These amounts are assigned to a specific function or program but are not allocated among participating functions and programs.
 - The Data Processing Fund had revenues of \$186,350 from sales to external parties. (See Exhibit 4D.) The cost of these sales is calculated to be \$169,400 (sales of \$186,350 less the 10% markup). In this example, the Data Processing Fund is included in the general government functional category, so the revenues and expenses from the fund’s external sales should be classified as part of the general government function.

- ⑤ Subtract step 4 items from the step 3 amount. This number is the amount to be allocated among participating functions or programs.
- ⑥ Enter the ISF allocation percentages. Multiply the step 5 amount by those percentages to allocate the remaining amounts of the ISF change in net assets to participating functions or programs.

Part 2

The purpose of Part 2 is to determine under which activity category (governmental or business-type) the various adjustments from Part 1 should be reported.

- ⑦ Report amounts not allocated to functions or programs in accordance with how the related ISFs are classified.
 - In this example all of the ISFs except the Utility Customer Services Fund predominantly serve governmental functions and are classified as governmental in nature. Therefore, all nonallocated amounts from these funds (interest expense of \$41,616, investment income of \$134,733, net transfers out of \$175,033, external sales of \$186,350, and cost of external sales of \$169,400) are governmental activities.
 - The Utility Customer Services Fund serves only enterprise funds. Therefore, its investment earnings (\$18,638) are classified as business-type activities.
- ⑧ Report amounts allocated to functions or programs in the appropriate activity category.
 - In this example the water services, sewer services, and parking facilities programs are reported as business-type activities. All other programs are reported as governmental activities.
- ⑨ Total the governmental activities and business-type activities columns. These totals are the ISF reconciling amounts that appear on the statements of changes of the governmental funds and enterprise funds, respectively.

Assigning ISF Residual Balances

Exhibit 4B illustrates a format that can be used to assign ISF assets and liabilities to governmental activities and business-type activities.

Because the Utility Customer Services Fund serves only enterprise funds, its net assets should be included with business-type activities in the statement of activities and statement of net assets.

Because the other internal service funds predominantly serve governmental funds, their combined net assets should be included with governmental activities in the statement of activities and statement of net assets.

Because the net assets of the other ISFs are included with governmental activities, the “look-back” adjustments to the enterprise functions (business-type activities) on Exhibit 4A create an internal “payable.” In other words, the ISFs reported as governmental activities paid \$138,768 for expenses of the business-type activities.

Schedule to Eliminate the Effect of Internal Service Fund Activity for the Statement of Activities

Step	Part One				Part Two		Step
		Utility Customer Services	Other Internal Service Funds		Governmental Activities	Business-type Activities	
①	Change in net assets (See Exhibit 4D.)	\$ 84,707	\$ (758,808)				
②	Indirect expenses [specify type]: Interest on long-term debt	—	41,616	→	\$ (41,616)	\$ —	⑦
	General revenues [specify type]: Investment earnings	(18,638)	(134,733)	→	134,733	18,638	
	Transfers (net)	—	175,033	→	(175,033)	—	
③	Net amount (to be assigned to programs)	66,069	(676,892)				
④	Program revenues [indicate specific program]: Charges for services (general government)	—	(186,350)	→	186,350	—	
	Program expenses [indicate specific program]: Direct expenses (general government)	—	169,400	→	(169,400)	—	
⑤	Net amount (to be allocated among programs)	\$ 66,069	\$ (693,842)				
⑥	Programs:						⑧
	General government						
	Public safety	15%	(104,077)	→	(104,077)	—	
	Public works	30%	(208,153)	→	(208,153)	—	
	Health and sanitation	20%	(138,768)	→	(138,768)	—	
	Culture and recreation	5%	(34,692)	→	(34,692)	—	
	Water services	10%	(69,384)	→	(69,384)	—	
	Sewer services	10%	(69,385)	→	—	(47,582)	
	Parking facilities	5%	(34,691)	→	—	2,968	
	Total allocations	5%	(34,692)	→	—	(28,085)	
	100%	\$ (693,842)					
		\$ (693,842)					
							⑨
	Total				\$ (620,040)	\$ (54,061)	↖

These are the amounts necessary to eliminate the effect of internal service fund activity—that is, to cause the internal service funds to “break even” with respect to internal charges. The \$620,040 is included in Exhibit 5 of Appendix 2 in the reconciliation of the net change in fund balances of governmental funds to the change in net assets of governmental activities. The \$54,061 is the difference between the change in net assets of enterprise funds in Exhibit 7 of Appendix 2 and the change in net assets of business-type activities in the statement of activities.

**Schedule to Assign Internal Service Fund Assets and Liabilities
in the Statement of Net Assets**

	<u>Governmental Activities</u>	<u>Business-type Activities</u>	
	<u>Other Internal Service Funds</u>	<u>Utility Customer Services</u>	
ASSETS			
Cash and cash equivalents	\$ 3,336,099	\$ —	\$237,677
Investments	150,237	—	64,575
Receivables, net	157,804	—	—
Inventories	139,328	—	—
Capital assets	8,940,052	—	—
Total assets	<u>12,723,520</u>	<u>—</u>	<u>302,252</u>
LIABILITIES			
Accounts payable	780,570	—	35,412
Internal payables	1,031,620	138,768	—
Noncurrent liabilities	<u>7,777,871</u>	<u>—</u>	<u>—</u>
Total liabilities	<u>9,590,061</u>	<u>138,768</u>	<u>35,412</u>
NET ASSETS			
Invested in capital assets, net of related debt	8,690,746	—	—
Unrestricted (deficit)	(5,557,287)	(138,768)	266,840
Total net assets	<u>\$ 3,133,459</u>	<u>\$(138,768)</u>	<u>\$266,840</u>

This amount represents the net assets attributable to *governmental* activities. It is included in the reconciliation of governmental fund balances to the net assets of governmental activities in Appendix 2, Exhibit 3.

The combination of these two amounts (\$128,072) represents the net assets attributable to *business-type* activities. It is included in the reconciliation of enterprise funds net assets to business-type activities net assets in Appendix 2, Exhibit 6.

The combination of these internal balances amounts is the total "Due to other funds" of \$1,170,388 on Exhibit 4C. The \$138,768 represents the allocated undercharges of \$69,384 to the Water Dept., \$34,692 to the Sewer Dept., and \$34,692 to the Parking Facilities Fund. (See the adjustments to eliminate the "effect" of internal service fund activity on the preceding schedule in Exhibit 4A.)

Combining Statement of Net Assets Internal Service Funds

The shaded numbers are entered in the allocation schedule worksheet in Exhibit 4B.

	Health, Life, and Casualty Insurance	Fleet Management	Telecom- munications	Data Processing	Other Internal Service Funds	Utility Customer Services	Total
ASSETS							
Current assets:							
Cash and cash equivalents	\$ 1,060,406	\$ 1,845,325	\$ 6,645	\$ 423,723	\$ 3,336,099	\$ 237,677	\$ 3,573,776
Investments	—	—	—	150,237	150,237	64,575	214,812
Receivables, net	124,767	11,363	203	21,471	157,804	—	157,804
Inventories	—	127,140	—	12,188	139,328	—	139,328
Total current assets	1,185,173	1,983,828	6,848	607,619	3,783,468	302,252	4,085,720
Capital assets:							
Buildings and equipment, net	21,383	2,821,024	5,526,642	571,003	8,940,052	—	8,940,052
Total assets	1,206,556	4,804,852	5,533,490	1,178,622	12,723,520	302,252	13,025,772
LIABILITIES							
Current liabilities:							
Accounts payable	508,610	77,931	144,840	49,189	780,570	35,412	815,982
Due to other funds	—	—	970,252	200,136	1,170,388	—	1,170,388
Compensated absences	11,123	69,714	97,449	59,404	237,690	—	237,690
Claims and judgments	1,687,975	—	—	—	1,687,975	—	1,687,975
Bonds, notes, and loans payable	—	—	249,306	—	249,306	—	249,306
Total current liabilities	2,207,708	147,645	1,461,847	308,729	4,125,929	35,412	4,161,341
Noncurrent liabilities:							
Claims and judgments	5,602,900	—	—	—	5,602,900	—	5,602,900
Total liabilities	7,810,608	147,645	1,461,847	308,729	9,728,829	35,412	9,764,241
NET ASSETS							
Invested in capital assets, net of related debt	21,383	2,821,024	5,277,336	571,003	8,690,746	—	8,690,746
Unrestricted	(6,625,435)	1,836,183	(1,205,693)	298,890	(5,696,055)	266,840	(5,429,215)
Total net assets	\$ (6,604,052)	\$ 4,657,207	\$ 4,071,643	\$ 869,893	\$ 2,994,691	\$ 266,840	\$ 3,261,531

The separate column displaying the subtotals for other internal service funds (it does not include the Utility Customer Services Fund) is presented only to help in tracing numbers from the fund financial statements to the allocation schedules. This column is not required to be presented in a combining statement.

Combining Statement of Revenues, Expenses, and Changes in Fund Net Assets
Internal Service Funds

	Health, Life, and Casualty Insurance	Fleet Management	Telecom- munications	Data Processing	Other Internal Service Funds	Utility Customer Services	Total
Operating revenues:							
Charges for services—internal	\$ 6,375,070	\$4,096,753	\$3,542,116	\$1,055,875	\$15,069,814	\$1,479,014	\$16,548,828
Charges for services—external	—	—	—	186,350	186,350	—	186,350
Miscellaneous	1,066,761	—	—	—	1,066,761	—	1,066,761
Total operating revenues	7,441,831	4,096,753	3,542,116	1,242,225	16,322,925	1,479,014	17,801,939
Operating expenses:							
Personal services	169,866	1,248,271	1,850,222	888,797	4,157,156	1,191,926	5,349,082
Contractual services	200,888	62,449	22,843	298,216	584,396	—	584,396
Utilities	—	2,616	212,196	—	214,812	24,868	239,680
Repairs and maintenance	2,497	1,523,774	389,132	45,087	1,960,490	—	1,960,490
Other supplies and expenses	55,041	23,656	89,252	66,496	234,445	196,151	430,596
Insurance claims and expenses	8,004,286	—	—	—	8,004,286	—	8,004,286
Depreciation	5,541	448,944	938,251	315,136	1,707,872	—	1,707,872
Total operating expenses	8,438,119	3,309,710	3,501,896	1,613,732	16,863,457	1,412,945	18,276,402
Operating income (loss)	(996,288)	787,043	40,220	(371,507)	(540,532)	66,069	(474,463)
Nonoperating revenues (expenses):							
Earnings on investments	58,908	52,925	—	22,900	134,733	18,638	153,371
Miscellaneous revenue	9,544	732	10,579	—	20,855	—	20,855
Interest expense	—	—	(35,185)	(6,431)	(41,616)	—	(41,616)
Miscellaneous expense	(14,948)	(39,790)	(120,949)	(316)	(176,003)	—	(176,003)
Total nonoperating revenues (expenses)	53,504	13,867	(145,555)	16,153	(62,031)	18,638	(43,393)
Income (loss) before contributions and transfers	(942,784)	800,910	(105,335)	(355,354)	(602,563)	84,707	(517,856)
Capital contributions	—	3,364	1,222	14,202	18,788	—	18,788
Transfers in (out)	(40,319)	—	9,008	(143,722)	(175,033)	—	(175,033)
Change in net assets	(983,103)	804,274	(95,105)	(484,874)	(758,808)	84,707	(674,101)
Net assets—beginning	(5,620,949)	3,852,933	4,166,748	1,354,767	3,753,499	182,133	3,935,632
Net assets—ending	\$(6,604,052)	\$4,657,207	\$4,071,643	\$ 869,893	\$ 2,994,691	\$ 266,840	\$ 3,261,531

The shaded numbers are entered in the allocation schedule worksheet in Exhibit 4A.

The separate column displaying the subtotals for other internal service funds (it does not include the Utility Customer Services Fund) is presented only to help in tracing numbers from the fund financial statements to the allocation schedules. This column is not required to be presented in a combining statement.

Exercise #5—Determining Major Funds

Paragraphs 75 and 76 establish the requirements for determining “major” governmental and enterprise funds. The major fund reporting requirements do not apply to internal service funds and fiduciary 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/expenses³⁷ 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.

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

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

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

* * *

Exhibit 5A illustrates the application of the major fund criteria to a government’s governmental and enterprise funds. Total assets, liabilities, revenues, and expenditures/expenses are shown for each fund. In addition, totals and percentages (10%) for all governmental funds and all enterprise funds are presented, as well as the *combined* totals and percentages (5%) for all governmental and enterprise funds. The shaded amounts indicate that the first step in the test—the 10% criterion—has been met. The far-right column discloses whether the fund qualified as a major fund based on *both* the 10% *and* 5% comparisons.

Among governmental funds, only three—SR7, SR8, and CPF3—meet the initial 10% criterion. SR7 and SR8 both have total *liabilities* in excess of the 10% benchmark (\$3,267,159). CPF3 exceeds the 10% criterion for *assets* (\$15,169,449). SR8, however, is not required to be reported as a major fund because it does not meet the second criterion. Its total liabilities of \$6,513,754 do not exceed the 5% governmental and enterprise funds combined cutoff amount (\$8,715,826). Similarly, CPF3’s total assets of \$21,321,620 fall short of the 5% mark (\$26,772,076), and therefore that fund is also not required to be reported as a major fund.

Only SR7, with total liabilities of \$12,829,985 that exceed *both* the 10% criterion (\$3,267,159) *and* the 5% criterion (\$8,715,826), is required to be reported as a major fund in the governmental fund financial statements. Those statements would present, at a minimum, four columns—the general fund, SR7, all other governmental funds, and a total governmental funds column.

All enterprise funds except ENT3 and ENT4 have at least one element that exceeds *both* the 10% *and* 5% benchmarks and would be shown in separate columns in the proprietary fund financial statements as major funds.

As demonstrated above, some funds will meet the first criterion (10%) but not meet the second (5%). Nevertheless, preparers should not bypass the first step of the test. Some funds will exceed the 5% requirement but not meet the first 10% benchmark. For example, the Debt Service Fund’s expenditures meet the 5% criterion but fail the initial 10% test. Similarly, ENT4’s liabilities exceed the 5% cutoff but do not meet the 10% criterion. Thus, neither the Debt Service Fund nor ENT4 is required to be reported as a major fund.

Determining Major Funds

	<u>Assets</u>	<u>Liabilities</u>	<u>Revenues</u>	<u>Expenditures/ Expenses</u>	<u>Exceeds</u>		<u>Qualifies as a Major Fund?</u>
					<u>10%</u>	<u>5%</u>	
General fund	\$ 49,173,890	\$ 7,862,866	\$145,682,174	\$116,292,880	N/A	N/A	always
Special revenue funds:							
SR1	5,450,058	859,898	2,141,676	270,609			no
SR2	10,308,338	573,337	7,678,162	2,210,684			no
SR3	118,124	3,226	431,789	515,268			no
SR4	1,501,859	1,433	2,326,182	2,954,631			no
SR5	321,869	60,696	52,799	64,905			no
SR6	6,825,027	123,139	6,746,992	6,010,772			no
SR7	13,858,494	12,829,985	431,309	1,792,222	X	X	yes
SR8	6,758,635	6,513,754	4,053,631	4,146,729	X		no
SR9	243	208,070	1,526,362	1,685,353			no
SR10	1,726,313	1,067,869	3,252,238	2,449,801			no
Debt service fund	10,306,296	708,954	5,017,692	15,464,559		X	no
Capital project funds:							
CPF1	15,052,294	1,762,238	—	7,977,027			no
CPF2	303,883	1,285	441,180	1,320,431			no
CPF3	21,321,620	91,001	—	768,181	X		no
CPF4	3,571,022	1,067	—	130,045			no
CPF5	5,096,526	2,773	—	1,206,247			no
Total governmental funds	151,694,491	32,671,591	179,782,186	165,260,344			
10% of total governmental funds	15,169,449	3,267,159	17,978,219	16,526,034			
Enterprise funds:							
ENT1	282,399,315	110,391,320	37,442,090	31,877,442	X	X	yes
ENT2	62,783,468	2,505,769	12,898,952	14,854,588	X	X	yes
ENT3	7,017,621	169,622	2,007,955	2,593,371			no
ENT4	9,235,650	8,810,604	1,820,753	2,375,639		X	no
ENT5	22,310,981	19,767,620	8,182,129	17,688,470	X	X	yes
Total enterprise funds	383,747,035	141,644,935	62,351,879	69,389,510			
10% of total enterprise funds	38,374,704	14,164,494	6,235,188	6,938,951			
Total governmental and enterprise funds	\$535,441,526	\$174,316,526	\$242,134,065	\$234,649,854			
5% of total governmental and enterprise funds	26,772,076	8,715,826	12,106,703	11,732,493			

Exercise #6—Reconciling Fund Financial Statements to Government-wide Financial Statements

One of the primary objectives of the reconciliation is to assist readers in understanding how funds relate to the government as a whole. To enhance readability, the number of items in the reconciliation should be kept to a minimum, but they should not be so aggregated as to be misleading. Similarly, the explanations of the items in the reconciliation should be brief. In many cases, brief explanations will be sufficient to allow users to assess the relationship between the statements. Preparers will need to balance the competing goals of providing enough information to be useful, but not so much as to be distracting.

The level of detail presented will generally be a function of the *location* of the reconciliation. If it is presented on a separate page, as a continuation of the financial statement, much more detail can be presented than would be possible on the face of the fund financial statements and, consequently, less additional explanation would be needed in the notes.

Paragraph 77 establishes the overall requirement for reconciling fund-based information to the statements of net assets and activities. It also specifies when additional information should be disclosed in the notes.

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.

* * *

Differences between the fund financial statements and the government-wide statements generally exist for three reasons:

1. Differences in the measurement focus
2. Differences in the basis of accounting
3. Reclassifications.

The first two differences apply only to governmental funds and activities. Enterprise funds and business-type activities use the same measurement focus and basis of accounting. For many governments, the amounts reported for total enterprise funds will be the same as the amounts reported for business-type activities in the government-wide statements—thus, no reconciliation will be required for those funds and activities.

Having different measurement focuses means that *what* is being measured is different. In governmental funds, current financial resources are measured, but in the government-wide statements, economic resources are measured. To illustrate the difference, bond proceeds are a source of financing in the funds, whereas in the government-wide statements they represent a liability. Using different bases of accounting means that *when* transactions and events are measured is different. For example, under the modified accrual basis of accounting, in the governmental funds property tax revenue is recognized if it is “available.” In the government-wide statements, property tax revenue is recognized in the period for which levied—regardless of when it is collected. Differences between the fund statements and the government-wide statements may also arise when activities accounted for in proprietary funds (internal service funds, for example) are reported as governmental activities (or vice versa) in the government-wide statements.

The reconciliations included in the illustrative statements in Appendix 2 (Illustrations A, B, and C) and in Appendix 3 present reconciling items caused by all three types of differences and represent typical adjustments that most governments will likely have to make. The purpose of this exercise is to explain the basis for making certain adjustments and to provide a “trail” through the reconciliation process so that the readers of this guide will have a better understanding of the mechanics of preparing a reconciliation.

Reconciliation of Fund Balances of Governmental Funds to Net Assets of Governmental Activities

Paragraph 85 in Statement 34 presents a list of some common items that will appear in the balance sheet reconciliations of many governments. It states:

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).

The minimum requirement is to reconcile fund balance to net assets. Examples of that approach are in Appendix 2, Exhibits 3, 24, and 35. A reconciliation approach that provides “line item” details that go beyond the minimum requirement is presented in Exhibit 10, Note 4a, of Appendix 3.

Reconciliation of Change in Fund Balances of Governmental Funds to the Change in Net Assets of Governmental Activities

Paragraph 90 in Statement 34 presents a list of some common items that will appear in the operating statement reconciliations of many governments. It states:

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.

The minimum requirement is to reconcile the change in governmental fund balances to the government-wide change in net assets for governmental activities. Examples of that approach are in Appendix 2, Exhibits 5, 26, and 37. Exhibit 10, Note 5b, of Appendix 3 illustrates the disclosure of in-depth explanations that preparers may choose to provide if they believe that the explanations presented in the fund financial statements are not sufficient. A reconciliation approach that provides “line item” details that go beyond the minimum requirement is presented in Exhibit 10, Note 5a, of Appendix 3.

Exhibit 6A provides additional details and explanations of each item in the governmental funds reconciliations in Appendix 2, Illustration A.

Reconciliation of Enterprise Fund Net Assets and Changes in Net Assets to Business-type Activities in the Government-wide Statements

Paragraph 104 discusses the reconciliation between enterprise fund financial statements and government-wide statements. It states:

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.

Exhibits 6B and 6C present line-by-line details of the reconciliations in Exhibits 6 and 7 in Appendix 2. Exercise #4 in this appendix explains the allocation of internal service funds' results and balances.

Appendix 2, Exhibit 3, reconciliation details:

Capital assets—This adjustment records the general capital assets that pertain to the activities accounted for in governmental funds. The underlying detail for this adjustment is presented in Note 1 in Exhibit 11 of Appendix 2. Note, however, that the totals reported in the government-wide statement of net assets and the detail in Note 1 include the capital assets of the internal service funds reported as governmental activities. (See the internal service fund detail in Exhibit 10 of Appendix 3.)

Capital assets, at historical cost	\$ 199,336,115
Accumulated depreciation	(38,253,407)
	<u>\$161,082,708</u>

Deferred revenue adjustment—Some revenues in the governmental funds are deferred because they are not collected within the prescribed time period after year-end. On the accrual basis, however, those revenues would be recognized, regardless of when they are collected. Sample City's accounting records indicate that this is the amount of revenue that has been deferred because of the availability criterion under the modified accrual basis of accounting.

\$ 9,348,876

Internal service funds allocation—The process of allocating internal service fund balances is explained in Exercise 4 of this appendix. The details for this adjustment are also presented in Exhibit 10, Note 4a, of Appendix 3.

\$ 3,133,459

Long-term liabilities—This adjustment records the general long-term obligations that pertain to the activities accounted for in governmental funds. In the prior model, these liabilities were presented in the general long-term debt account group, except for the interest accrual. This is a "combined" adjustment; therefore, note disclosure of the details is required by paragraph 77. Note 4 in Appendix 2, Exhibit 11, provides those details. In addition, the long-term debt disclosures in Note 2 of Appendix 2, Exhibit 11, also provide details underlying this adjustment. Keep in mind that the total long-term liabilities reported in the government-wide statement of net assets and the details in Note 2 also include the long-term liabilities of the internal service funds reported as governmental activities. (See the internal service fund detail in Exhibit 10 of Appendix 3.)

Bonds and notes payable	\$ 82,140,000
Less deferred interest from refunding	(3,068,230)
Accrued interest	755,233
Compensated absences	5,104,433
Litigation settlement—general fund	584,304
Combined adjustment	<u>\$ 85,515,740</u>

Appendix 2, Exhibit 5, reconciliation details:

Capital outlay and depreciation adjustment—This adjustment removes the capital expenditures reported in Appendix 2, Exhibit 4, and records depreciation expense. In this example, the entire amount reported as capital outlay on Exhibit 4 meets Sample City's capitalization threshold. In some cases, expenditures reported as capital outlay will not be capitalized, creating a difference between the expenditure and the amount of the adjustment in the reconciliation. The amount of depreciation charged to each function or program is based on asset usage and is illustrated in the detailed reconciliation in Exhibit 10, Note 5a, of Appendix 3. The depreciation expense details are also presented in Note 1 of Appendix 2, Exhibit 11. Again, the details in Note 1 include the depreciation expense from the internal service funds.

Capital outlay	\$ 16,718,649
Depreciation expense	(2,678,932)
Net adjustment	<u>\$ 14,039,717</u>

Cost of land sold—Under the current financial resources measurement focus, in the funds, proceeds from the sale of capital assets are reported as a source of financing. In the government-wide statement, however, the assets sold had been capitalized previously and thus have a "book value" that needs to be removed. The difference between the proceeds and the book value is the gain or loss that is recognized in the statement of activities. This adjustment reduces the proceeds by the book value of the asset sold.

\$ 823,000

Change in revenue accruals—The purpose of this adjustment is to recognize the net change in "unavailable" revenues. Under the modified accrual basis of accounting, revenues are not recognized unless they are deemed "available" to finance the expenditures of the current period. Accrual-basis recognition is not limited by availability, so certain revenues need to be reduced by the amounts that were unavailable at the beginning of the year and increased by the amounts that were unavailable at the end of the year. This adjustment records a net increase in revenues—unavailable revenues at the end of the year exceed beginning unavailable revenues by this amount.

\$ 1,920,630

Debt transactions—Borrowing and repaying debt affect the fund financial statements and the government-wide statements differently. Governmental fund financial statements are presented using the current financial resources measurement focus; government-wide statements are prepared using the flow of economic resources measurement focus. In the governmental funds, bond proceeds are financing sources and repayments of debt principal are reported as expenditures. Those transactions increase and decrease liabilities in the government-wide statements. This adjustment is necessary to remove the bond proceeds and debt principal payments from the operating statement. This is a “net” adjustment, and additional details are required in the notes to the financial statements. Those additional details are provided in Note 5 in Exhibit 11 of Appendix 2. All the amounts needed for this adjustment are presented in the statement of revenues, expenditures, and changes in fund balances in Exhibit 4 of Appendix 2.

Debt issued:	
Refunding general obligation bonds	\$ 22,205,000
Refunding revenue bonds	15,840,000
Redevelopment agency bonds	18,000,000
Special assessment bonds	1,300,000
Total proceeds	<u>57,345,000</u>
Repayments:	
To paying agent:	
For bond principal	(33,875,000)
Additional amount—deferred interest	(3,409,144)
Total to the paying agent	<u>(37,284,144)</u>
To bondholders	(3,450,000)
Total repayments	<u>(40,734,144)</u>
Net adjustment	<u>\$ 16,610,856</u>

Expense accruals—Under the modified accrual basis of accounting, expenditures are not recognized for transactions that normally are not paid with expendable available financial resources. Compensated absences, claims and judgments, and special termination benefits are common examples. In addition, interest on long-term debt is not recognized under the modified accrual basis of accounting until due, rather than as it accrues. This adjustment is needed to record the long-term effect of current-period transactions. The adjustment is a combination of four items. (See Note 5 in Exhibit 11 of Appendix 2.)

The ending compensated absences accrual is less than the beginning accrual.	\$ 149,906
A claim to be paid by the general fund was adjudicated.	(584,304)
The deferred amount on advance refundings is amortized over the remaining life of the debt.	(340,914)
Accrued interest on general obligation bonds is recognized.	(174,772)
Total adjustment	<u>\$ (950,084)</u>

Internal service funds allocation—The process of allocating internal service fund results is explained in Exercise 4. The details for this adjustment are also presented in Exhibit 10, Note 5a, of Appendix 3.

\$ (620,040)

**Reconciliation of the Enterprise Funds
Statement of Net Assets
to the Statement of Net Assets for Business-type Activities
December 31, 2002**

	Total Enterprise Funds	Internal Service Funds Allocation (See Exhibit 4B)	Business-type Activities Statement of Net Assets
ASSETS			
Current assets:			
Cash and cash equivalents	\$ 8,785,821	\$237,677	\$ 9,023,498
Investments	—	64,575	64,575
Receivables, net	3,568,121	—	3,568,121
Due from other governments	41,494	—	41,494
Inventories	126,674	—	126,674
Total current assets	<u>12,522,110</u>	<u>302,252</u>	<u>12,824,362</u>
Noncurrent assets:			
Restricted cash and cash equivalents	1,493,322	—	1,493,322
Capital assets:			
Land	3,835,150	—	3,835,150
Distribution and collection systems	39,504,183	—	39,504,183
Buildings and equipment	129,164,832	—	129,164,832
Less accumulated depreciation	(21,115,414)	—	(21,115,414)
Total noncurrent assets	<u>152,882,073</u>	<u>—</u>	<u>152,882,073</u>
Total assets	<u>165,404,183</u>	<u>302,252</u>	<u>165,706,435</u>
LIABILITIES			
Current liabilities:			
Accounts payable	751,430	35,412	786,842
Due to other funds	175,000	138,768	313,768
Compensated absences	121,677	—	121,677
Claims and judgments	—	—	—
Bonds, notes, and loans payable	4,304,609	—	4,304,609
Total current liabilities	<u>5,352,716</u>	<u>174,180</u>	<u>5,526,896</u>
Noncurrent liabilities:			
Compensated absences	486,705	—	486,705
Claims and judgments	—	—	—
Bonds, notes, and loans payable	73,995,568	—	73,995,568
Total noncurrent liabilities	<u>74,482,273</u>	<u>—</u>	<u>74,482,273</u>
Total liabilities	<u>79,834,989</u>	<u>174,180</u>	<u>80,009,169</u>
NET ASSETS			
Invested in capital assets, net of related debt	73,088,574	—	73,088,574
Restricted for debt service	1,451,996	—	1,451,996
Unrestricted	11,028,624	128,072	11,156,696
Total net assets	<u>\$ 85,569,194</u>	<u>\$128,072</u>	<u>\$ 85,697,266</u>

**Reconciliation of the Enterprise Funds Statement of Revenues,
Expenses, and Changes in Fund Net Assets
to the Statement of Activities
For the Year Ended December 31, 2002**

	(Segments—See App. 2, Exh. 11, Note 6)				
	<u>Water Department</u>	<u>Sewer Department</u>	<u>Total Water and Sewer Fund</u>	<u>Parking Facilities</u>	<u>Total Enterprise Funds</u>
Revenues:					
Interest and investment revenue	\$ 217,378	\$ 237,415	\$ 454,793	\$ 146,556	\$ 601,349
Internal service fund allocation (See Exhibit 4A.)*					18,638*
Investment earnings—statement of activities					<u>\$ 619,987</u>
Direct expenses:					
Personal services			\$3,400,559	\$ 762,348	\$ 4,162,907
Contractual services			344,422	96,032	440,454
Utilities			754,107	100,726	854,833
Repairs and maintenance			747,315	64,617	811,932
Other supplies and expenses			498,213	17,119	515,332
Total operating expenses	\$2,642,774	\$3,101,842	5,744,616	1,040,842	6,785,458
Depreciation	549,987	613,153	1,163,140	542,049	1,705,189
Interest expense	402,972	1,197,858	1,600,830	1,166,546	2,767,376
Miscellaneous expense	—	—	—	46,846	46,846
Total fund expenses	3,595,733	4,912,853	8,508,586	2,796,283	11,304,869
Internal service fund allocations (See Exhibit 4A.)*	47,582	(2,968)	44,614	28,085	72,699*
Program expenses—statement of activities	<u>\$3,643,315</u>	<u>\$4,909,885</u>	<u>\$8,553,200</u>	<u>\$2,824,368</u>	<u>\$11,377,568</u>

*The net adjustment to business-type activities is:

\$ 18,638
(72,699)
\$(54,061)

Exercise #7—Indirectly Determining Direct-method Cash Flows

Paragraph 105 requires governments to use the direct method for reporting their proprietary funds' cash flows for operating activities. Prior to implementation of Statement 34, governments had the option to use either the direct or the indirect method. Paragraph 105 states:

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.

Statement 9, paragraph 31, states that under the direct method, governments should, at a minimum, separately report these classes of operating cash receipts and payments:

- a. Cash receipts from customers
- b. Cash receipts from quasi-external operating transactions with other funds
- c. Other operating cash receipts, if any
- d. Cash payments to other suppliers of goods or services
- e. Cash payments to employees for services
- f. Cash payments for quasi-external operating transactions with other funds, including payments in lieu of taxes
- g. Other operating cash payments, if any.

* * *

Items a, d, and e generally will account for the majority of cash flows from operating activities and, depending on the particular accounting system, may require substantial time and effort to accumulate actual amounts. As mentioned in footnote 82 to paragraph 440 in the Basis for Conclusions of Statement 34, however, acceptable approximations of these amounts may be determined indirectly.

Essentially, the accrual-basis revenues and expenses are adjusted for changes in related accounts receivable and payable. Exhibits 7A and 7B demonstrate how to indirectly determine the direct-method cash flows for cash receipts from customers and for cash paid to employees and suppliers.

Operating revenue is adjusted to determine "cash received from customers" by (1) adding the beginning accounts receivables to account for cash collected on prior years' sales and (2) deducting the end-of-the-year accounts receivable to adjust for the cash not collected from this year's sales. In addition, the increase in the allowance for uncollectibles should be deducted to adjust for the noncash reduction in net receivables.

Salaries and benefits expense is adjusted to determine "cash paid to employees" by (1) adding the beginning payroll-related accruals to recognize the cash that was paid out this year for last year's payroll expenses and (2) deducting the ending payroll-related accruals to account for the cash that will be paid next year for payroll expenses this year.

Total operating expenses, excluding salaries and benefits, depreciation (an allocation), and the increase in the allowance for uncollectibles (an adjustment of revenue), are adjusted to determine the "cash paid to suppliers" by adding the beginning accounts payable and deducting the ending accounts payable.

(The required reconciliation of operating cash flows to operating income is not illustrated.)

**Indirectly Determining Direct-method Cash Flows
Enterprise Fund**

STATEMENT OF NET ASSETS

	<u>Current Year</u>	<u>Prior Year</u>	<u>Net Change</u>
ASSETS			
Current assets:			
Cash and cash equivalents	\$ 86,034	\$ 92,706	\$ (6,672)
Investments	2,600,000	2,300,000	300,000
Accrued interest	37,808	58,516	(20,708)
Accounts receivable (net)	195,595	152,641	42,954
Due from other funds	2,018,690	1,625,087	393,603
Total current assets	<u>4,938,127</u>	<u>4,228,950</u>	<u>709,177</u>
Property, plant, and equipment, net	976,652	1,156,297	(179,645)
Total assets	<u>5,914,779</u>	<u>5,385,247</u>	<u>529,532</u>
LIABILITIES AND NET ASSETS			
Current liabilities:			
Accounts payable	106,870	90,336	16,534
Salaries and benefits payable	27,721	23,533	4,188
Compensated absences	26,320	18,160	8,160
Due to other funds	1,095,632	622,481	473,151
Current portion of capital lease payable	318,774	360,702	(41,928)
Total current liabilities	<u>1,575,317</u>	<u>1,115,212</u>	<u>460,105</u>
Noncurrent liabilities:			
Capital lease payable—noncurrent	621,982	641,334	(19,352)
Total liabilities	<u>2,197,299</u>	<u>1,756,546</u>	<u>440,753</u>
Net assets:			
Invested in capital assets, net of related debt	35,896	154,261	(118,365)
Unrestricted	3,681,584	3,474,440	207,144
Total net assets	<u>\$3,717,480</u>	<u>\$3,628,701</u>	<u>\$ 88,779</u>

OPERATING REVENUES AND EXPENSES

Revenues:	
Operating revenues	\$ 639,744
Other revenues	34,506
Total operating revenues	<u>674,250</u>
Operating expenses:	
Salaries and benefits	545,201
Supplies and materials	86,950
Repairs and maintenance	385,489
Utilities	11,460
Bad debt expense*	16,696 (increase in reserve)
Other operating expenses	134,518
Depreciation	405,132 (allocation)
Total operating expenses	<u>1,585,446</u>
Operating income (loss)	<u>\$ (911,196)</u>

*In the statement of revenues, expenses, and changes in fund net assets, the increase in the reserve for uncollectibles would be a reduction of revenue, rather than an expense. See paragraph 100 (footnote 41).

Indirectly Determining Direct-method Cash Flows
Enterprise Fund

Cash received from customers:

Operating revenues	\$ 639,744
Customer receivables—beginning	152,641
Increase in bad debt reserve	(16,696)
Customer receivables—ending	(195,595)
	<u>\$ 580,094 (a)</u>

Cash paid to employees:

Salaries and benefits	\$ 545,201
Salaries and benefits payable—beginning	23,533
Salaries and benefits payable—ending	(27,721)
Compensated absences—beginning	18,160
Compensated absences—ending	(26,320)
	<u>\$ 532,853 (b)</u>

Cash paid to suppliers:

Supplies and materials	\$ 86,950
Repairs and maintenance	385,489
Utilities	11,460
Other operating expenses	134,518
Total	<u>618,417</u>
Accounts payable—beginning	90,336
Accounts payable—ending	(106,870)
	<u>\$ 601,883 (c)</u>

Cash flows from operating activities:

Cash received from customers	\$ 580,094 (a)
Other operating cash receipts	34,506
Cash paid to employees	(532,853) (b)
Cash paid to suppliers for goods and services	(601,883) (c)
Net cash used for operating activities	<u>\$ (520,136)</u>

Exercise #8—Estimating Historical Cost Using Current Replacement Cost

Methods of establishing initial infrastructure values are discussed in paragraphs 157 and 158. When historical cost records are inadequate, estimated historical cost using current replacement costs may be used.

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.

Allowing the use of current replacement cost and adjusting for price-level changes back to an asset's acquisition year was a technique the Board used to reduce the costs and effort of implementing the new standard. This is more fully discussed in the Basis for Conclusions:

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. . . .

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.

* * *

The purpose of this illustration is to demonstrate how historical cost may be estimated using current replacement cost deflated by a price-level change factor.

Summary of Facts

- The county is focusing on recording its rural access road network at the transition date of June 30, 2003.
- Current construction cost per lane-mile for a rural access road is approximately \$500,000.
- The county has elected to limit its *transition capitalization* to road projects that resulted in acquisition, construction, or significant reconstruction or improvement of county roads since June 30, 1980 (paragraph 149). During this period, 87 miles of rural access roads were constructed, reconstructed, or significantly improved.

- Because the county has had a consistent, ongoing construction program, an average age for these projects was determined to be 11.5 years—the average of the oldest road (23 years) and the newest road (0 years). See Exercise #9 for additional methods of calculating average age.
- Price-level changes, per the table of Price Trends for Federal-aid Highway Construction, published in *Price Trends for Federal-aid Highway Construction* by the U.S. Department of Transportation, Federal Highway Administration, Office of Program Administration, Office of Infrastructure.

<u>Year</u>	<u>Composite Index</u>
1991	107.5
.	.
.	.
.	.
2003	131.9*

Estimation of Historical Cost

Lane-miles $\times$ average cost per lane-mile $\times$ (year of acquisition index $\div$ current-year index), rounded:

$$87 \text{ lane-miles} \times \$500,000 \times (107.5 \div 131.9) = \$35,453,000$$

Calculation of Accumulated Depreciation as of June 30, 2003

Estimated useful life: 25 years[†]

Estimated historical cost $\div$ estimated useful life $\times$ average age, rounded:

$$\$35,453,000 \div 25 \text{ years} \times 11.5 = \$16,308,000$$

*Extrapolated from 1999 for illustration purposes.

[†]Used for purposes of illustration only. Refer to Questions 47 through 50 for guidance on estimating useful lives.

Exercise #9—Calculating Weighted-average Age for General Infrastructure Assets Recorded at Transition

Use of an average age of general infrastructure assets can simplify the calculation of accumulated depreciation at transition. Exercise #8 uses a simple average age to calculate accumulated depreciation at transition, and the example in paragraph 159 refers to an estimated weighted-average. The following exercise demonstrates two methods of calculating weighted-average age.

Summary of Facts

A state government has a 35-mile arterial road that has been subject to multiple construction projects that overlap earlier projects since 1980, as shown in the schedule below:

<u>Year</u>	<u>Project</u>	<u>Mileposts</u>
1980	1	1–15
1982	2	16–25
1984	3	26–30
1988	4	6–12
1989	5	26–35

If construction costs are known, weighted-average age may be computed based on the proportion of costs to the total. Alternatively, weighted-average age may be calculated in proportion to the number of miles constructed.

<u>Year</u>	<u>Project</u>	<u>Mileposts</u>	<u>Age in 2002</u>	<u>Age Weighted by Cost</u>		<u>Age Weighted by Miles</u>	
				<u>Cost (in 000's)</u>	<u>Cost × Age</u>	<u>Number of Miles</u>	<u>Miles × Age</u>
1980	1	1–15	22	\$15,000	\$330,000	15	330
1982	2	16–25	20	10,300	206,000	10	200
1984	3	26–30	18	5,500	99,000	5	90
1988	4	6–12	14	10,500	147,000	7	98
1989	5	26–35	13	16,000	208,000	10	130
				<u>\$57,300</u>	<u>\$990,000</u>	<u>47</u>	<u>848</u>
Average age:					<u>17.28</u>		<u>18.04</u>

Neither method of computing an average age is recommended over the other. Governments should consider their own facts and circumstances including the costs of obtaining the information needed by the alternative methods.

Exercise #10—Determining Major General Infrastructure Assets

Paragraph 154 states that general infrastructure assets at transition may be limited to major general infrastructure assets acquired after a specific date. Paragraph 156 provides the definition for 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) in fiscal years ending after June 30, 1980, or that received major renovations, restorations, or improvements during that period.

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.

* * *

Illustration

The county in this illustration would determine its *major general infrastructure assets* in the following manner using gross cost estimates:*

	Preliminary Estimated Cost	Percentage of General Capital Assets at June 30, 1999 (\$45,524,000)
Roadway network:		
Rural access subsystem	\$35,453,000	77.9%
Rural arterial subsystem	55,395,000	121.7%
Urban access subsystem	3,432,000	7.5%
Urban arterial subsystem	1,500,000	3.3%
Total roadway network	<u>\$95,780,000</u>	210.4%
Bridge spans network:		
20 to 40 feet subsystem	\$ 4,875,000	10.7%
41 to 60 feet subsystem	2,500,000	5.5%
Greater than 60 feet subsystem	15,387,000	33.8%
Total bridge spans network	<u>\$22,762,000</u>	50.0%

*Preliminary cost estimates may be made in various ways and need only be precise enough to permit determination of whether the network or subsystem would be considered major. For example, the estimate of the urban arterial subsystem could be made by multiplying the number of lane-miles by *current* replacement cost per lane-mile. Estimation of the acquisition date and deflation of the replacement cost to this date are unnecessary because the preliminary estimate was sufficient to determine that the subsystem would not be considered major.

Conclusion

If the determination of major general infrastructure assets is made at the *network* level, both networks—roadway and bridge spans—are considered major because their preliminary estimated costs each exceed 10 percent of the cost of other general capital assets. If the determination is made at the *subsystem* level, then all subsystems, except the urban arterial subsystem, would be considered major because their preliminary estimated costs exceed the 5 percent threshold. Initial capitalization at transition is not required for the urban arterial subsystem, although it is encouraged. Nevertheless, the county is required to capitalize acquisition, construction, or significant reconstruction or improvement of urban arterial roads *prospectively*.

TOPICAL INDEX*

Accompanying schedule for reconciliations: 190

Accounting Principles Board:

Opinion No. 20: 50

Opinion No. 21: 267

Opinion No. 30: 139, 212

Accounting Research Bulletin No. 43: 209

Accrued interest on deep-discount debt: 87

Accumulated depreciation: 33

At transition, weighted-average method: 271. *See*
Appendix 4, exercise 9

Activity distinguished from a fund: 18, 161

Advance refundings at transition: 267

Agency fund clearing accounts: 225, 226

Allocations:

Depreciation: 107–109

Grant revenues: 119, 120

Indirect expenses: 106, 135

Program revenues: 133

Reconciliations: 106

Statement of activities: 105

American Institute of Certified Public Accountants
(AICPA):

Not-for-profit model: 268

Applicability of Statement 34: 1

Asset management systems: 53, 66–69

Assets held for others in governmental or proprietary
funds: 16

Basic financial statements:

As part of minimum requirements: 2, 4

Relationship to GPFS: 3

Basis of accounting:

Budgets: 193

Fiduciary funds: 224

Governmental funds: 189

Betterments: 25

Biennial budgets: 250

Blended component units: 239

As major funds: 181

Budgetary basis of accounting: 193

Major funds criteria: 186

Budgetary comparisons:

As basic statements: 247, 248

“Elective” major special revenue funds: 245

Format: 249

Optional: 246

As RSI: 246, 247, 254

Budgets. *See also* Budgetary basis of accounting;

Budgetary comparisons:

Basis of accounting: 193

Biennial: 250

Final: 253

Interim: 251

Original: 251, 252

Building permits: 115, 117, 151

Buildings: 36, 37

Comprehensive annual financial report: 158, 242,
243, 246

Capital assets:

Additions and improvements: 61

Betterments: 25

Buildings: 36, 37

Capitalization of interest: 30, 31

Capitalization policy: 29, 67, 68, 272

Construction in progress: 32, 34

Depreciation. *See* Depreciation

*Unless otherwise noted, the topics in this index are referenced to questions and answers.

Disclosures: 232
 Donated assets: 28
 Estimated fair value: 28, 276
 Financed by debt of another government: 94, 286
 Inexhaustible: 27, 80
 Infrastructure. *See* Infrastructure assets
 Inventory of: 67, 68
 Joint construction: 287
 Land: 27, 34, 276
 Land improvements: 25, 27, 35, 46
 Library books: 26
 Major classes: 233
 Not being depreciated: 34, 35
 Residual value: 45
 Serve essentially all functions: 107, 108
 Shared: 107, 108
 Site improvements: 25
 Works of art, historical treasures: 76

Capital contributions:
 From joint venture participants: 216, 217
 Recognition: 123

Capital grants and contributions: 134

Capitalization of interest: 30, 31

Capitalization policy: 29, 67, 68, 272

Capital-related debt: 91
 Issued for others: 94
 Refundings: 92
 Unspent bond proceeds: 89

Cash flows. *See* Statement of cash flows

Categorical grants: 120

Charges for services: 115, 116
 Fines and forfeitures: 118
 Internal charges: 117
 Special assessments: 128, 129

Charts used in MD&A: 12

Claims and judgments related to governmental activities: 23

Classified format for government-wide statement of net assets: 81

Clearing accounts:
 Assets held for other funds: 225
 Payroll clearing account: 226

Collections:
 Capitalization: 79
 Capitalized prior to Statement 34: 78
 Inexhaustible: 80
 Library books: 26
 Multiple: 79
 Organization policy: 77

Colleges and universities:
 Applicability of Statement 34: 1
 Permanent endowments: 159

Combining statements: 158
 Fiduciary funds: 179
 Internal service funds: 178, 206

Comparative data:
 Distinguished from comparative statements: 9
 Government-wide statements: 15
 MD&A requirements: 9
 In MD&A using charts and graphs: 12

Comparative financial statements: 8

Compensated absences: 83

Component unit:
 Blended: 239
 Does not issue separate report: 242, 243
 Early implementation: 265, 266
 Effective date: 265, 266, 270
 Fiduciary funds: 244
 Fiduciary in nature: 223
 Fund financial statements: 242, 243
 Information that “rolls up” includes component units of its own: 241
 Infrastructure assets at transition: 270
 Segment disclosures: 238
 In the statement of activities: 17

Composite depreciation: 51, 52. <i>See</i> Appendix 4, exercises 1 and 2	Factor in pricing policy: 163, 169
Condition assessment: 64, 65, 67, 68, 73–75, 280	Individual assets: 43, 44
Consistency: 255	Infrastructure assets: 41, 108
Method changes: 256	Internal service funds: 155
Condition level: 70–72	Land improvements: 46
Conduit debt: 195	Residual value: 45
Construction in progress: 32, 34	Shared assets: 107, 108
Contingencies:	Unallocated: 110
Relationship to MD&A: 13	When the modified approach is no longer permitted: 63
Contributed capital:	Derived tax revenues: 125, 127
As a component of net assets: 207	Designations:
Excluded from “total annual revenues”: 262	Distinguished from restrictions: 100
Currently known facts, decisions, or conditions:	Statement of net assets: 85
Examples: 13	Direct expenses: 105
Focus on governmental and business-type activities: 14	Depreciation: 107–109
Debt issue costs paid out of bond proceeds: 203	Interest expense: 111–113
Debt payable solely from fees and charges: 166, 167	Internal charges: 151
Debt service as a factor in pricing policy: 163	Loss on disposition of capital assets: 131
Dedicated tax revenues: 125–127	Reported net of program revenues: 132
Deep-discount debt:	Direct method cash flows:
Accrued interest: 87	Estimating: 219. <i>See</i> Appendix 4, exercise 7
Depreciation:	Disclosures:
Adjusted for gain or loss on disposition of capital assets: 131	Accumulated depreciation: 33
Allocations: 107–109	Capital assets: 232
Assets that serve essentially all functions: 107, 108	Capitalization of interest: 30
Changing from the modified approach: 63	Depreciation: 110, 232
Composite and group methods: 51, 52	Detailed explanations of reconciling items: 191, 192
Direct expenses: 107–109	Financial statements of external investment pools: 221
Disclosures: 110, 232	Governmental funds: 234
Displayed in the statement of activities: 108, 110	Indirect expense allocation: 152
Estimated useful lives: 47–51	Interest expense: 114
	Long-term liabilities: 234
	Material violations of finance-related legal provisions: 254
	Pension and postemployment healthcare plans: 220
	Summary of significant accounting policies: 230, 231
	Unusual or infrequent transactions or events: 212
	Distributions to joint venture participants: 217

Due within one year:	Recovery of costs through fees and charges: 164, 168–170
Compensated absences: 83	Reported as governmental activities: 18, 19, 218
Pension liabilities: 84	Reporting expenses by functions: 211
Earmarked revenues distinguished from restricted assets: 100	Reporting expenses by natural classifications: 211
Effective date: 263, 264	Reporting pledged revenues: 210
Business-type activities: 262	Required: 160, 161, 164, 166, 170
Component units: 265, 266	Restricted assets: 209
Eligible assets: 54	Statement of cash flows: 219
Eliminations:	Environmental mitigation: 40
Assets held for others in governmental or proprietary funds: 16	Equity interest in a joint venture:
Effects of internal service funds: 147. <i>See</i> Appendix 4, exercise 4	By a governmental fund: 199
Within a functional category: 151	Governmental joint ventures under Statement 34: 259
Indirect element of internal charges: 152, 153	Net assets component: 101
Interfund balances for major fund determination: 188	Escheat funds: 174
Interfund reimbursements: 149, 150	Estimated useful lives: 47–51
Interfund services provided and used: 149–151	Estimating historical cost: 288–290
Interfund transfers: 154	Using current replacement costs. <i>See</i> Appendix 4, exercise 8
Internal allocations: 153	External investment pools: 221
Internal service fund transactions with outside parties: 148	Extraordinary and special items:
Within nonmajor funds: 180	Determining significance: 204
Enabling legislation:	Fund financial statements: 204, 205
Earmarked revenues: 100	Government-wide statements: 204, 205
Restrictions: 96, 100	Extraordinary items: 139, 140, 142
Encumbrances included in original budget: 252	Distinguished from special items: 140, 142
Enterprise funds:	Examples: 141
Contributed capital: 207, 208, 213	Fiduciary funds:
Criteria: 160–163, 166–170, 268	Agency funds: 225, 226
Debt payable solely from fees and charges: 166, 167	Basis of accounting: 224
Modified approach: 55	Component units: 223
Nonoperating revenues: 213	Definition: 173
Operating and nonoperating distinctions: 214, 215	Investment trust funds: 221, 222
Principal revenue source: 162	Major funds: 179
Reclassify from multiple-activity governmental fund: 161	Pension trust funds: 220
Reconciliations: 218	Postemployment healthcare plans: 220
	Final budgets: 253

Financial Accounting Standards Board (FASB):	Statement No. 9: 214, 215
Applicability of pronouncements to government-wide statements: 20	Statement No. 10: 23, 160, 165, 227
Applicability of pronouncements to internal service funds: 20	Statement No. 12: 24
Statement No. 34: 31	Statement No. 14: 17, 181, 217, 239–242, 265
Statement No. 62: 31	Statement No. 20: 20
Statement No. 95: 219	Statement No. 21: 174
Statement No. 106: 24	Statement No. 23: 267
Fines and forfeitures: 132	Statement No. 24: 121
Classification in the statement of activities: 118	Statement No. 25: 220, 222
Fishing and hunting licenses: 115	Statement No. 26: 220
Food stamp revenues: 121	Statement No. 27: 21, 24, 220
Functional categories, distinguished from programs: 258	Statement No. 29: 268
Fund-type reporting: 157, 158	Statement No. 31: 179, 221, 222, 225
Fiduciary funds: 179, 220, 223	Statement No. 33: 137, 138, 197
Internal service funds: 178	Statement No. 34:
Nonmajor funds: 176	Footnote 19: 64
GAAP-basis budgets: 193	Footnote 21: 63
Gain or loss on disposal of capital assets:	Footnote 22: 78
General revenues: 131	Paragraph 6: 2
Infrastructure assets: 42	Paragraph 7: 3, 4
Garbage collection fees: 115	Paragraph 8: 6, 7, 13
Gas tax: 134	Paragraph 9: 12
General revenues:	Paragraph 11: 7, 10
Dedicated taxes: 125–127	Paragraph 11a: 11, 230
Gain or loss on disposition of capital assets: 131	Paragraph 11b: 12
Grants and contributions: 120, 122, 124, 213	Paragraph 11c: 14
Multiprogram grants: 120	Paragraph 11h: 7, 10, 13, 14
Restricted: 125–127	Paragraph 13: 16, 244
Golf course fees: 115	Paragraph 14: 15, 17
Governmental Accounting Standards Board (GASB):	Paragraph 15: 18
Interpretation No. 2: 195	Paragraph 17: 20
Statement No. 6: 129, 194	Paragraph 18: 28
	Paragraph 19: 36
	Paragraph 20: 33
	Paragraph 23: 66
	Paragraphs 23–24: 62, 63
	Paragraph 27: 76–79
	Paragraphs 27–29: 26
	Paragraph 31: 82, 83
	Paragraph 32: 86
	Paragraph 33: 89
	Paragraph 34: 95–97, 100, 101, 200
	Paragraph 35: 86, 98
	Paragraph 39: 19, 103
	Paragraph 41: 105
	Paragraph 43: 152, 153
	Paragraph 44: 110
	Paragraph 46: 113, 114

Paragraph 47: 115, 116, 121
Paragraph 47a: 117, 124
Paragraph 48: 118, 125, 133
Paragraph 49: 116, 128, 129
Paragraph 50: 116, 119, 120, 124, 134, 143
Paragraph 51: 130, 136
Paragraph 52: 116, 124, 125, 127
Paragraph 53: 123, 143
Paragraph 55: 139
Paragraph 56: 139
Paragraph 59: 147, 149, 153, 218
Paragraph 60: 149–151
Paragraph 62: 218
Paragraph 65: 159
Paragraph 67: 160–163, 268
Paragraph 67a: 166, 167
Paragraph 67b: 164, 170
Paragraph 67c: 168–170
Paragraph 68: 165
Paragraph 69: 173
Paragraph 70: 171
Paragraph 72: 173, 174
Paragraph 75: 158, 175, 176
Paragraph 76: 162, 185
Paragraph 76a: 182, 245
Paragraph 76b: 245
Paragraph 77: 11, 190, 191
Paragraph 81: 196
Paragraph 84: 157, 176, 201
Paragraph 86: 202
Paragraph 88: 203
Paragraph 89: 212
Paragraph 94: 20
Paragraph 96: 157, 178
Paragraph 98: 207, 208
Paragraph 99: 209
Paragraph 100: 143, 210, 212
Paragraph 101: 213
Paragraph 102: 214, 215
Paragraph 103: 216
Paragraph 106: 179, 220, 221, 223
Paragraph 111: 225, 226
Paragraph 112: 198, 228, 229
Paragraph 112a(1): 196, 227
Paragraph 112a(2): 149
Paragraph 112b(1): 154

Paragraph 112b(2): 149
Paragraph 115a: 230
Paragraph 115e: 29
Paragraph 115h: 231
Paragraph 117: 110
Paragraph 117d: 155
Paragraph 119: 194
Paragraph 119c: 83
Paragraph 119d: 234
Paragraph 122: 103, 104, 210, 235–237
Paragraph 126: 241, 244
Paragraph 130: 246, 247, 250
Paragraph 130a: 252
Paragraph 130b: 253
Paragraph 131: 246, 254
Paragraph 134: 257
Paragraph 135: 260
Paragraph 136: 5, 146, 257, 258
Paragraph 137: 258
Paragraph 138: 4, 159, 257, 265, 266, 268
Paragraph 139: 4, 257
Paragraph 142: 266
Paragraph 143: 262, 263, 265
Paragraph 146: 267
Paragraph 147: 268
Paragraph 148: 270
Paragraph 150: 275
Paragraph 151: 273
Paragraph 152: 279, 280
Paragraph 156: 283, 284
Paragraph 159: 290
Paragraph 314: 147, 148, 155, 218
Paragraph 315: 151
Paragraph 364: 111
Paragraph 380: 176
Paragraph 381: 157, 175
Paragraph 385: 178
Paragraph 387: 162
Paragraph 391: 164
Paragraph 423: 20
Paragraph 430: 207
Paragraph 433: 123
Paragraph 440: 219
Paragraph 456: 238, 243
Statement No. 35: 1, 215

Governmental activities:	Indirect expenses: 105
Claims and judgments: 23	Allocations: 106, 135
Compared to governmental funds in MD&A: 11	Depreciation: 107, 108
Compensated absences: 83	Disclosures: 152
Long-term debt: 22	Factor in pricing policy: 170
Pension liabilities: 21, 22	Reimbursements as program revenue: 135
Governmental funds:	Infrastructure assets:
Accrual basis of accounting: 189	Definition: 36, 37
Compared to government-wide activities in MD&A: 11	Depreciation: 43, 44, 51, 52, 108
Deferred revenues: 197	Eligible assets: 54
Disclosures: 234	Environmental mitigation: 40
Equity interest in a joint venture: 199	Estimating historical costs. <i>See</i> Appendix 4, exercise 8
Long-term receivables: 197	Financed by bonds of another government: 286
Reconciliations: 189	Gain or loss on disposal: 42
Reserved fund balance: 200, 201	Joint construction: 287
Governmental joint ventures:	Land associated with: 276
Equity interest under Statement 34: 259	Modified approach. <i>See</i> Modified approach
Grant revenues:	Network: 37–39, 54, 56, 68, 72, 272
Allocations: 119, 120	Preservation: 58
Grants and contributions:	Record keeping: 67, 272
Capital: 134	Residual value: 45
Capital versus operating: 213	Roads: 41, 52, 60
Enterprise funds: 213	Subsystem: 37–39, 52, 54, 56, 68, 72, 272
General revenues: 120, 122, 124, 213	Transition provisions: 229, 278, 280, 281
Investment earnings: 136	Calculating weighted-average age. <i>See</i> Appendix 4, exercise 9
Operating: 134	Capitalization: 269–271, 273–275, 277, 281–285, 288–290
Program revenues: 119, 121, 122, 124, 134, 213	Determining major general infrastructure assets: 282–285. <i>See</i> Appendix 4, exercise 10
Shared revenues: 122, 124, 134	Estimating historical cost: 288–290
Graphs used in MD&A: 12	Modified approach: 278–281
Hotel–motel tax: 127	Weighted-average method: 271
Identifiable activity for segment disclosures: 236	Infrequent in occurrence: 139, 141
Implementation phase. <i>See</i> Effective date	But not unusual in nature: 212
Incomplete presentation:	Interest expense:
Fund statements only: 4	Capital leases: 112
Government-wide statements only: 4	Direct expenses: 111–113
	Disclosures: 30, 114
	Displayed in the statement of activities: 111, 114
	Essential to a program: 113
	Internal service funds: 155

Interfund balances and activity: Effect on major funds: 188	Investment trust funds: Required financial statements: 222
Interfund loans: Repayment period: 196, 227 Reporting long-term amounts: 198	Joint venture: Equity interest: 199, 216, 217, 259 Statement of net assets: 101
Interfund reimbursements: Eliminations: 149, 150	Land: 27, 34, 276
Interfund services provided and used: 228 Eliminations: 149–151 Payment in lieu of taxes: 229	Land improvements: 25, 27, 35, 46
Interfund transfers: Eliminations: 154 Payment in lieu of taxes: 229 Reclassified loans: 196, 227 In the statement of activities: 154	Letter of transmittal: Location: 6 Relationship to MD&A contents: 7
Interim budget: 251	Liabilities related to restricted assets: 99
Internal charges: Eliminations: 149–151, 155	Library books: 26
Internal Revenue Code Section 457, deferred compensation plans: 171	Licenses and permits: 132
Internal service funds: Combining statements: 206 Definition: 165 Depreciation expense: 155 Eliminations: 147, 148, 155, 156, 218. <i>See</i> Appendix 4, exercise 4 Interest expense: 155 Major funds: 178, 182 Predominant participant: 165 Reported in a single column: 178 Reporting assets and liabilities in government-wide statement of net assets: 156 Transactions with outside parties: 148, 165	Long-term liabilities: Disclosures: 234 Governmental activities: 22
Inventory of capital assets: 67, 68	Look-back adjustment for internal service funds: 147, 155, 156, 218
Investment earnings as program revenues: 136	Lottery sales revenue: 133
	Maintenance: Modified approach: 53, 57 Roads: 41, 60
	Major classes of assets: 233
	Major component units: Cash flows reporting: 238 Combining statements: 241 Criteria: 240
	Major fund criteria: Basis of accounting: 186 Operating and nonoperating distinction: 184 Other financing sources and uses: 185 Two-step test: 183

Major funds:	Condition assessment: 64, 65, 67, 68, 73–75, 255, 280
Blended component units: 181	Condition level: 70–72
Budgetary comparisons: 245	Definition: 53
Capital projects funds: 177	Eligible assets: 54
Consistency from year to year: 177	Maintenance and preservation: 53, 57
Criteria: 177, 182–188. <i>See</i> Appendix 4, exercise 5	Networks and subsystems: 56
Effects of interfund balances and activity: 188	No longer permitted: 62–65
Effects of reconciling items: 187	Presentation in statement of net assets: 34
Enterprise funds: 184	Roads: 59
Fiduciary funds: 179	RSI disclosures: 255
Governmental funds: 185	Transition provisions: 278–281
Internal service funds: 178, 182	Use by enterprise funds: 55
Separate columns required: 175	
Major general infrastructure assets: 282–285. <i>See</i> Appendix 4, exercise 10	Monuments: 76
Management’s discussion and analysis (MD&A):	Motor fuel tax: 134
In comparative statements: 8	Multiprogram grants:
Comparing fund financial statements to government-wide statements: 11	General revenues: 120
Condensed financial information: 12	Program revenues: 119
Currently known facts, decisions, or conditions: 13	National Council on Governmental Accounting (NCGA):
Location: 6	Interpretation 10: 250
Minimum requirements: 10	Statement 1: 96, 103, 158, 200, 224, 276
For a PERS: 261	Net assets:
Relationship to letter of transmittal contents: 7	Contributed capital: 207
Required contents: 10	Invested in capital assets, net of related debt: 87
As RSI: 10	Required components: 85, 86, 93, 98, 207, 208. <i>See</i> Appendix 4, exercise 3
Use of charts and graphs: 12	Terminology: 85, 93
When comparative data are presented in financial statements: 9	
Material violations of budgetary spending limitations: 254	Net pension obligation (NPO): 21, 84
Minimum requirements for GAAP: 2, 3	Network: 37–39, 54, 56, 68, 72, 272
Fund-only statements prohibited: 4	Nonmajor funds:
Government-wide-only statements prohibited: 4	Combining statements: 158
Minimum requirements for MD&A: 10	Elimination of interfund balances and activity: 180
Modified approach:	Fund balance reporting: 157, 176
Additions and improvements: 53, 61	Reserved fund balances: 201
Asset management systems: 53, 66–69	Single column required: 176
Change in condition assessment method: 256	Nonoperating revenues: 213
	Operating grants and contributions: 215

Notes to financial statements. *See* Disclosures

Notes to RSI: 254

Not-for-profit organizations:

Transition: 268

On-behalf payments: 121

Operating and nonoperating distinction:

Government-wide statement of activities: 143

Major funds criteria: 184

Operating subsidies or capital-related appropriations: 215

Using Statement 9 guidance: 214, 215

Operating grants and contributions: 134

Operating and nonoperating distinctions: 215

Optional budgetary comparisons: 246

Original budget: 251

Encumbrances: 252

Other financing sources and uses:

Debt proceeds: 203

Issuance premium or discount: 203

Major fund criteria: 185

Reporting: 202

Other postemployment benefits (OPEB):

Recognition and reporting in government-wide statements: 24

Pass-through grants: 121

Payment in lieu of taxes: 229

Payroll clearing accounts: 226

Pension liabilities:

Due within one year: 84

Governmental activities: 21, 22

Pension trust funds: 220

Permanent endowments: 159

Net asset components: 98

Permanent funds: 123

Earnings: 130

Governments engaged only in business-type activities: 159

Pledged revenues: 210

Postemployment healthcare plans: 220

Premiums, discounts, issue costs at transition: 267

Preservation costs: 53, 57, 58

Pricing policies: 168, 169

Primary elements of Statement 34 model: 2

Principal revenue source: 162

Private donations: 123, 213

Private-purpose trust funds: 172–174, 224

Program revenues:

Allocations: 133

Classifications: 116–118

Examples: 115

Fines and forfeitures: 118

Food stamp revenues: 121

Grants and contributions: 119, 121, 122, 124, 134, 213

Internal charges: 151

Investment earnings: 136

Lottery sales: 133

Multiprogram grants: 119

Netted against direct expenses: 132

On-behalf payments: 121

Pass-through grants: 121

Permanent fund earnings: 130

Reimbursements for indirect expenses: 135

Sources: 115, 116

Special assessments: 128, 129

Proprietary funds:	Recovery of costs through fees and charges: 164, 168, 169
Disclosure of unusual or infrequent transactions or events: 212	Pricing policies: 170
Reporting expenses by functions: 211	Reduced-rate loan programs: 113
Reporting expenses by natural classifications: 211	Reporting entity. <i>See</i> Component unit
Restricted assets: 209	Required disclosures. <i>See</i> Disclosures
Prospective application at transition: 267	Required supplementary information (RSI). <i>See also</i> RSI disclosures
Public employee retirement systems (PERS):	Budgetary comparisons: 254
External financial statements: 261	Modified approach: 255
Option to use separate columns for individual plans: 261	Reserved fund balance:
Required statements: 261	Definition: 200
Public entity risk pools: 160	Distinguished from restricted net assets: 200
Quasi-external transactions: 228	Noncurrent receivables: 198
Reasonable time for repayment of interfund loans: 196, 227	Nonmajor funds: 201
Reciprocal interfund activity: 228	Residual value: 45
Reclassifications:	Resources or activities that benefit both the government and private parties: 172
Effect on the reconciliations: 19, 218	Resources or activities that benefit discretely presented component units: 173
For government-wide financial statements: 18, 19, 156, 218	Restricted assets:
Interfund loans as transfers: 196, 227	Bond proceeds: 89
Reconciliations:	Capital assets: 88
Accompanying schedule: 190, 192	Classification as noncurrent: 209
Allocation of indirect expenses: 106	Government-wide statement of net assets: 82
Combined adjustments: 191	Related liabilities: 99
Combined government-wide and fund financial statements: 146	Special revenue funds: 96
Detailed explanations: 192	Restricted net assets:
Effect on major funds: 187	Definition: 95, 97, 99
Enterprise funds: 218. <i>See</i> Appendix 4, exercise 6	Distinguished from reserved fund balances: 200
Governmental funds: 189. <i>See</i> Appendix 4, exercise 6	Enabling legislation: 100
Location: 190	Permanent endowments: 98
Net adjustments: 191	Unspent bond proceeds: 89
Reclassifications: 19, 218	Restricted revenues: 122
Required disclosures: 191	Multiprogram grants: 119, 120

Restrictions:	Single-program governments:
Enabling legislation: 96	Combined government-wide and fund financial statements: 5, 146
Purposes: 97	Comparative financial statements: 8
Revenue-backed debt:	Definition: 258
Also backed by full faith and credit: 237	Site improvements: 25
Segment disclosures: 235, 237	Special assessments: 128, 129
Roads. <i>See also</i> Infrastructure assets	Debt: 194
Asset management systems: 67, 69	Special items: 139, 140, 142
Maintenance: 41, 60	Distinguished from extraordinary items: 140, 142
Modified approach: 59	Examples: 141
Reconstruction: 59	Special-purpose government:
Replacement: 41, 52, 60	Definition: 257
Resurfacing: 41, 60	Special reporting provisions: 257
RSI disclosures:	Special-purpose government engaged only in business-type activities:
Changes to condition assessment method, basis, or scale: 255	Governmental component unit: 260
Sales tax: 100, 122, 125	Required statements: 260
Scope of Statement 34: 1	Special-purpose tax: 126
SEA (service efforts and accomplishments) reporting in MD&A: 10	Special revenue funds: 172, 173
Segment disclosures: 210	Restricted assets: 96
Absence of revenue-backed debt: 235	State appropriations: 215
Component units: 238	Statement of activities:
Identifiable activity: 236	Allocations: 105
Segments:	Alternative formats: 144–146
Grouped as a single activity: 104	Business-type activities: 143
Statement of activities reporting: 103, 104	Combined with fund financial statements: 146
Shared capital assets: 107, 108	Eliminations: 149–152, 154
Shared revenues:	Indirect expenses: 105, 106, 152
Capital vs. operating: 134	Interfund transfers: 154
General vs. program revenue: 122, 124	Internal service fund transactions with outside parties: 148
Restricted: 122	Level of detail required: 19, 103–105, 132, 144–146
	Reporting component units: 17

Statement of cash flows:	Term endowments:
Component units: 243	Net asset components: 98
Estimating direct method cash flows: 219. <i>See</i>	Total annual revenues:
Appendix 4, exercise 7	Budgeted or actual: 264
Statement of net assets:	Capital contributions: 262
Capital assets not being depreciated: 34	Transfers: 263
Classified format: 81	Traffic control fees: 115
Compensated absences: 83	Transfers:
Conduit debt: 195	Eliminations: 154
Designations: 85	Excluded from major fund determination: 185, 188
Equity interest in a joint venture: 199	Excluded from “total annual revenues”: 263
Liquidity format: 81, 82	Transient occupancy tax: 127
Presentation of accumulated depreciation: 33	Transition provisions: 267
Reporting internal service fund balances: 156. <i>See</i>	Infrastructure. <i>See</i> Infrastructure assets
Appendix 4, exercise 4	Not-for-profit organizations: 268
Restricted assets: 82	Uncollectible revenues:
Special assessment debt: 194	Exchange transaction: 138
Statement of revenues, expenditures, and changes in	Governmental activities: 138
fund balances: 202	Taxes: 137
State sales tax: 100	Unemployment compensation funds: 160, 164
Subsequent events:	Unrestricted net assets:
Relationship to MD&A: 13	Definition: 102
Subsystem: 37–39, 52, 54, 56, 68, 72, 272	Disclosure of the effect of debt issued for others: 94
Summary of significant accounting policies:	Equity interest in a joint venture: 101
Description of the government-wide statements: 230	Unspent bond proceeds: 89, 90
Use of restricted resources: 231	Unusual in nature: 139, 141
Swimming pool fees: 115	But not infrequent in occurrence: 212
Taxes. <i>See also</i> Shared revenues; Special	Works of art, historical treasures:
assessments	Derecognition: 78
Dedicated taxes—display: 126	Formal policy not required: 77
Distinguished from user fees: 127	Meaning of “inexhaustible”: 80
Imposed by another government: 122, 124, 134	Monuments: 76
Imposed by the reporting government: 124–127	Recognizing individual collections: 79
Not user fees: 127	
Uncollectible: 127, 137	

