



GASB QUESTIONS AND ANSWERS

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ALTEC

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Mike has twice been a member of the AICPA Professional Ethics Executive Committee (1989-1992 and 2000-2003), and served on the Auditing Standards Board from 1997 to 2000. From 1986 to 1993, he also served as a member of AICPA Independence and Behavioral Standards Subcommittee, and as Subgroup Chairman of the Governmental Technical Standards Committee. During this time he conducted numerous investigations of complaints filed by federal, state and local agencies alleging substandard performance of audits of governmental and nonprofit entities, and represented the Professional Ethics Division at hearings of the Joint Regional Trial Board.

He contributed to the *Implementation Guide* for GASB Statement 34, AICPA Statement of Position 98-3, *Audits of States, Local Governments and Not-for-Profit Organizations Receiving Federal Awards*, revisions to the AICPA Audit and Accounting Guide, *Audits of State and Local Governmental Units*, the AICPA Practice Aid *Fraud Detection in a GAAS Audit*, revisions to the Louisiana Governmental Audit Guide and in drafting state legislation affecting governmental accounting and auditing requirements. He has served as technical consultant and instructor for the Louisiana Division of Administration (Office of Community Development) and as consultant to the Louisiana Department of Education. Mike frequently appears as moderator and panelist on the Accountants' CPE Network (ACPEN).

Mike has been named twelve times as an Outstanding Instructor by the American Institute of CPAs and several state societies, and received a Special Recognition Award from the Society of Louisiana CPAs Board of Directors for his contributions to continuing education in 1994. In addition, he was awarded the 2001 National Education and Training Award from the Association of Government Accountants and in 2009 was named national Beta Alpha Psi Business Information Professional of the Year.

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GASB Questions and Answers

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Description: Financial statement preparers often encounter unusual items that present unique problems of presentation and disclosure. Small issues can sometimes confound the preparer and often delay completion of the financial statements. This course addresses many of those items, such as:

- The financial reporting entity
- Deposits with financial institutions
- Investments
- Cash flow statements
- Risk financing
- Pensions
- Financial statements and management's discussion and analysis
- Other guidance

Delivery method: Live presentation

Learning objectives: To enable participants to efficiently prepare governmental financial statements

Experience/Prerequisites: Minimum to advanced level of auditing experience

Program level: Minimum to overview

Who should attend: Staff with responsibility governmental financial statements; partners and managers responsible for planning, reviewing governmental financial statements

Advance preparation: None

Recommended CPE credit: 8 hours (400 minutes) (Accounting and auditing/Yellow Book)

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Introduction

Since the Governmental Accounting Standards Board was established in 1984, governmental financial reporting continues to evolve. Even as this course is written, there are 10 exposure drafts and preliminary views documents, all likely to become part of the body of GAAP for state and local government, in process.

Financial statement preparers are faced with the daunting task of trying to keep up with new pronouncements as they become effective. Sometimes this makes it difficult to remember what, for some, may be considered basic principles that apply to the financial statements and disclosures.

This course will review some of the major areas and trouble spots, in the hope of making preparing financial statements and disclosures efficient.

Chapter 1

The Financial Reporting Entity

The basic requirements for defining the governmental financial reporting entity were established in Statement 14, *The Financial Reporting Entity*, adopted in June 1991. Statement 14 was amended by Statement 39, *Determining Whether Certain Organizations are Component Units*, in May 2002, and again by Statement 61, *The Financial Reporting Entity: Omnibus*, in November 2010.

Combining the guidance from these pronouncements provides the following definitions:

Primary government – any state or general purpose local government (city or county, for example) and any special-purpose government that meets the following criteria:

- It has a separately elected governing body
- It is legally separate
- It is fiscally independent

Legally separate entities are those that are created as a body corporate or corporate and politic, if they otherwise have corporate powers that would distinguish them as being separate from the primary government. Generally, this means that the legally separate entity has its own name, has the power to sue and be sued in its own name, and has the right to buy, sell, lease and mortgage property in its own name. A special purpose government that does not possess the above powers should be considered as a part of the primary government that holds those powers.

Fiscal independence means that an entity does not require substantive approval of a primary government in order to:

- Adopt its budget
- Levy taxes or set rates or charges
- Issue bonded debt

Component units – component units are legally separate¹ (from the primary government) entities for which the elected officials of the primary government are financially accountable, or may be included for other reasons, as discussed below.

Financially accountable component units are those for which the governing board of the primary government;

- Appoints a voting majority of the component unit's governing board, and

¹ A component unit can be a governmental organization, a nonprofit corporation or a for-profit corporation.

- Has the ability to impose its will on the component unit, *or* there is potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the primary government.

Appointment of the governing board must be substantive, that is, it must be more than simply confirming appointments made by individuals or groups other than the primary government. In addition, if the appointment is limited to selecting from a slate of candidates provided by a group other than the primary government, the appointment lacks substance. If financial decisions of the component unit require more than a simple majority, the primary government would have to appoint at least the number required to pass such financial decisions.

Imposition of will is evidenced by the primary government's ability to influence the component unit's operations. Any of the following conditions would indicate that the primary government has the requisite ability to impose will:

- The ability to remove members of the governing board at will;
- The ability to modify or approve the budget of the component unit;
- The ability to modify or approve rate or fee changes affecting revenues, such as water usage rate increases;
- The ability to veto, overrule, or modify the decisions of the component unit's governing board;
- The ability to appoint, hire, reassign or dismiss those persons responsible for day-to-day operations (management) of the entity.

Other conditions may indicate the ability to impose will; a distinction should be made between substantive approvals and ministerial approval.

Financial benefit or burden may exist in a variety of ways. The benefit or burden may result from legal entitlements or obligations, or it may be less formalized and exist because of decisions made by the primary government, or agreements between the primary government and a component unit. An organization has a financial benefit or burden relationship with the primary government if any one of the following conditions exists:

- The primary government is legally entitled to or can otherwise access the organization's resources;
- The primary government is legally obligated or has otherwise assumed the obligation to finance the deficits or, or provide financial support to, the organization;
- The primary government is obligated in some manner for the debt of the organization.

Exchange transactions between organizations and the primary government should not be considered manifestations of financial benefit or burden.

Fiscally dependent component units are those which are dependent on the primary government to adopt their budgets, levy their taxes, or issue their debt *and* there is a potential for the organization to provide specific financial benefits to, or impose specific financial burdens on, the primary government. Fiscally dependent component units may be legally elected and legally separate.

Other organizations may be included as component units, if the nature and significance of their relationship with a primary government are such that exclusion from the reporting entity would cause the financial statements to be misleading, as determined through the use of management's professional judgment, based on the entity's relationship with the primary government.

An organization can be a component of only one primary government.

A legally separate, tax-exempt organization should be reported as a component unit of a reporting entity if *all* of the following criteria are met:

- The economic resources received or held by the separate organization are entirely or almost entirely for the direct benefit of the primary government, its component units, or its constituents;
- The primary government is entitled to, or has the ability to otherwise access, a majority of the economic resources received or held by the separate organization;
- The economic resources received or held by an individual organization that the specific primary government, or its component units, is entitled to, or has the ability to otherwise access, are significant to that primary government.

Legally separate, tax-exempt component units that meet the above criteria should be discretely presented.

Related organizations are those for which the primary government appoints a majority of the governing board, but are not financially accountable to the primary government. The primary government should disclose, in its financial statements the nature of its accountability for related organizations. Groups of related organizations with similar relationships may be summarized and disclosed together.

Joint ventures are legal entities or other organizations that result from a contractual arrangement and are owned, operated or governed by two or more participants as separate and specific activities subject to joint control, in which the participants retain:

- Ongoing financial interest, or
- Ongoing financial responsibility.

Ongoing financial interest includes an equity interest or any other arrangement that causes a participating government to have access to the joint venture's resources. Access may occur directly, such as when the joint venture pays its surpluses to the participants, or indirectly, such as when the joint venture undertakes projects of interest to the participants.

Ongoing financial responsibility means that the participating government is obligated in some manner for the debts of the joint venture, or if the joint venture's continued existence depends on continued funding by the government. In proprietary funds, the equity interest is accounted for initially at cost, with any share of the operating results modifying the investment account, regardless of whether the amount is actually remitted. In determining the participant's share of the net income or loss, any profit on the operating transactions between the proprietary fund and the joint venture should be eliminated. Nonoperating transactions between the participant and the joint venture increase or decrease the equity interest. In governmental funds, the equity interest in a joint venture does not meet the definition of a financial resource, and thus the investment in the joint venture is not presented as an asset.

Jointly governed organizations are regional governments or multigovernmental arrangements, governed by representatives from each of the governments that create the organization. They may seem similar to joint ventures, but many do not meet the definition of a joint venture because there is no ongoing financial interest or responsibility by the participating governments. Only disclosures are required for jointly governed organizations.

Undivided interests are arrangements that resemble a joint venture, but no entity or organization is created by the participants. Two or more parties own property in which title is held individually to the extent of each party's interest. A government participating in such an arrangement should report its own assets, deferred outflows, liabilities, deferred inflows, revenues and expenses/expenditures.

Stand-Alone governments are legally separate governmental organizations that:

- Do not have a separately elected governing body, and
- Do not meet the definition of a component unit as discussed above

This category may include some special-purpose governments, related organizations, joint ventures, jointly governed organizations and pools. A stand-alone government with a majority of its governing board appointed by a primary government should disclose that accountability relationship in its financial statements.

Presentation of component units

Because of their relationship with the primary government, some component units should be blended as though they are part of the primary government; most component units should be discretely presented. Discrete presentation entails reporting component unit financial data in columns separate from the primary government. The discrete column should be located to the right of the primary government (including blended component units) and distinguished by providing descriptive column headings.

Blending is generally reflective of the fact that, even though the component unit is legally separate from the primary government, the operations and activities of the component unit are so intertwined with those of the primary government that they are essentially the same as those of the primary government.

Blending of a component unit is required when:

- The component unit's governing body is substantively the same as the governing body of the primary government *and* there is a financial benefit or burden relationship between the primary government and the component unit *or* management of the primary government has operational responsibility for the component unit.²
- The component unit provides services entirely, or almost so, to the primary government or otherwise exclusively, or almost so, benefits the primary government even though it does not provide services to it. The essence of this type of relationship is much the same as an internal service fund, where the goods or services are provided to the primary government itself rather than to the citizenry. Usually such services are financing services provided solely to the primary government, such as a building authority created to finance construction of office buildings for the primary government. If a component unit provides services to more than just the primary government should also be blended if the services provided to others are insignificant to the overall activities of the component unit. A component unit that provides services exclusively, or almost so, that benefit the primary government indirectly should also be blended. An example is a component unit that provides services on behalf of the primary government to its employees, rather than directly to the primary government.
- The component unit's total debt outstanding, including leases, is expected to be repaid entirely or almost entirely with resources of the primary government. Such repayment is generally provided through a continuing pledge and appropriation by the primary government to the component unit, who, in turn, pledges those appropriation payments as the primary source of repayment of its debt.

² Management of the primary government would be deemed to have operational responsibility for the component unit if it manages the activities of the component unit in essentially the same manner in which it manages its own programs, departments or agencies. "Management" for this purpose consists of persons below the level of the governing board responsible for the day-to-day operations of the primary government, such as a county executive or city manager.

The reporting entity discloses, in the notes to financial statements, details of the major component units. The determination of a “major” component unit is solely based on the nature and significance of its relationship to the primary government, considering the following factors (any of them could result in classification of a component unit as major):

- The services provided by the component unit to the citizenry are such that separate reporting as a major component unit is considered to be essential to financial statement users;
- There are significant transactions with the primary government; or
- There is a significant financial benefit or burden relationship with the primary government.

Major component unit reporting requirements may now be satisfied by any one of the following:

- Presenting each major component unit in a separate column in the reporting entity’s statements of net asset and activities;
- Including combining statements of major component units in the reporting entity’s basic financial statements after the fund financial statements; or
- Presenting condensed financial statements in the notes to the reporting entity’s financial statements.

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

Questions and answers – the financial reporting entity

Q. Can fiscal dependence result solely from reliance on funding from another government?

A. No. Fiscal dependence should not be confused with financial benefit or burden. Fiscal dependence is related to control or oversight relationships, rather than day-to-day financing of operations. Fiscal dependence does not necessarily imply that a financial benefit or burden relationship exists. Likewise, reliance on funding does not necessarily imply that a fiscal dependence relationship exists.

Q. Would a primary government that is temporarily placed under the direct fiscal control of another entity lose its fiscal independence?

A. No. Footnote 3 of Statement 14 states that “A primary government that is temporarily under the fiscal control of another government continues to be fiscally independent for purposes of this statement.” Therefore, a government in this situation would continue to apply the provisions of Statement 14 as a primary government.

Q. A potential component unit of a county is legally separate and has a separately elected governing board. The organization determines its own operating budget, but the county is required to approve its capital budget. Is the potential component unit fiscally independent?

A. No. Fiscal independence requires that a government be able to “determine its budget without another government’s having the authority to approve and modify that budget.” If another government has substantive approval authority for a portion of an organization’s budget, the organization would not meet this criterion and should be evaluated as a potential component unit because it is fiscally dependent on the other government.

Q. A statute grants the state oversight control over the budgets of all counties and municipalities of the state. Given the various financial benefits and burdens that exist between a state and its local governments, should the counties and municipalities be evaluated as potential component units of the state under the fiscal dependency criteria?

A. No. Statement 14 states that “component units are legally separate organizations for which the elected officials of the primary government are financially accountable.” Further, Statement 14 states that a primary government is “any state government or general purpose local government.” Therefore, because counties and municipalities are general purpose governments, they should not be considered potential component units of the state.

Q. State law prohibits certain types of special-purpose governments from incurring long-term debt. Are these special-purpose governments ineligible to be evaluated as primary governments because of the requirement that fiscal independence requires an entity to be able to issue its own debt?

A. No. Statement 14 provides that a special-purpose government is not fiscally independent if it cannot issue bonded debt without the approval of another government. In this case, the special-purpose government’s fiscal abilities are limited because they cannot issue debt, but they are not dependent upon another government. Statement 14 notes that “a special-purpose government that is statutorily prohibited from incurring debt may be fiscally independent if it possesses the other two powers because the statutory prohibition does not subordinate the special-purpose government to another government for debt approval.” The fiscal dependency issue is not whether the governments can or cannot issue bonded debt, but whether they can do so only with the approval of another government.

Q. A housing authority is the general partner of a limited tax credit partnership (a legally separate entity). The limited partners have limited rights regarding the operation of the partnership, and the housing authority possesses essentially all authority over day-to-day operations. Should the housing authority be considered to have appointed a voting majority of the partnership’s board?

A. Yes. The board of the housing authority is acting as the general partner of the limited tax credit partnership, which is tantamount to the housing authority appointing a voting majority of the board of the partnership.

Q. An organization concludes that it qualifies as a component unit of a primary government, based on the “misleading to exclude” criterion of Statement 14, as amended, but the primary government does not reach the same conclusion. Should the organization identify itself as a component unit of the primary government?

A. No. The ultimate responsibility to decide whether an organization is a component unit rests with the primary government, not with the potential component unit. So in this case, the decision by the primary government that the organization is not a component unit overrides the opinion of the potential component unit regarding the “misleading to exclude” criterion. The organization should describe the relationship with the primary government in the notes to its financial statements.

Q. What are display options when there is only one discretely presented component unit?

A. When there is only one component unit, the options discussed in Statement 14, to present major component unit information in combining statements or in the notes, are not applicable because the major component unit reporting requirements are met by discrete presentation in the government-wide financial statements.

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. The “aggregated total” financial information of a discretely presented component unit is taken from its statement of net position and statement of activities. Statement 34, as amended, defines the scope of those statements to exclude fiduciary funds.

Q. How should a blended component unit (A) that has a discretely presented component unit of its own (B) be included in the primary government’s financial reporting entity?

A. Because the blending criteria are met, the component unit A should be presented as if it were part of the primary government. Consistent with that notion, component unit B would be treated as a component unit of the primary government and would be discretely presented.

Q. Statement 14 requires that the general fund of a blended component unit be reported as a special revenue fund. However, Statement 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, limits the use of special revenue funds to account for specific revenue sources that are restricted or committed for specified purposes. Does Statement 54 affect the reporting of a blended component unit as a special revenue fund?

A. No. Statement 54 does not amend the requirement that a general fund of a blended component unit be reported as a special revenue fund of the primary government.

Q. How should the financial statements be presented when a component unit has a different fiscal year than the primary government?

A. Statement 14 states that the reporting entity (which reports using the primary government's fiscal year) should incorporate the financial statements for the component unit's fiscal year that ends during the reporting entity's fiscal year. However, if the component unit's fiscal year ends within the first quarter of the reporting entity's subsequent fiscal year, the reporting entity can incorporate that fiscal year of the component unit, rather than the fiscal year that ends within the reporting entity's fiscal year.

Q. An organization that was reported as a component unit no longer qualifies as a component unit. How should the primary government report that change in the reporting entity?

The primary government should restate its beginning net position as if the organization was not included in the reporting entity in the preceding year. In addition, the primary government should make the disclosures required (paragraph 87 of Statement 14). The financial statements would report "net position, beginning of the year (as restated)," and the restatement would be explained in the notes.

Chapter 2

Deposits with Financial Institutions and Investments

The guidance on disclosures related to deposits and investments was originally presented in Statement 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements*, and was amended by Statement 40, *Deposits and Investment Risk Disclosures*. To apply these statements, the preparer needs to both identify investments and deposits and to distinguish between the two.

Statement 31, *Accounting and Reporting for Certain Investments and External Investment Pools*, defines an *investment* as “a security or other asset acquired primarily for the purpose of obtaining income or profit.” Therefore, a government’s purpose for acquiring a particular asset often is important to identifying it as an investment. For example, land held by a public employee retirement system with the intent to allow it to appreciate and sell it would be an investment. Land held related to low-income housing would not be considered an investment.

Some assets may produce income or profit, but are outside the scope of the disclosure requirements of Statements 3 and 40. For example, interest-bearing tax receivables produce income, but are not subject to the disclosure requirements. Enterprise fund capital assets produce income or profit if user charges exceed the cost of those assets. However, neither Statement 3 nor 40 were intended to apply to such assets. Governments often earn interest on deposits with financial institutions, but interest-bearing deposits should generally be treated as deposits, not as investments.

Deposits with financial institutions are deposit accounts in banks, savings associations and credit unions. These may be demand accounts, savings accounts, time deposits, including NOW accounts and certificates of deposit.

In addition, what constitutes *investments* for a governmental entity may be specified in the law, though often, investment laws list both deposits and investments. On occasion, they may also include types of items that are not consistent with the types of items for which Statements 3 and 40 disclosures are appropriate. For example, state law may authorize a government to “invest” in low-interest loans to students. Notwithstanding their interest-bearing feature, these student and other program loans are interest-bearing receivables, and are not intended to be subject to the disclosure requirements.

The disclosure requirements related to deposit and investment risk disclosure are limited to:

- Deposits that are not covered by depository insurance and are:
 - Uncollateralized,
 - Collateralized with securities held by the pledging financial institution, or
 - Collateralized with securities held by the pledging financial institution’s trust department or agent but not in the depositor-government’s name.

- Investment securities that are:
 - Uninsured,
 - Not registered in the name of the government, and
 - Held by either (a) the counterparty or (b) the counterparty's trust department or agent but not in the government's name.

The Statement 3 disclosures generally referred to as category 1 (covered by depository insurance) and 2 deposits and investments (secured by collateral held by the government's agent in the government's name) were eliminated by Statement 40. However, Statement 40 did not change the required disclosure of authorized investments or the requirements for reporting certain repurchase agreements and reverse repurchase agreements, and it maintains, with modification, the level-of-detail disclosure requirements of Statement 3.

Questions and answers – deposits with financial institutions and investments

Q. Statement 40 requires investment disclosures to be organized by “investment type.” What is an “investment type”?

A. Statement 40 does not define *investment type*. Prescribing a list of investment types may mislead readers of the financial statements considering the diversity of investments that may carry similar terminology but exhibit diverse risks. Different investment terms and risks are features that give investments differing forms. For example, a government may hold two U.S. Treasury investments, one a 10-year bond and the other an interest-only strip (the interest portion of a Treasury Bond). Although both are U.S. Treasury securities, they have different risk characteristics. By not prescribing investment types, preparers are able to apply professional judgment and select investment types that fit the facts and circumstances; however, investment with significantly different risk profiles should not be aggregated into a single investment type.

Q. A government has a position in an external investment pool. Does the investment-type disclosure “look through” to the investments of the pool, or should the investment be characterized as an investment in an external investment pool?

A. A position in an external investment pool is in itself a type of investment. Therefore, a government's position in an external investment pool should be characterized as an investment in an external investment pool. An investment type disclosure “looking through” to the investments of the pool is not required.

Q. Does Statement 40 define *investment policy* or require an investment policy to be formally adopted?

A. Diversity in practice prevents specifically defining what is meant by either a deposit or investment policy. However, an investment policy is considered to be a formally adopted policy that sets forth a government's allowable deposits or investments. An investment policy may be formally adopted through legal or contractual provisions or by other means, usually by the governing board. However, a government's informal policies

or general investment practices are not a required disclosure. For these policies and practices, the government would disclose that no policy had been adopted if a required disclosure was applicable. For example, historically an airport authority has invested in securities rated in the top category of credit risk as issued by nationally recognized statistical rating organizations. The airport authority is not required by an investment policy to invest in top-rated securities but has been doing so for the past ten years absent any investment policy. In this case, the airport authority should disclose that no credit risk policy has been adopted.

Statement 40 indicates that only brief disclosures are required and a government should not include details of its investment policies in its disclosures. Many investment policies are long and can be quite detailed. If broad cash management and investment policies have been adopted, only a brief description of the policy that is related to the risks discussed in Statement 40 should be disclosed.

Q. Statement 3 requires disclosure of the types of investments authorized by legal or contractual provisions. How detailed should this disclosure be?

A. The disclosure should be brief but informative. The objective of the disclosure is to give users basic information about the government's investment environment and its potential risk.

The disclosures can include a citation of the legal provisions that list authorized investments, but that should not be the only information provided. On the other hand, users should not be given needless detail. If the list of investment types authorized by legal or contractual provisions is long and detailed, appropriate summary information may be given. For instance, a state law listing permissible investments may be several pages long, including, for example, specific U.S. agency obligations in which local governments may invest. In this situation, the note disclosure might summarize these authorized investments as "various U.S. agency obligations."

If legal provisions require only that investments be selected on the basis of a prudent-person rule, only that information need be disclosed, that is, the government does not need to disclose the types of investments it selects in adherence to the rule, unless another legal requirement requires the use of specific investment types.

Q. A certain external investment pool is a 2a7-like pool as defined by Statement 31, but is not rated. Is a credit risk disclosure required?

A. Yes. Although the SEC's Rule 2a7 (of the Investment Company Act of 1940) includes restrictions on the type of investments a pool may hold, a 2a7-like pool may still be exposed to credit risk. If the pool is rated, the credit quality of the 2a7-like pool should be disclosed, or if the pool is unrated, the disclosure should indicate that fact.

Q. A state government sponsors an unrated external investment pool. Does Statement 40 require the pool to get a rating?

A. No. In the event that the external investment pool is not rated, the state government and other participants in the pool should disclose the fact that the pool is unrated, as provided in Statement 40, as amended.

Q. After the close of the fiscal year, but before the issuance of the financial statements, a debt investment's credit quality rating is downgraded. Should this be reported as a subsequent event?

A. Statement 56, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*, requires disclosure of subsequent events when the omission of the disclosure would cause the financial statements to be misleading. Whether or not a debt investment's credit quality rating downgrade is material to the reporting entity's financial statements calls for the exercise of professional judgment. Restrictions on the type of investments allowed by legal or contractual provisions and by the government's investment policies may prevent a government from having a large credit risk exposure in a single entity's investment (concentration of credit risk). A single investment's downgrade after the date of the financial statements generally may not represent a subsequent event requiring disclosure. However, should the government have a concentration of credit risk in a single investment, credit quality rating downgrades after the date of the financial statements may expose the government to a significantly higher level of credit risk exposure that may require disclosure as a subsequent event.

Q. A government invests in a mutual fund that restricts its investments to obligations of the U.S. government or those explicitly guaranteed by the U.S. government. Is the credit quality rating of this mutual fund required to be disclosed?

A. Yes. Despite the holdings within the fund's portfolio, mutual funds are exposed to some degree of credit risk. Although certain U.S. government securities and agencies are guaranteed, mutual funds that invest in these securities are not.

Q. Statement 3 required the display of three categories of custodial credit risk. Does Statement 40 require disclosure of information about those three categories?

A. No. An exception-based disclosure requirement was adopted in Statement 40 for reporting custodial credit risk. Categories 1 and 2 disclosures have been eliminated. Disclosure of custodial credit risk is required only when a government has a Category 3 exposure. Because Statement 40 reduces custodial credit risk disclosures to one circumstance, all reference to categories of custodial credit risk has been eliminated.

Q. Are investments in money market funds subject to custodial credit risk disclosures?

A. No. Money-market funds are a type of open-ended mutual funds that are not subject to custodial credit risk.

Q. What makes a custodian an agent of the government? Does the government have to select the custodian? Is a written contract required?

A. A securities custodian is the government's agent if it acts as the representative of the government to protect the government's rights in the securities. In evaluating whether the custodian is the government's agent, the preparer should examine the conditions under which the custodian will release the securities. Factors of (a) who selects the custodian and (b) written evidence of the agency relationship may provide additional evidence of an agency relationship.

The function of a custodial agent is to hold and release securities. To determine whether the custodian is the government's agent, one should determine whether the custodian acts at the direction of the government in holding and releasing securities. The more important of these two functions is the release of securities because improper release can expose the government to risk of loss.

A custodian that is the government's agent will release securities to the government or to someone else at the government's direction without having to obtain approval from anyone else. Further, the government's custodial agent will not release securities owned by the government at someone else's direction without the government's approval. A custodial agent that releases securities owned by the government at someone else's approval and without the government's approval is not acting as the government's agent.

The conditions for release of collateral or repurchase agreement securities pledged to the government differ from the conditions for release of securities owned by the government. This difference is because both the pledgee government and the pledgor counterparty have rights in the securities. A custodian that is the government's agent will not release the securities to the pledgor counterparty or to someone else at the pledgor's direction unless the government (a) approves, (b) informs the custodian it has completed its transaction with the pledgor counterparty, or (c) commits an act of default. Because of the pledgor counterparty's rights in the securities, however, a custodian that is the government's agent probably will also not release the securities to the government or to someone else at the government's direction unless the pledgor counterparty (a) approves or (b) commits an act of default. This requirement for the custodian to protect the rights of the pledgor counterparty does not necessarily diminish the fact that the custodian is the government's agent.

Often a collateral pledge agreement or repurchase agreement permits the pledgor to substitute securities of equal or greater value with the custodian without the specific approval of the pledgee government. Such a situation would not change the fact that the custodian is the government's agent because the collateral pledge or repurchase agreement constitutes the government's prior approval for the release of the securities. However, if the custodian permits substitution by the pledgor counterparty in the absence of the government's current or prior approval, evidence that the custodian is the government's agent would be diminished or eliminated.

The government's selection of the custodian would provide additional evidence that the custodian is the government's agent. However, a custodian that is not selected by the government may still be the government's agent.

In many cases, there will be written evidence of an agency relationship between the government and a custodian. Sometimes, the writing is a contract; in other cases legal provisions serve as written evidence of the relationship. The absence of a writing does not mean that the custodian cannot be the government's agent; however, the preparer would need to closely evaluate the actual relationship between the government and the custodian to determine whether an agency relationship exists.

Q. Is a financial institution's safekeeping department the same as a trust department?

A. No. Financial institutions provide safekeeping services as a normal business function. A trust department is a separate fiduciary function authorized by and regulated under various state and federal laws. Assets held by a trust department as custodial agents for outside parties are considered legally separate from the assets of the financial institution and are held strictly on a fiduciary basis. Custody by a safekeeping department should be evaluated as custody by a financial institution rather than a trust department.

Q. For purposes of risk disclosure, is a certificate of deposit an investment or a deposit?

A. It depends on whether the certificate of deposit is negotiable. Negotiable CDs are securities that normally are sold in \$1 million units and that can be traded in a secondary market; they should be treated as investments for purposes of the disclosure requirements of Statements 3 and 40. Nonnegotiable CDs are time deposits that are placed by depositors directly with financial institutions and that are generally subject to a penalty if redeemed before maturity; they should be treated as deposits for purposes of the disclosure requirements of Statements 3 and 40. Because nonnegotiable CDs are deposits, no interest rate risk or credit risk disclosures are required by Statement 40.

Chapter 3

Cash Flow Statements

GASB Statement 9, *Reporting Cash Flows of Proprietary and Nonexpendable trust Funds and Governmental Entities That Use Proprietary Fund Accounting*, as amended by Statement 34, *Basic Financial Statements – and Management’s Discussion and Analysis*, provide the guidance on presentation of cash flows. The standards require presentation of cash flow by the direct method for all proprietary funds (there is no government-wide cash flow statement). A statement of cash flows is generally not required for discretely presented component units; however, for proprietary component units that are blended (as an enterprise fund) a statement of cash flows would be required for that fund, either presented separately as a major fund, or aggregated with other nonmajor enterprise funds.

Governmental cash flow statements present cash flows in four categories:

- Operating activities
- Noncapital financing activities
- Capital and related financing activities
- Investing activities

Operating activities is the “residual” category, so that cash flow activities that do not meet the definition of noncapital financing, capital and related financing or investing activities are reported in the operating activities category. Operating activities generally result from providing services or producing and delivering goods. Cash flows from operating activities are generally the cash effects of transactions that enter into the determination of operating income.

Noncapital financing activities including borrowing money for purposes other than the acquisition, construction or improvement of capital assets, and repayment of those amounts, including interest. Interfund and intergovernmental receipts and payments are generally noncapital financing activities, as are property and other taxes collected that are not specifically restricted to capital purposes.

Capital and related financing activities include acquiring and disposing of capital assets, borrowing money for the acquisition, construction or improvement of capital assets and repayment of those amounts, including interest, and paying for capital assets obtained from vendors on credit. In a defeasance of debt, the proceeds of the refunding issue used to refund capital debt should be reported as a cash inflow in the capital and related financing category, and the payment to defease the existing capital debt should be reported as a cash outflow in the capital and related financing category.

Investing activities including making and collecting loans (other than program loans), and acquiring and disposing of debt or equity instruments.

Noncash investing, capital and financing activities that affect recognized assets and liabilities, but do not result in cash receipts or cash payments during the period, should be reported.

Questions and answers – cash flow statements

Q. Is the definition of cash and cash equivalents limited to investments with an original maturity of three months or less?

A. Generally, the three-month criterion is the deciding factor. The definition of cash equivalents in Statement 9 refers to short-term, highly liquid investments that are both (a) readily convertible to known amounts of cash and (b) so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. Although this definition appears to be somewhat broad, the reference to “three month or less” provides more specific guidance.

Because the definition of cash equivalents is a vital part of a cash flow presentation, a uniform definition should be used by all government enterprises. Therefore generally only investments with original maturities of three months or less meet the definition of cash equivalents.

Q. How should a negative cash balance be presented in the statement of cash flows?

A. For purposes of the statement of cash flows, a negative cash balance should be assumed to be zero. This is consistent with traditional balance sheet reporting of zero cash and a liability for the negative amount. Because the accumulation of cash flows during the period results in a negative cash balance, an adjustment should be made to the cash flow amounts. An increase to zero in cash balance should be incorporated into the statement of cash flows by reporting an inflow in the noncapital financing activities category. This presentation reports the circumstances as if the banking system implicitly financed the negative cash situation. In the subsequent period, an assumption should be made that the “loan” was repaid, and a noncapital financing outflow should be reported.

The presentation of implicit financing contradicts the requirement that cash flows not be reported unless they actually occur. The alternatives to this solution, however, are impractical and also have their own inconsistencies and contradictions.

Q. Should a cash flow be presented if the proceeds of revenue bonds issued by a finance authority are remitted directly to another organization?

A. No. If bond proceeds are remitted directly to another organization, there are no cash flows to report. If, however, the proceeds are received by the governmental enterprise (deposited in a cash or cash equivalent account of the governmental enterprise) for distribution to another organization, cash flows do occur. The governmental enterprise is operating as an intermediary. Because the cash inflow and cash outflow do not meet the criteria of the capital and relating financing, noncapital financing or investing activities

category, both should be presented in the operating activities category.

Q. If a certificate of deposit that does not meet the definition of a cash equivalent automatically rolls over at maturity, is there a cash flow?

A. No. A cash flow does not occur, unless there is a deposit to or withdrawal from cash or a cash equivalent. Therefore, a rollover does not affect the statement of cash flows. The CD is merely converted from one investment instrument to another.

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

A. Yes. Generally, governments can estimate certain direct method cash flow amounts by adjusting for beginning and ending receivables and payables.

Q. Should all items reported as part of operating income be included in the operating activities category?

A. Not necessarily. Classification of a transaction for operating statement purposes should not dictate its classification in the statement of cash flows. The transaction should first be evaluated according to the definitions of the capital and related financing, noncapital financing and investing activities categories.

Statement 9 definitively states that operating cash flows include “all transactions and other events that are not defined as capital and related financing, noncapital financing or investing activities.” Therefore, operating income should not be considered a criterion for classifying cash flows.

If a transaction is included in operating income and its resulting cash flow meets the definition of a category other than operating activities, the items should be presented as a reconciling item in the reconciliation of operating income to net cash flow from operating activities. For example, if a financing authority includes interest income as a component of operating income, the cash received from interest income should be presented in the investing activities category. The reconciliation of operating income to net cash flow from operating activities should begin with reported operating income, and the interest income amount should be deducted as a reconciling adjustment to operating income, similar to depreciation.

Q. Rent income is often presented in the *nonoperating income* section of the operating statement. Should rent be classified as an operating activity or as some other activity?

A. The basic question is whether rent income meets the classification criteria of the noncapital financing, the capital and related financing, or the investing activities category. If not, the cash flows should be classified as operating activities, because that is the residual category. Rent income is not specifically addressed in Statement 9; however, that should not necessarily lead one to categorize rent as an operating activity. The characteristics of the rent-generating asset should be examined.

The definition of the investing activities does not specifically address the possibility that the investment could be a tangible capital asset such as land; however, the list of investments described is not intended to be all-inclusive. If the land or other capital asset generating the rent income is being held as an investment (because it is being held for appreciation or resale), rent should be classified as an investing activity. If, however, the land or capital asset is being managed solely as a rent-generating operation, the cash inflows from rent should be classified with operating activities.

Q. Where should gains and losses on investments be presented?

A. Gains and losses, per se, should not be presented in the statement of cash flows. Rather, proceeds from the sale of the investments (including gains and losses) should be reported as a cash inflow in the investing activities category.

Q. Investment earnings are sometimes included in operating income. Should the cash flows be classified as an operating activity?

A. No. Investment earnings should be classified in the investing activities category. The statement of cash flows is not intended to replicate, on a cash basis, the operating statement. It is intended to complement the accrual-basis financial statements. The classification of cash flows provides functional information about financing and investing activities. This approach concentrates on the underlying nature of a transaction. Therefore, earnings on investments should be classified as investing activities, regardless of why the investments are made, what the earnings are used for, and where the income is reported on the operating statement. If investment earnings are included in operating income, the related cash flows should be presented as a deduction from operating income in the reconciliation of operating income to net cash flows from operating activities.

Q. How should interest on cash and cash equivalents be presented?

A. Interest earnings, by nature, are an investing activity. Therefore, interest on cash and cash equivalents should be considered an investing activity, even though cash and cash equivalents are not investments.

Q. How should interest on customer deposits be classified?

A. Although customer deposit transactions are considered operating activities, interest earned on the deposits is an investing activity.

Q. Would property taxes levied by a hospital district for care of indigent patients be classified as an operating activity?

A. No. Property taxes, unless levied for capital purposes, should be classified as noncapital financing activities. Even if the amount levied is calculated to finance estimated costs of care of the indigent, it is not a charge for services. Instead, property

tax payers are financing the care of the indigent. The nature of the receipt is a subsidy, which is defined in Statement 9 as noncapital financing activities inflow.

Q. How should refundable customer deposits be classified?

A. Cash flows from deposits made by customers, and the eventual repayment of the deposits, should be classified as operating activities because the transactions do not meet the definitions of either the financing activities or investing activities categories. Although the deposits are refundable, they are not loans from the customers. Therefore, these are not financing activities. And although the deposits may be invested or may otherwise earn interest, the receipts of the deposits are not investing activities.

Q. How should capital contributed by developers and other individuals be classified?

A. Cash contributed specifically to defray the cost of acquiring, constructing or improving capital assets should be presented in the capital and related financing activities category. Noncash transactions (such as the contribution of water and sewer lines by a developer) should be disclosed in a schedule to the statement of cash flows.

Q. How should tap fees be classified?

A. The portion of a fee that is received to defray the operating costs associated with connecting a customer with a utility system and that is reported in operating income should be presented in the operating activities category. Any portion of the fee that is to be used for the specific purpose of defraying the cost of acquiring, constructing or improving capital assets should be presented in the capital and related financing category.

Q. Where should insurance proceeds be presented?

A. Insurance proceeds are specifically identified in only one place in Statement 9 (paragraph 24d), the capital and related financing activities category, which includes proceeds from insurance on capital assets that are stolen, damaged or destroyed. Other insurance proceeds should be classified in the residual category – operating activities.

Q. What are the factors for determining whether a grant received meets the criteria for classification as an operating activity?

A. In Statement 9, the view was adopted that grants received generally should be treated as subsidies. Capital grants should be considered capital and related financing activities, and all other grants should be considered noncapital financing activities. However, it was recognized that certain arrangements that are called “grants” appear to be contracts for services. Grants of this type should be classified as operating activities. The determination of whether a grant is, in substance, a purchase of services requires the exercise of judgment. To be classified as an operating cash inflow, the grant should finance a program that the grantee would not otherwise undertake (for example, a senior citizens’ transportation service). Therefore, the grant is not subsidizing an existing

program. It reimburses the costs of a new program, whose activity is inherently part of the operations of the grantor. A grant with these characteristics should be considered an operating activity.

Q. Should the cash outflows for payroll taxes and employee-related costs, such as fringe benefits, be reported with either “cash payments to employees for services” or “cash payments to other suppliers of goods or services” or should they be reported separately?

A. Statement 9, as amended, requires presentation of cash flows from operating activities by major class, and lists a minimum of seven classes. One of the major classes is “cash payments to employees for services.” Statement 9 does not provide a definition for this or any other of the major classes referred to in paragraph 31. It is reasonable to group cash payments for payroll taxes and fringe benefits with cash payments to employees, even though the cash is not paid directly to the employees. Payroll taxes and fringe benefits are paid on behalf of employees and are an integral part of employment costs.

On the other hand, further detail is encouraged if it would be useful. Therefore, it may be helpful to present cash flows for payroll taxes and fringe benefits separately from payments to employees if the amounts are significant.

Q. Can the reconciliation of operating income to net cash flow from operating activities be presented in notes to the financial statements?

A. No. The reconciliation is a requirement of cash flow reporting and should be presented as part of the statement of cash flows, as a separate schedule (preferably on the same page).

Chapter 4

Risk Financing Activities

Statement 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, addressed issues related to self-insurance and participation in public entity risk pools.

Statement 10 notes that governments are subject to a variety of risks, including:

- Torts
- Theft of, damage to, or destruction of assets
- Business interruption
- Errors or omissions
- Job-related illnesses or injury to employees
- Acts of God
- Other risks of loss of participating entities assumed under a policy or participation contract issued by a public entity risk pool.

Risk management is defined as the process of managing an organization's activities to minimize the adverse effects of certain types of losses. The main elements of risk management are risk control (to minimize the losses that strike an organization), and risk financing (to obtain finances to provide for or restore the economic damages that arise from such losses). Risk financing techniques include risk retention (sometime referred to as self-insurance), risk transfer to and from an insurer (either a commercial insurance company or a public entity risk pool), and risk transfer to a non-insurer.

A key question in this discussion is whether in fact there has been a transfer of risk, or whether risk is retained by the governmental entity. A government may, for example, make a payment in the form of a premium or required contribution to an insurer or pool, with the ultimate charge to the entity determined based on its actual loss experience. If the losses exceed the initial payment, there will be an additional charge to the entity, to fully reimburse the insurer for those losses. If the premium exceeds the losses, there will be a refund to the entity. In this situation, risk has been retained, and the initial payment is more in the nature of a deposit, and the insurer is functioning as a claims servicer.

On the other hand, an insurer may collect premiums it believes will cover the costs of all claims for which the insurer is obligated. If losses exceed the premiums collected, there is no additional assessment; if the losses are less than the premiums, there will be no refund. Except for deductible amounts, it would appear that risk has been transferred to the insurer.

A *public entity risk pool* is defined as "a cooperative group of governmental entities joining together to finance an exposure, liability or risk." Risk may include property and liability, workers' compensation, or employee health care. A pool may be a stand-alone entity or be included as part of another governmental entity that acts as the pool's

sponsor. A governmental entity that acts as a pool's sponsor may also participate in the pool for its own risk management function.

There are four basic types of public entity risk pools:

- Risk sharing pools – in which governments pool risks and funds and share in the cost of losses;
- An insurance-purchasing pool – in which governments pool funds or resources to purchase commercial insurance products;
- A banking pool – in which governments accumulate monies made available to pool members in the event of loss on a loan basis; and
- A claims-servicing or account pool – in which a pool manages separate accounts for each pool member from which the losses of that member are paid.

Pools that represent banking or claims-servicing pools do not represent a transfer of risk. All public entity risk pools account for their activities in enterprise funds, regardless of whether there is a transfer of risk. Premiums or contributions are recognized as revenue over the contract period, in proportion to the amount of risk protection provided. If the premium is subject to adjustment, the premium revenue is recognized as follows:

- If the ultimate premium is reasonably estimable, the estimated premium is recognized as revenue over the contract period.
- If the ultimate premium cannot be estimated, the cost recovery method or the deposit method may be used, until such time as the ultimate premium can be estimated.

A liability for unpaid claims cost (including incurred but not reported claims) should be accrued when insured events occur, or for claims-made policies, in the period in which the event that triggers coverage under the policy or participation contract occurs.

Entities other than pools who conduct self-insurance activities may use the general fund, internal service fund, or (as provided in Statement 66) special revenue funds to account for those activities. In the general fund or special revenue fund, an expenditure and liability for losses should be recognized when:

- Information available before the financial statements are issued indicates it is probable that a loss has been incurred, and
- The amount of the loss is reasonably estimable.

The general or special revenue fund may use any method to determine the charges made to the other funds, but if the total amount charged the other funds exceeds the expenditures and liabilities determined above, the excess amounts are reported as operating transfers.

The same criteria apply to recognition of claims in the internal service fund; however, the internal service fund may use historical or actuarial methods to determine charges to

other funds, provided that they are adjusted over a reasonable period of time so that internal service fund revenues and expenses are approximately equal. In addition, the internal service fund may include a provision for catastrophic losses.

Questions and answers – risk financing and related insurance issues

Q. What is the difference between recognizing revenue under the cost recovery method and the deposit method?

A. Under both methods, revenue is not fully recognized until the ultimate premium can be reasonably estimated. The methods differ regarding the recognition of revenue before the ultimate premium is known. With the cost recovery method, premiums are recognized as revenue throughout the duration of the policy, but only to the extent that claims costs have been incurred. The remainder of the premium is recognized as revenue only when the ultimate premium is reasonably estimable. The deposit method does not recognize any premiums as revenue through the duration of the policy. Only when the ultimate premium is reasonably estimable are premiums recognized as revenue.

The cost recovery method may be more appropriate for retrospectively rated policies. Ultimate premiums for those types of policies are typically based on claims experience. Throughout the policy period, as events that trigger coverage occur and claims costs are incurred, premium revenue can be recognized to the extent that claims costs are probable and estimable. The deposit method may be more appropriate for reporting-form policies, where, for example, the ultimate premium is based on the value of property (for property coverage) or on payroll (for workers' compensation coverage) at some point in the future. At the point that the valuation is made, the ultimate premium can be determined.

Q. What are incurred but not reported (IBNR) claims?

A. IBNR claims include three elements:

- Known loss events that are expected to later be presented as claims;
- Unknown loss events that are expected to become claims; and
- Expected future developments on claims already reported.

IBNR is largely an estimate of loss and claim adjustment expenses associated with future likely activity on incurred claims based on historical actual results that establish a reliable pattern.

Q. How are IBNR claims to be estimated and recognized?

A. IBNR claims are generally estimable. Initially, it may take time to accumulate a history of the proper data if those data are not currently available. If the historical results of an entity are not representative, supplementary analysis, including the use of historical actual results of other entities with similar structure, risk assumptions, and risk exposure, should be considered. Other factors to be considered are changes in operations or the

operating environment, demographic changes, and statutes and regulations.

Other sources of data may be used, for example, the AICPA Audit and Accounting Guide, *Health Care Entities*, provides guidance on the use of statistical and other data to estimate the amount and probability of medical malpractice IBNR claims for a hospital. The concepts in that guide can be applied to risks other than healthcare. In any case, the assistance of an actuary may be desirable, although it is not required.

Statement 10 requires recognition of claims cost, including future development on claims, and related liabilities if they are both probable and reasonably estimable. However, paragraph 27 requires disclosure of the nature of the contingency and a statement that an estimate cannot be made in situations in which a loss is probable but has not been accrued because it is not estimable. It also requires disclosure when a loss is reasonably possible but not probable. The disclosure of a reasonably possible loss should include an estimate of possible loss or range of loss; otherwise it should include a statement that an estimate cannot be made.

Q. When can a claim liability be removed from the statement of net position/balance sheet?

Statement 10 provides that if an annuity is purchased in the claimant's name to satisfy a claim liability *and* the likelihood that the pool will be required to make future payments is remote, the pool should remove the annuity contract (from assets) and the covered liability from the statement of net position/balance sheet. A pool usually pays a lump sum for an annuity contract. That lump sum plus the earnings on it is used to make periodic payments to the claimant under the terms of a settlement with the claimant. However, the pool is generally not completely relieved of responsibility. It should evaluate whether the insurance company or institution from which the annuity contract was purchased can fulfill its obligation to pay out the required annuities.

Unless the claimant has provided the pool with a signed agreement releasing the pool from any and all further obligation, the pool should still include the liability amount in the disclosure of aggregate outstanding liabilities removed from the statement of net position/balance sheet. The requirement for this disclosure is provided because the substance of these transactions is similar in nature to transactions involving an in-substance defeasance.

Q. Do annuity contracts that are held by the pool but that designate the claimant as the annuitant qualify as being "in the claimant's name"?

A. Yes, provided that the pool cannot unilaterally change that designation. The intent of "in the claimant's name" is to distinguish the contracts from those that are held for general investment or other purposes. When contracts are purchased only in the name of the pool or in a name that can be changed unilaterally by the pool, there is nothing that would distinguish the contracts from any other investment. It would be inappropriate to treat these types of investments as having defeased a specific claim liability.

Q. Do the requirements of Statement 10 to account for the estimated costs of unreported claims under a claims-made policy apply only if the policy period ends on or before the statement of net position/balance sheet date?

A. No. The relationship of the policy period ending date and the statement of net position/balance sheet date is not relevant. Under a claims-made policy, risk is transferred to the insurer only to the extent that covered claims are reported during the claims reporting period described in the policy. For example, if a policy period ends on June 30, and an insurable incident occurs on June 29, but is not reported until July 1, it is outside the policy coverage. Unless it has purchased “tail coverage” or the policy has a period beyond the policy year when claims may be reported, the entity would be responsible for payment of the claim. If the entity had a June 30 year-end, it should account for the claim and include any unpaid portion of the liability on the statement of net position/balance sheet.

Q. Under a retrospectively rated policy, when should a liability for premiums be recognized?

A. With this type of policy, final premiums are determined after loss experience is known, and the initial payment under the policy is generally the minimum payment. Under a policy where the entity’s premiums are based just on its own loss experience, there should be a minimum amount of known premium liability that should be recognized. Any amounts above the minimum that are probable and reasonably estimable should be accrued.

Similarly, under a policy where the entity’s premiums are based on the loss experience of a group of entities, at least the minimum premium liability should be recognized. Any amounts above the minimum premium should be accrued if it is probable and estimable.

Chapter 5

Employers' Accounting for Pensions

GASB Statement 68, *Accounting and Financial Reporting for Pensions*, supersedes earlier guidance on pensions, and is effective for periods beginning after June 15, 2014 (June 30, 2015 and later year-ends).

The major change effected by Statement 68 for single and agent employers is the requirement that they record the *net pension liability* (previously referred to as the unfunded liability) in their government-wide and proprietary financial statements. The net pension liability is the total pension liability (the present value of projected benefit payments) less the amount of plan net position (net position restricted for pensions). Projected benefit payments are discounted to present value using a discount rate that combines the expected long-term rate of return (to the extent the plan is funded) and a high-quality, tax-exempt municipal bond fund rate (to the extent the plan is not fully funded). Calculations must conform to standards established by the Actuarial Standards Board, using a single actuarial method (the entry-age normal method). Actuarial valuations are required at least every other year, with more frequent valuations encouraged. The standard establishes several categories of deferred outflows of resources and deferred inflows of resources resulting from pension calculations:

- Differences between expected and actual demographic assumptions (such as attrition and mortality)
- Differences between expected and actual earnings
- Contributions to the plan after the measurement date, if the measurement date is a date other than the reporting date.

Governmental funds will recognize a pension liability and pension expenditures to the extent the above determined liabilities and expenses will require the use of current available resources. There are substantial disclosures and required supplementary information (RSI) provided for in the standard.

Cost-sharing employers record a net pension liability, pension expense and deferred outflows and inflows based on their respective shares of the collective liability, expense and deferred items for the plan. Each cost-sharing employer's respective share is based on the ratio of the employer's contributions to the total contributions to the plan. Accordingly, the standard establishes an additional category of deferred outflows and inflows (in addition to those above) for cost sharing employers, which relates to differences between the employer's current contribution ratio and the expected long-term contribution ratio. Note disclosures and RSI for cost-sharing employers are comparable to those for single and agent employers, but also include presentation of the collective amounts for the plan as a whole.

Cost-sharing employers can elect a measurement date as early as the last day of their previous fiscal year.

Questions and answers – employers’ accounting for pensions

Single and agent employers

Q. A single or agent employer provides pensions to its employees through a defined benefit pension plan that is administered through a trust that has the characteristics identified in paragraph 4 of Statement No. 68. The employer does not have a special funding situation and does not have a payable to the pension plan. If there is no requirement that the employer make contributions to the plan, does Statement 68 apply to the employer?

A. Yes. If the single or agent employer provides benefits to its employees through a defined benefit pension plan that is administered through a qualified trust (or equivalent arrangement), an employer that does not have a special funding situation should follow the provisions of paragraphs 18–47 of Statement 68 for pension liabilities to employees.

Q. A state makes contributions to an Internal Revenue Code Section 457 deferred compensation plan for its employees. Does Statement 68 apply to the employer’s involvement in the Section 457 plan?

A. No. Despite similarities between Section 457 plans and certain plans that are reported by governments as pension plans, for purposes of financial reporting, a Section 457 plan is not classified as a pension plan. This distinction was not modified by Statement 68. Therefore, Statement 68 does not apply to employer reporting for benefits provided through a Section 457 plan.

Q. An employer offers an unfunded (“pay-as-you-go”) plan (that is, the employer’s annual contributions are approximately equal to that year’s benefit payments) that provides supplemental defined benefit pensions to certain employee classes. The plan is administered through a trust that has the characteristics identified in paragraph 4 of Statement 68. Does Statement 68 apply to pensions provided through an unfunded plan?

A. Yes. Regardless of the method or timing of funding the benefits, if the supplemental pensions are provided through a plan that is administered through a trust (or equivalent arrangement), the Statement applies.

Q. Does Statement 68 apply to a governmental employer that provides pensions through a single-employer plan that is administered by the employees’ union if benefits are negotiated periodically (for example, every three to five years)?

A. If the pension plan is administered through a trust (or equivalent arrangement) Statement 68 is applicable to the state or local government whose employees are provided with pensions through the plan. This is the case regardless of the nature of the entity administering the plan or whether the benefits provided through the plan are subject to periodic negotiation.

Q. The terms of a pension specify that an employer is required to contribute 7.5 percent of each employee's annual salary to an individual employee account. Individual employee accounts are credited with interest at a rate of 5 percent per year, as specified in the benefit terms, and are assessed an administrative fee based on the average balance of assets in the account for the year. During retirement, an employee draws down the balance of the account, with interest continuing to accrue at the specified interest rate. Should this pension be classified as defined benefit or as defined contribution for purposes of applying Statement 68?

A. This pension is defined benefit for purposes of applying Statement 68. To be classified as a defined contribution pension, paragraph 10 of Statement 68 specifies that all three of the following criteria are required to be met:

- An individual account is provided for each employee.
- The plan terms define the amount of contributions that the employer is required to make (or credits that it is required to provide) to an active employee's account for periods in which the employee renders service.
- The pension that an employee will receive will depend only on the contributions (or credits) to the employee's account, actual earnings on investments of those contributions (or credits), and the effects of forfeitures of contributions (or credits) made for other employees, as well as pension plan administrative costs, that are allocated to the employee's account.

Although the pension provided in this question meets the first two of these criteria, it does not meet the third criterion because the interest credited to an employee's account is based on a specified rate regardless of the actual earnings on the underlying investments made with the assets in the account. Because the pension does not meet all three of the criteria identified in paragraph 10 of Statement 68 to be classified as defined contribution, it should be classified as defined benefit for purposes of applying Statement 68.

Q. The terms of a pension otherwise meet the criteria in paragraph 10 of Statement 68 to be classified as defined contribution but provide that after an employee retires, the employee has the option to annuitize some or all of their account balance through the purchase of an individual annuity contract with a third party. Is this plan defined contribution for financial reporting purposes?

A. Yes. In the circumstance described in this question, the purchase of the annuity is a separate transaction between the employee and the third party. Because there is no potential for a change in the obligation of the employer related to the amounts that will be provided to the employee as a result of the annuity purchase option, in this case, the annuitization of the employee's account balance does not impact the classification of the pension as defined contribution.

Q. A public employee retirement system (PERS) administers the assets, the payment of benefits, and the general recordkeeping and support services for pensions provided to the employees of three employer governments. A separate actuarial valuation is performed for separate classes of employees (for example, general government employees versus public safety employees), and employers make contributions for each class at the rate for the class applied to the employer's active-employee covered payroll for the class. Plan assets legally are available to pay benefits to any employee. What type of plan(s) is the PERS administering?

A. The classification of the plan depends on whether there is a legal segregation of assets for purposes of providing benefits to the different classes of employees. In this situation, although different rates are calculated for different classes of employees, all plan assets legally are available to pay benefits of any employee, regardless of their employment class. Therefore, this plan is a cost-sharing multiple-employer plan for purposes of applying Statement 68.

Q. For purposes of classifying a defined benefit pension plan as single employer or multiple employer under paragraph 11 of Statement 68, does it matter whether the component unit is discretely presented or blended by the primary government?

A. No. For purposes of paragraph 11 of Statement 68, the primary government and its component unit are considered to be one employer regardless of whether the component unit is discretely presented or blended by the primary government.

Q. A single-employer defined benefit pension plan is used to provide pensions to the employees of a state government and several governments that are component units of the state. In their stand-alone financial reports, should each of the component units report as a single employer?

A. No. Paragraph 18 of Statement 68 requires that component units apply the cost-sharing employer requirements of Statement 68 for their own stand-alone financial reports. Therefore, each government would report its proportionate share of the collective net pension liability and would follow the requirements of paragraphs 48–82 of Statement 68 (for cost-sharing employers that do not have a special funding situation) or paragraphs 92–96 of that Statement (for cost-sharing employers that have a special funding situation). Only in the financial report of the reporting entity (that is, the financial report that includes both the state and its component units) would note disclosures and RSI be presented in conformity with the requirements of paragraphs 37–47 of Statement 68 for a single employer.

Q. What guidance does Statement 68 provide regarding recognizing a portion of the net pension liability in fund financial statements if a portion of the net pension liability of a single or agent employer will be paid from an enterprise, internal service, or fiduciary fund?

A. Except for blended component units, Statement 68 does not establish specific requirements for allocation of the net pension liability or other pension-related measures to individual funds. However, for proprietary and fiduciary funds, consideration should be given to NCGA Statement 1, *Governmental Accounting and Financial Reporting Principles*, paragraph 42, as amended, which requires that long-term liabilities that are “directly related to and expected to be paid from” those funds be reported in the statement of net position or statement of fiduciary net position, respectively.

Q. If a single employer’s fiscal year-end is the same as the fiscal year-end of the pension plan through which it provides benefits, can the employer report a net pension liability as of a measurement date that is one year earlier than the “as of” date of the net pension liability reported by the plan at the same fiscal year-end?

A. Yes. To avoid a circumstance in which employer financial reports potentially would be delayed awaiting information that also is included in the pension plan’s financial report, Statement 68 permits the measurement date of the net pension liability reported by a single or agent employer to be as of a date no earlier than the end of its prior fiscal year provided that the actuarial valuation used to determine the net pension liability meets the timing requirements, and that the measure meets the requirement, and that the plan and the employer use the same assumptions when measuring similar or related information. Single-employer pension plans are required by Statement No. 67, *Financial Reporting for Pension Plans*, to report information about the net pension liability of the employer as of the plan’s fiscal year-end. Therefore, for example, in financial statements as of June 30, 20X5, a single-employer pension plan is required to report a net pension liability measured as of June 30, 20X5, whereas the single employer that provides benefits through the plan can report a net pension liability with a measurement date of June 30, 20X4, if the requirements of paragraphs 22 and 23 of Statement 68 are met.

Q. If an employer participates in more than one defined benefit pension plan, is the employer required to use the same measurement date for each (collective) net pension liability?

A. No. Paragraph 18 of Statement 68 specifies that the requirements of that Statement related to liabilities to employees for pensions, which include the provisions of the Statement for the selection of the measurement date of the (collective) net pension liability, should be applied separately to the pensions provided through each defined benefit pension plan. Therefore, provided that the measurement date for each (collective) net pension liability meets the requirements of Statement 68, the related pension liabilities presented in an employer’s financial report can have different measurement dates. For example, in financial statements for its fiscal year ended June 30, 20X5, an employer can report a net pension liability with a measurement date of December 31, 20X4, for pensions provided through single-employer Pension Plan A and a proportionate share of the collective net pension liability with a measurement date of March 31, 20X5, for pensions provided through cost-sharing Pension Plan B.

Q. If a change occurs in a factor relevant to measurement of the pension plan's fiduciary net position between the measurement date of the net pension liability and the employer's current fiscal year-end, should the net pension liability that is reported by the employer in the current fiscal year be updated to include the effects of the change?

A. No. The employer should report the net pension liability determined as of the measurement date. The effects of a change in the pension plan's fiduciary net position that occurs subsequent to the measurement date of the net pension liability reported in the current fiscal year should be reflected in the net pension liability as of the next measurement date, that is, in the next fiscal year.

Q. If the total pension liability is less than the pension plan's fiduciary net position, should the net balance be displayed in a single or agent employer's statement of net position as a negative net pension liability or as a net pension asset?

A. A net pension liability that is negative is, and should be displayed as, an asset in the employer's statement of net position.

Q. Should a net pension liability (or aggregation of net pension liabilities) be displayed on a separate line on the face of the financial statements?

A. The net pension liability is not required to be displayed separately on the face of the financial statements. However, for some governments, it will be a significant balance, which may be displayed separately on the face of the financial statements. Liabilities for net pension liabilities associated with different pension plans may be aggregated for display, and pension assets for net pension assets associated with different plans may be aggregated for display. However, aggregated pension assets and aggregated pension liabilities should be separately displayed.

Q. Can net pension liabilities associated with different plans be displayed in the aggregate if the liabilities do not have the same measurement date?

A. Yes. Statement 68 does not limit the aggregation of pension liabilities based on measurement dates.

Q. Is the actuarial valuation date required to have the same relationship to the measurement date in each reporting period (or, for employers that have biennial actuarial valuations, to the measurement date in every other reporting period)?

A. No. Unlike the measurement date of the net pension liability, which is required to maintain the same relationship with the employer's fiscal year-end from period to period (for example, in every year, the employer uses a measurement date of June 30 of the prior fiscal year), the date of the actuarial valuation that is used to determine the employer's net pension liability at the measurement date can vary from period to period (or every 2 periods when biennial valuations are used) provided that it is within 30 months and 1 day of the employer's fiscal year-end.

Q. What is the earliest date of an actuarial valuation that can be used as the basis for determining the total pension liability component of the net pension liability reported by a single or agent employer at its June 30, 20X5 fiscal year-end?

A. Paragraph 22 of Statement 68 permits use of an actuarial valuation as of a date 30 months and 1 day earlier than the employer's most recent fiscal year-end as the basis for the total pension liability reported by a single or agent employer. Therefore, in its June 30, 20X5 financial statements, the employer can use the results of an actuarial valuation as of December 31, 20X2, or later.

Q. The measurement date for the net pension liability of a single or agent employer is June 30. Actuarial valuations of the total pension liability component of the net pension liability are obtained annually as of December 31. In conformity with the requirements of paragraph 22 of Statement 68, the results from the mid-year actuarial valuation are updated to June 30. Are there specific procedures that are required for an update for financial reporting purposes?

A. No. Statement 68 does not establish specific procedures for this purpose. Therefore, professional judgment should be applied to determine the extent of procedures necessary to faithfully represent the total pension liability as of the measurement date. In all circumstances, the total pension liability should include all significant effects of transactions and other events between the actuarial valuation date and the measurement date. In some circumstances, for example, if there are few differences between expected and actual experience, no changes in benefit terms, and no circumstances suggesting that a significant change of assumption is needed, it might be reasonable to roll forward the results of the mid-year actuarial valuation to the measurement date with few adjustments. However, in other circumstances, more significant adjustments might be necessary to update the results of the mid-year actuarial valuation to the measurement date. The Statement also requires that in evaluating the extent of procedures necessary to update the measure to the measurement date, among the factors that should be considered is whether a new actuarial valuation is needed for this purpose.

Q. When actuarial valuations are performed biennially, does Statement 68 require an update to the total pension liability in the intervening year for purposes of financial reporting by single or agent employers?

A. Yes. The total pension liability reported in a single or agent employer's financial statements should be a new measure each year, based either on a new actuarial valuation as of the measurement date or on an actuarial valuation performed as of a date no earlier than 30 months and 1 day prior to the end of the employer's fiscal year that is updated to the measurement date. If update procedures are used and significant changes occur in, for example, benefits, the covered population, or other factors affecting the valuation results between the actuarial valuation date and the measurement date of the net pension liability, professional judgment should be used to determine the extent of the procedures

needed to roll forward the measurement of the total pension liability, and consideration should be given to whether a new actuarial valuation is needed.

Q. The amount of a defined benefit pension is determined based on an employee's years of service and final three-year average pay. The calculation of pay for this purpose includes the employee's base salary and overtime pay. Should the projection of benefit payments include an assumption about overtime pay?

A. Yes. In this circumstance, overtime pay should be considered in the projection of benefit payments. Paragraph 24 of Statement 68 requires that the projection of benefit payments include all benefits to be provided to the employees in accordance with the benefit terms. That paragraph further specifically requires that the effects of projected salary changes be included in the projection of benefit payments in circumstances in which the pension formula incorporates future compensation levels. Although not part of the employee's base salary, the pension formula establishes overtime compensation as a relevant factor in determining the amount of an employee's pension. Therefore, consistent with the requirements of paragraph 24 of Statement 68, the projected impact of future overtime compensation on the benefit payments that will be made to the employee should be included in the measure.

Q. A collective-bargaining agreement that includes a provision for a postemployment benefit increase has been made prior to the measurement date of the net pension liability. However, the increase does not go into effect until after the current measurement date. Should the increase in projected benefit payments as a result of this agreement be included in the measurement of the total pension liability?

A. Yes. The actuarial present value of projected benefit payments should include benefits to be provided pursuant to a contractual agreement, including a collective-bargaining agreement, that is in effect at the measurement date. In other words, the issue is whether the agreement is in effect at that date, not whether the benefits included in the agreement will begin to accrue or begin to be paid by that date.

Q. If the actuarial valuation date is earlier than a single or agent employer's measurement date and the long-term expected rate of return assumption remains the same at the measurement date as it was at the actuarial valuation date, does the discount rate have to be evaluated for significant changes between the actuarial valuation date and the measurement date?

A. Yes. A change in the discount rate can occur due to factors other than a change in the long-term expected rate of return. For example, a change in the municipal bond yield or index rate (if used in the determination of the discount rate) or a change in the projected fiduciary net position of the pension plan that affects the relative weighting of the long-term expected rate of return and the municipal bond yield or index rate can affect the discount rate. Therefore, these and other factors, if applicable, should be considered when evaluating whether changes have occurred that should be reflected in the total pension

liability at the measurement date, either through update procedures or through a new actuarial valuation.

Q. As of what date should the long-term expected rate of return and the municipal bond yield or index rate that are used to establish the discount rate be determined—the valuation date or the measurement date?

A. The long-term expected rate of return on pension plan investments is an assumption, and assumptions generally are not required to be updated between actuarial valuation dates unless there is an indication that the assumption is no longer valid. Therefore, the expectation developed as of the actuarial valuation date can be used at the measurement date unless it is determined to no longer be appropriate. In contrast, the municipal bond yield or index rate is not an assumption and should be determined as of the measurement date. If the actuarial valuation to determine the total pension liability is performed earlier than the measurement date, consideration should be given to changes in the municipal bond yield or index rate, along with other factors that potentially affect the discount rate, such as the pension plan's fiduciary net position, to evaluate whether those factors would result in changes that should be reflected in the total pension liability at the measurement date, either through update procedures or through a new actuarial valuation.

Q. At its December 31, 20X3 fiscal year-end, a single or agent employer recognizes a net pension liability with a measurement date of June 30, 20X3. For purposes of reporting pension expense and deferred outflows of resources and deferred inflows of resources related to pensions, over what period should changes in the net pension liability be determined?

A. The changes in the net pension liability to be recognized in conformity with paragraph 33 of Statement 68 are those occurring since the last measurement date—that is, the measurement period. In this circumstance, the measurement period includes all changes after June 30, 20X2 (the prior-year measurement date) and through June 30, 20X3 (the current-year measurement date). With the exception of contributions to the pension plan from the employer subsequent to the measurement date of the net pension liability, which are required by paragraph 34 of Statement 68 to be reported as a deferred outflow of resources related to pensions at the employer's fiscal year-end, changes in the net pension liability that occur after the measurement date are not accounted for until the next fiscal year.

Q. Should the balances of deferred outflows of resources and deferred inflows of resources related to pensions be adjusted for interest?

A. No. All changes, including interest on the total pension liability and changes in the pension plan's fiduciary net position, are included in the net pension liability. Therefore, interest should not separately be calculated on the balances of deferred outflows of resources and deferred inflows of resources related to pensions.

Q. Should balances of deferred outflows of resources and deferred inflows of resources arising from a single source—that is, from differences between expected and actual experience with regard to economic or demographic factors, changes of assumptions, or differences between projected and actual earnings on pension plan investments—in different periods be reported as separate amounts or net of each other?

A. Consistent with the requirements of paragraph 33a of Statement 68, balances of deferred outflows of resources and deferred inflows of resources arising from differences between expected and actual experience in different periods should not be reported net. Similarly, balances of deferred outflows of resources and deferred inflows of resources arising from changes of assumptions in different periods should not be reported net. In contrast, paragraph 33b of Statement 68 requires that deferred outflows of resources and deferred inflows of resources arising from differences between projected and actual earnings on pension plan investments in different periods be netted and reported as deferred outflows of resources related to pensions if the net balance is a debit and reported as deferred inflows of resources related to pensions if the net balance is a credit.

Q. For purposes of determining pension expense, should the balances of deferred outflows of resources or deferred inflows of resources arising from a single source—for example, differences between expected and actual experience with regard to economic or demographic factors—in different periods be aggregated?

A. No. For purposes of determining pension expense, records of the closed-period “layers” arising in each year, as well as the period over which each of the layers is required to be recognized in pension expense, are needed. However, for presentation in the notes to the financial statements, the layers of deferred outflows of resources should be aggregated to present balances of deferred outflows of resources by source, and the layers of deferred inflows of resources should be aggregated to present balances of deferred inflows of resources by source.

Q. What should be included in the amounts reported as deferred outflows of resources for a single or agent employer’s contributions made subsequent to the measurement date?

A. For purposes of paragraph 34 of Statement 68, the deferred outflow of resources reported by an employer should include contributions made by the employer during its fiscal year that will be reflected in the net pension liability in the next measurement period—that is, the amount of contributions through the end of the employer’s fiscal year to be recognized by the pension plan on the accrual basis of accounting in the next measurement period. The deferred outflow of resources would not include the employer’s payments subsequent to the measurement date to satisfy a contribution receivable recognized by the plan prior to the end of the current measurement period.

Q. If, at the measurement date, the pension plan’s fiduciary net position is sufficient to make benefit payments that are due and payable, should any portion of a single or agent employer’s net pension liability be recognized in financial statements prepared using the current financial resources measurement focus and modified accrual basis of accounting?

A. No. In circumstances in which the pension plan's fiduciary net position is sufficient to make benefit payments that are due and payable, no portion of the net pension liability should be recognized in financial statements prepared using the current financial resources measurement focus and modified accrual basis of accounting.

Q. If, at the measurement date, the pension plan's fiduciary net position is not sufficient to make benefit payments that are due and payable, should any portion of a single or agent employer's net pension liability be recognized in financial statements prepared using the current financial resources measurement focus and modified accrual basis of accounting?

A. Yes. In circumstances in which the pension plan's fiduciary net position is not sufficient to make benefit payments that are due and payable, the employer should recognize an amount equal to the amount of benefits due and payable that exceeds the pension plan's fiduciary net position as a net pension liability in financial statements prepared using the current financial resources measurement focus and modified accrual basis of accounting.

Q. If an employer reports pension liabilities that have different measurement dates, is the employer required to update the measures to the same measurement date for purposes of presenting the total pension-related measures required by paragraph 37 of Statement 68 or for disclosing additional information about the pension liabilities that is required by Statement 68?

A. No. Information reported in notes about pension liabilities focuses on conditions as of the measurement date. For purposes of presenting information to meet the requirement of paragraph 37 of Statement 68 for disclosure of the total amounts of pension-related measures if those amounts are not otherwise identifiable from information presented in the financial statements, the employer should disclose the total of the amounts reported in the financial statements for pensions provided through each plan, regardless of differences in their measurement dates. As specified by paragraphs 38 and 75 of Statement 68, the information that is required to be provided in notes should be disclosed for benefits provided through each defined benefit pension plan in which the employer participates. If different measurement dates are used for pensions provided through different plans, the information in notes about each benefit arrangement should reflect its individual measurement date.

Q. Should all contributions made to the pension plan by a single or agent employer during the employer's fiscal year be included in the amount of contributions that paragraph 40d of Statement 68 requires to be disclosed?

A. No. For purposes of paragraph 40d of Statement 68, contributions should include only (a) the amount of actual contributions, which are cash contributions from the employer to the pension plan that would be recognized as additions from contributions in the pension plan's schedule of changes in fiduciary net position during the period that coincides with

the employer's fiscal year, and (b) the amount of contributions from the employer to the pension plan that would be recognized by the pension plan as a current receivable during the period that coincides with the employer's fiscal year. This would exclude, for example, payments made to satisfy employer payables to the pension plan that arose in an earlier fiscal year.

Q. For purposes of providing information about contributions that is required by paragraph 40d of Statement 68, what should be considered a contribution recognized by the pension plan as a current receivable?

A. For purposes of paragraph 40d of Statement 68, current receivables are the portion of pension plan receivables that (a) would be recognized as additions from the employer's contributions during the employer's reporting period and (b) would be collectible within a year as of the end of the employer's reporting period. For example, a receivable recognized by the pension plan for an employer's contributions related to the last month of the employer's fiscal year that have not been paid at that date but that are expected to be paid in the following month would be a current receivable of the pension plan.

Cost-sharing employers

Q. Historically, a cost-sharing employer has contributed 100 percent of its contractually required contributions, which are actuarially determined. Is the employer required to recognize a portion of the collective net pension liability even though it has contributed an amount equal to its contractually required contributions in the past?

A. Yes. Statement 68 requires that a cost-sharing employer recognize its proportionate share of the collective net pension liability determined in conformity with the provisions of paragraphs 48–50 of Statement 68, regardless of whether it has made its contractually required contributions in the past.

Q. If a cost-sharing employer's fiscal year-end is the same as the fiscal year-end of the pension plan through which it provides benefits, can the employer report its proportionate share of the collective net pension liability as of a measurement date that is one year earlier than the "as of" date of the (collective) net pension liability reported by the plan at the same fiscal year-end?

A. Yes. To avoid a circumstance in which employer financial reports potentially would be delayed awaiting information that also is included in the pension plan's financial report, Statement 68 permits the measurement date of the collective net pension liability used by a cost-sharing employer to determine its reported pension liability to be as of a date no earlier than the end of its prior fiscal year, provided that the actuarial valuation used to determine the collective net pension liability meets the timing requirements of paragraph 60 of Statement 68 and that the measure meets the requirement of paragraph 61 of Statement 68 that the plan and the employers use the same assumptions when measuring similar or related information. Cost-sharing pension plans are required by Statement 67 to report information about the (collective) net pension liability as of the

plan's fiscal year-end. Therefore, for example, in financial statements as of June 30, 20X5, a cost-sharing pension plan is required to report a (collective) net pension liability measured as of June 30, 20X5, whereas a cost-sharing employer that provides benefits through the plan can report a proportionate share of the collective net pension liability with a measurement date of June 30, 20X4, if the requirements of paragraphs 60 and 61 of Statement 68 are met.

Q. If an employer participates in more than one defined benefit pension plan, is the employer required to use the same measurement date for each (collective) net pension liability?

A. No. Paragraph 18 of Statement 68 specifies that the requirements of that Statement related to liabilities to employees for pensions, which include the provisions of the Statement for the selection of the measurement date of the (collective) net pension liability, should be applied separately to the pensions provided through each defined benefit pension plan. Therefore, provided that the measurement date for each (collective) net pension liability meets the requirements of Statement 68, the related pension liabilities presented in an employer's financial report can have different measurement dates. For example, in financial statements for its fiscal year ended June 30, 20X5, an employer can report a net pension liability with a measurement date of December 31, 20X4, for pensions provided through single-employer Pension Plan A and a proportionate share of the collective net pension liability with a measurement date of March 31, 20X5, for pensions provided through cost-sharing Pension Plan B.

Q. Can a measure of employer plus employee contributions be used as the basis for an employer's proportion?

A. No. Paragraph 48a of Statement 68 specifies that an employer's proportion is "a measure of the proportionate relationship of (1) the employer . . . to (2) all employers and all nonemployer contributing entities." Employees are specifically excluded from the definition of nonemployer contributing entities in paragraph 139 (glossary) of Statement 68. Therefore, employee contributions should not be considered in the determination of the employer's proportion.

Q. An employer has an expectation that its future contribution requirements will diminish relative to the contribution requirements of all contributing entities and ultimately will be zero—for example, the employer begins providing pensions to new hires through a defined contribution plan, rather than through the cost-sharing plan, so that its future covered payroll and, hence, its future contributions will decrease relative to others over time because contributions are assessed as a percentage of covered payroll. For purposes of paragraphs 48–50 of Statement 68, can the employer assume that its proportion is zero percent because in the long term it expects its required contributions to reduce to zero?

A. No. Even though the employer expects that its share of required contributions ultimately will reduce to zero, it would not be appropriate to use zero percent as its share in the current period because it expects to be required to make contributions in some

future periods. It should use an approach for determining its basis that is consistent with the manner in which contributions are assessed, and if it chooses to use a forward-looking basis as is encouraged in paragraph 48a of Statement 68, that basis should consider both short-term and long-term contribution requirements. For example, the employer could determine its proportion by comparing the present value of its expected future contributions to the present value of the expected future contributions of all contributing entities.

Q. If the total pension liability is less than the pension plan's fiduciary net position, should a cost-sharing employer's proportionate share of the collective net balance be displayed in the employer's statement of net position as a negative liability or as an asset?

A. A net pension liability that is negative is an asset. Therefore, the cost-sharing employer should display its proportionate share of the collective balance as an asset in its statement of net position.

Q. What should be included in the amounts reported as deferred outflows of resources for a cost-sharing employer's contributions made subsequent to the measurement date?

A. For purposes of paragraph 57 of Statement 68, the deferred outflow of resources reported by an employer should include contributions made by the employer during its fiscal year that will be reflected in the net pension liability in the next measurement period—that is, the amount of contributions through the end of the employer's fiscal year to be recognized by the pension plan on the accrual basis of accounting in the next measurement period. The deferred outflow of resources would not include the employer's payments subsequent to the measurement date to satisfy a contribution receivable recognized by the plan prior to the end of the current measurement period.

Q. What is the earliest date of an actuarial valuation that can be used as the basis for determining the total pension liability component of the collective net pension liability, a proportion of which is reported by a cost-sharing employer at its June 30, 20X5 fiscal year-end?

A. Paragraph 60 of Statement 68 permits use of an actuarial valuation as of a date 30 months and 1 day earlier than the employer's most recent fiscal year-end as the basis for the total pension liability that is used to determine a cost-sharing employer's proportionate share of the collective net pension liability. Therefore, in its June 30, 20X5 financial statements, the employer can use the results of an actuarial valuation as of December 31, 20X2, or later.

Q. If, at the measurement date, the pension plan's fiduciary net position is sufficient to make benefit payments that are due and payable, should any portion of a cost-sharing employer's proportionate share of the collective net pension liability be recognized in financial statements prepared using the current financial resources measurement focus and modified accrual basis of accounting?

A. No. In circumstances in which the pension plan's fiduciary net position is sufficient to make benefit payments that are due and payable, no portion of the employer's proportionate share of the collective net pension liability should be recognized in financial statements prepared using the current financial resources measurement focus and modified accrual basis of accounting.

Q. If, at the measurement date, the pension plan's fiduciary net position is not sufficient to make benefit payments that are due and payable, should any portion of a cost-sharing employer's proportionate share of the collective net pension liability be recognized in financial statements prepared using the current financial resources measurement focus and modified accrual basis of accounting?

A. Yes. In circumstances in which the pension plan's fiduciary net position is not sufficient to make benefit payments that are due and payable, the employer should recognize an amount equal to its proportionate share of the amount of benefits due and payable that exceeds the pension plan's fiduciary net position as its proportionate share of the collective net pension liability in financial statements prepared using the current financial resources measurement focus and modified accrual basis of accounting.

Q. Should all contributions made to the pension plan by a cost-sharing employer during the employer's fiscal year be included in the amount of contributions that paragraph 76c of Statement 68 requires to be disclosed?

A. No. For purposes of paragraph 76c of Statement 68, contributions should include only (a) the amount of actual contributions, which are cash contributions from the employer to the pension plan that would be recognized as additions from contributions in the pension plan's schedule of changes in fiduciary net position during the period that coincides with the employer's fiscal year, and (b) the amount of contributions from the employer to the pension plan that would be recognized by the pension plan as a current receivable during the period that coincides with the employer's fiscal year. This would exclude, for example, payments made to satisfy employer payables to the pension plan that arose in an earlier fiscal year.

Q. If a cost-sharing employer uses different proportions to determine its share of different pieces of the collective net pension liability (for example, for different classes of employees), is the employer required to disclose its proportion of the net pension liability for each class?

A. No. Paragraph 80b of Statement 68 requires disclosure of only the employer's overall proportion of the collective net pension liability, with a discussion of the basis on which the proportion is determined.

Q. A cost-sharing multiple-employer plan is used to provide pensions only to volunteer firemen. The volunteers are not paid a salary. Therefore, there is no covered-employee payroll. How does this affect requirements for cost-sharing employer presentation of information in schedules of RSI about measures of the employer's proportionate share of

the collective net pension liability and employer contributions in relation to covered employee payroll?

A. The requirements of Statement 68, paragraphs 81a and 81b, for ratios that present the employer's proportionate share of the collective net pension liability and employer contributions, respectively, as a percentage of covered-employee payroll would not be applicable for employers that provide benefits through this plan. Therefore, those ratios should not be presented in the RSI schedules.

Chapter 6

Financial Statements and Management's Discussion and Analysis

GASB Statement 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments* (as amended) provides overall guidance on financial reporting and disclosures. It is applicable to all states and local governmental entities, including general purpose governments, public school districts, public benefit corporations, public employee retirement systems, public utilities, public hospitals, and for public colleges and universities (through the adoption of Statement 35).

Statement 34 establishes the minimum requirements for reporting as:

- **Management Discussion and Analysis (MD&A)** introduces the financial statements by providing a brief, objective and easily readable analysis of the governmental unit's performance for the year and its financial position at year end.
- **Government-wide financial statements** provide aggregated information about the governmental entity as a whole. These statements provide information about the primary government and its component units without displaying funds or fund types. The financial statements will distinguish between the governmental and business-type activities (separate columns for each) of the primary government and between the total primary government and its discretely presented component units. Fiduciary activities are not presented at the entity-wide level of reporting. This approach uses the "flow of economic resources" measurement focus and the accrual basis of accounting. This means that revenues from exchange transactions will be recorded when earned, and that capitalization of capital assets (including infrastructure) and an allocation of the cost of those assets will generally be required.
- **Fund financial statements** present information about the primary government's major funds and blended component units. Governments will present separate financial statements for governmental and proprietary fund types. A separate statement of fiduciary responsibility will present a balance sheet and changes in net assets of fiduciary fund types. A combined balance sheet for all fund types will no longer be presented. General capital assets (formerly referred to as general fixed assets) and general long-term liabilities will be reported only in the government-wide financial statements, as assets and liabilities of governmental activities. Continuing the current requirements, governmental fund financial statements focus on fiscal accountability and therefore report the flows and balances of current financial resources using the modified accrual basis of accounting. Proprietary and fiduciary fund accounting report operations under the economic resource measurement focus and the accrual basis of accounting.

* **Notes to financial statements**

Governments cannot issue the government-wide financial statements only (or the fund financial statements only). Omission of either would constitute an incomplete set of financial statements. Certain single-program governments may combine their government-wide and fund financial statements.

Major funds always include the general fund, and always exclude internal service funds. Beyond that, major funds within the governmental and proprietary fund categories are determined based on amount of the funds' assets and deferred outflows, liabilities and deferred inflows, revenues, and expenses/expenditures relative to the same totals for the category (10% or more) and for all funds (5% or more). In addition, any other fund which management believes is of sufficient importance to the users of the financial statements can be a major fund. Appropriate identification of major funds is critical, since materiality must be considered for each of the following:

- In the government-wide financial statements:
 - Governmental activities
 - Business-type activities
 - Discretely presented component units in the aggregate
- In governmental and proprietary fund financial statements:
 - Each major fund
 - Nonmajor funds in the aggregate

Questions and answers – financial statements and management's discussion and analysis

Q. If a government (engaged in both governmental and business-type activities) 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 required to be met for both years presented?

A. No. If the government presented *comparative data* (as opposed to comparative statements, notes and RSI), the requirements should be met for the current year (with comparisons to the prior year).

Q. Statement 34 identifies the contents of MD&A. Are governments permitted to discuss other issues, not included in the prescribed requirements?

A. No. Because MD&A is regarded as RSI, the information presented should be limited to the areas required. Nevertheless, each specific requirement should be addressed as described in Statement 34. Some governments will provide only minimal information to meet each requirement, whereas others will provide additional analytical or descriptive data. There is no limit (other than perhaps readability) to the information that may be provided *if it provides additional details about the required elements*.

Information that does not address the required elements should not be presented in MD&A, but may be reported as supplementary information, or could be included in a transmittal letter.

Q. If a government accounts for certain assets held for others (certain deposits, for example) in a governmental or proprietary fund, does Statement 34 require those assets and liabilities to be eliminated for the statement of net position?

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

Q. Can activities that are accounted for in an enterprise fund (a transit system, for example) be reported as governmental activities in the government-wide financial statements?

A. Yes. The terms *activity* and *fund* are not synonymous. “Activity” 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 Statement 34, the statement of activities *usually* follows the categorizations used in the fund financial statements (such that governmental activities are usually accounted for in governmental funds, and business-type activities are accounted for in enterprise funds). Nevertheless, governments can realign their activities if they believe that this would more faithfully represent their operating objectives and philosophies. The reconciliations from the governmental and enterprise fund financial statements would explain the reclassification.

Q. Are governments required to use the “consumption” method of accounting for inventories in the government-wide financial statement of net position?

A. Yes. The consumption method of inventory accounting is consistent with the economic resource measurement focus and the accrual basis of accounting required in the government-wide financial statements. Thus, if the government uses the purchases method in its governmental funds, and the consumption method produces different results, the difference should be included in the reconciliations of governmental fund financial statements to governmental activities.

Q. Statement 37 clarifies that construction-period interest on assets used in governmental activities should not be capitalized. If capital assets used in enterprise funds are financed with general long-term debt, should a portion of the interest on that debt be capitalized as construction-period interest?

A. Generally, no. Statement 34 states that interest on general long-term debt generally should not be allocated to functions or programs as a direct expense. Therefore, unless the debt is expected to be retired by the enterprise fund, it is considered general long-term

debt, and construction-period interest should not be included in the cost of the capital assets constructed.

The interest capitalization requirement in Statement 62 does not require or anticipate matching specific debt to specific assets. Generally that Statement requires a portion of *all* interest expense to be allocated to the costs of *all* assets under construction during the period. Therefore, if the enterprise fund has any type of debt, the portion of the interest expense that theoretically could have been avoided generally should be capitalized as part of the cost of assets constructed during the period.

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 assets or individual assets.

Q. What is “composite depreciation”? Is it 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 rate is applied annually to the acquisition cost of the collection as a whole.

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 asset account of the composite group and be depreciated using the composite rate.

Q. Should the animals in a zoo be considered capital assets and therefore, be capitalized and depreciated over the estimated lives of the animals? Could zoo animals be considered a collection?

A. Zoo animals should be considered to be capital assets, because they meet the definition – assets used in operations that have a useful life of greater than one year. They may also be considered a collection. Collections of works of art, historical assets and similar assets need not be capitalized in the circumstances described in Statement 34.

Only successful breeding colonies of zoo animals would likely meet the requirement in Statement 34 that collections be “preserved.”

Q. Can the statement of net position 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, distinguishing between current and long-term assets and liabilities.

Q. Statement 34 states that all internal balances should be eliminated from the total primary government column. However, because some governments have blended component units with different fiscal years, the internal accounts may be “out of balance” at the reporting date due to the timing difference. In those situations is it acceptable to report an internal balance in the total primary government column?

A. Yes. In those instances, the total primary government column would report an internal balance. Statement 14 requires that the reason for the imbalance be disclosed in the notes.

Q. A government issued general obligation bonds for the purpose of constructing capital facilities for an enterprise fund. The government’s officials have determined that the enterprise fund will make the principal and interest payments on the bonds. On the government-wide statement of net position, would the government report governmental activities with debt but no asset and business-type activities with the asset but no debt?

A. No. NCGA Statement 1, as amended, states that bonds, notes and other long-term liabilities directly related to and expected to be paid from proprietary funds should be included in the accounts of such funds. Therefore, in this situation, the debt should be reported as enterprise fund (and thus BTA) debt, because it is expected that the enterprise fund will repay the debt. If that were not the case, however, in the government-wide statement of net position, business-type activities would report an asset and no debt, and the governmental activities would report debt and no asset.

Q. In the previous question, if the recipient of the capital asset is a discretely presented component unit, rather than an enterprise fund, should the component unit include the debt in its financial statements?

A. A government (in this case, the component unit) should report the general obligation debt of another government as a liability only if it has a legal obligation to repay it. This answer differs from the previous one because the debt is an obligation of the primary government (a separate legal entity), and within its legal entity, the government may *assign* the debt to the fund from which repayment is expected. On the other hand, a component unit is an entity legally separate from the primary government and a similar assignment of debt cannot be made. Both Statements 33 and 34 regard transactions with discretely presented component units as external transactions.

Q. How should a government report correction of an error in previously issued financial statements?

A. A correction of an error is addressed in Statement 62, as amended, which requires that the correction of an error be reported as a restatement of beginning net position/fund balances, 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 position. A correction of an error should be reported as a prior period adjustment. Governments should implement that requirement by either displaying the amount on the face of the statement as an adjustment to *beginning net position/fund balance, as previously reported*, or by displaying *beginning net position/fund balance, as restated*, with an explanation of the restatement in the notes to the financial statements. When comparative statements are presented, corresponding adjustments should be made to the transactions and balances for all periods presented to incorporate the retroactive application of the prior period adjustments.

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 component of net position should include the debt?

A. 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 *net investment in capital assets* component of net position. Rather, that portion of the debt should be included in the same net position 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 position 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” and the remainder in the restricted component. Generally, the effect on net position will be negligible, since the restricted cash will approximate related debt outstanding. Reporting both the restricted cash and the debt in the same classification of net position will prevent one classification from being overstated while another is understated by a similar amount.

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 *net investment in capital assets* component of net position?

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 should be considered as “capital-related.”

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.

Q. If a government has capital assets, but no related debt or deferred inflows of resources, should the net position account be titled “investment in capital assets”?

A. Yes. The net position title “net investment in capital assets” implies that there is capital debt or deferred outflows of resources and may mislead readers if used when there is no debt or deferred inflow of resources.

Q. If outstanding capital debt exceeds the carrying value of capital assets reported, what caption should be used for the net position component?

A. The account title “net investment in capital assets” should be used, even if the amount is negative. Reporting in that manner informs the financial statement reader that there is capital debt.

Q. Should construction retainages payable be considered related debt for purposes of calculating the *net investment in capital assets* component of net position?

A. Yes. A retainage payable represents a liability attributable to the acquisition, construction or improvement of capital assets, and thus would be included in that net position calculation.

Q. When should net position be reported as restricted?

A. Restricted net position, as defined in Statement 34, as amended, should be reported when constraints placed on net position use are either:

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

Q. A general state statute pertaining to local government finances requires that “revenues derived from a fee or charge shall not be used for any purpose other than that for which the fee or charge was imposed.” If certain fees of a local government have been charged for the specific purpose of future infrastructure replacement, should those accumulated fees be reported as *restricted net position* in the statement of net position?

A. Yes. The general statute applies to all jurisdictions in the state and creates a legally enforceable restriction on the use of resources raised through fees and charges. Therefore the residual net position should be displayed in a restricted net position account.

Q. A government passes enabling legislation that creates a new (or incremental) tax and imposes a legally enforceable restriction on the use of the tax revenues. Subsequently, the government uses some of the tax revenues for a purpose not specified by the enabling legislation. Should the net position generated by the tax continue to be reported as restricted?

A. Paragraph 5 of Statement 46 states that when resources are restricted by enabling legislation are used for a purpose other than those set forth by the legislation, the government should reevaluate the legal enforceability of the restrictions. If it determines, in its professional judgment, that the restrictions are no longer legally enforceable, then from that period forward the accumulated resources and the future resources generated by the tax should be reported as unrestricted.

Q. Are there specific criteria that should be considered in determining whether net position is unrestricted?

A. No. Unrestricted net position is the “residual” component of net position. It consists of net position that does not meet the definition of *restricted* or *net investment in capital assets*.

Q. A city uses a single enterprise fund to account for its water and electric utilities. Separate accounts are used for capital assets, liabilities, revenues and expenses of the two utility operations. Can the city report a single “utilities” function in the statement of activities?

A. No. Provision of water and generation and distribution of electricity are *different* activities. The separate accounting satisfies the *identifiable* criterion. The city should report, for example, “Water Utility” and “Electric Utility” as separate functions or programs in the statement of activities.

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. As explained in the Basis for Conclusions in Statement 34, 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.

Q. Is 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.

Q. Are governments allowed to report fines and forfeitures separately from other revenues in the charges for services category?

A. Yes. A government may present significant components of program revenue categories in separate columns under the category heading. For example, if fines and forfeitures are significant, a government may choose to present a separate column for fines and forfeitures under the “Charges for Services” heading, or it may retitle the single column to be more descriptive, for example, “Charges for Services, Fees, Fines and Forfeitures.”

Q. State law explicitly prohibits using revenue from fines to finance the expenditures of a public safety, police or traffic enforcement function. In this circumstance, should fines be reported as general revenue, because they cannot be used to offset the expenses of the specific function that may have generated those revenues?

A. No. Charges for services, which include fines, should be reported as program revenue of the function that generates it, regardless of whether there are restrictions or limitations on the use of that revenue. Fees, fines and charges do not have to be based on the cost of the underlying program or function. The concept of “net cost” reporting in the statement of activities is based on the notion that all functions or programs require the use of government resources, and some contribute to the government’s resources by generating revenues through fees, fines and charges, or by accepting grants and contributions from parties outside the government. The “net cost” of a function or program is the difference between (a) the expense and (b) the charges, fees, and fines that derive directly from it and the grants and contributions that are restricted to it.

Q. In some communities, revenues from fines can be substantial and may even be one of the most significant revenues in the general fund. Because these communities rely on fines as an important source of financing for many activities, would it be more appropriate to report fines as *general revenues*, similar to other revenues that fund multiple programs?

A. No. As indicated in the previous answer, the *use* of revenues from fees, fines, and charges does not affect the classification as program revenue. The only consideration for nontax revenues is: “From which function does the revenue derive?”

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 programs and report it as program revenue?

A. No. Statement 34 requires 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.

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

A. No. The requirement applies to taxes levied or imposed by the reporting government on its own taxpayers. 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 of Statement 34.

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

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 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.

Q. State law requires that 20 percent of the state's lottery sales revenue 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 Statement 34, as amended, the revenue derives directly from the program itself. However, presentation of charges for services as 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 education programs) reduces the state's need to use general revenues to support the education function.

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. Statement 34 clearly states that fund statements should present the financial information of each major fund in a separate column. 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 fund column would similarly obscure the information about important individual funds.

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

A. No. 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.

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. 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.

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

A. No. Governments should not include internal service fund data in the major fund calculation. 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. 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.

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. Statement 34 requires a separate column to be presented for each fiduciary fund type (pension and other employee benefit trust funds, investment trust funds, private-purpose trust funds, and agency funds).

Q. A government that prepares comparative financial statements is required to report two individual funds as major funds in the current year that were included in the nonmajor funds aggregation in the prior year. Should the major/nonmajor fund presentation from the prior year be restated so that the nonmajor fund ending fund balances reported in the prior year will agree with the beginning fund balances presented in the current year?

A. No. The statements for the prior year should present the major/nonmajor fund detail as it resulted from the application of the major fund criteria at that time. Even though the beginning fund balances for the nonmajor funds will not agree with the ending balances presented in the prior year, the fund balances for the total governmental funds are not affected by the change in major funds. The government should consider disclosing an explanation of the difference in the notes.

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. 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, it would be evaluated against the major fund criteria with the reporting entity's other governmental funds.

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 revenue and expenses, which include both operating and nonoperating categories.

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 or reclassify it as a transfer. Liabilities arising from interfund transactions do not constitute long-term liabilities and therefore should be reported in governmental funds. 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.

Q. For governmental funds, how should long-term receivables and deferred inflows of resources be recognized?

A. Recognition of assets (in this case, long-term receivables) and revenues for exchange transactions is determined by when revenue is earned and when it becomes available. Asset and revenue recognition in 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 reported as a deferred inflow of resources in governmental funds.

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 that is an extraordinary or special item in the statement of activities, but not in the fund financial statements) can also occur. For example, a local government assumes the debt of another organization, either because it is required to as a guarantor, or because it has a moral obligation to do so. There has been no flow of financial resources; thus there is no extraordinary or special item 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 position and would be reported.

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 would it be reported in the statement of activities?

A. In the enterprise fund’s financial statements, 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. 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 position. If the grant was restricted to that specific activity, the government would report it as

program revenue (either operating or capital, as appropriate) in the statement of activities. If it was not restricted to that activity, the grant would be reported as general revenue in the statement of activities.

Q. What disclosures should a phase 3 government that does not elect to retroactively report infrastructure make for infrastructure that is not included in the basic financial statements?

A. The requirements related to the selection of accounting policies and methods from existing acceptable alternatives and the requirement to disclose the policy for capitalizing assets would apply. Phase 3 governments that do not elect to retroactively report infrastructure should include a statement in their summary of significant accounting policies, on an ongoing basis, such as “General infrastructure assets acquired prior to July 1, 2003, are not reported in the basic financial statements.” “General infrastructure assets include all roads and bridges and other infrastructure assets acquired subsequent to July 1, 2003” or other language that indicates how infrastructure was capitalized.

Q. If a special revenue fund does not meet the percentage criteria (to be a major fund) but is reported as a major fund because the government believes it is particularly important to users, is a budgetary comparison schedule required for that “major” special revenue fund?

A. Yes. The extended use of major fund reporting 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) should be met.

Q. A government presents its budgetary comparison in a schedule as RSI. Can a budget-to-actual comparison for a nonmajor special revenue fund be included in that schedule?

A. No. The information presented in RSI is limited to that which is *required*. Statement 34 sets the scope of the budgetary comparison as the general fund and major special revenue funds. Therefore, because the schedule can only include major special revenue funds, *any special revenue fund presented is a major fund*, regardless of whether it would otherwise be required to be reported as such under the percentage criteria. Thus, the consequence of presenting additional special revenue funds in the budgetary comparison schedule is that those funds are subject to all major fund reporting requirements, and are therefore not considered nonmajor.

Q. Does the “final budget” include amendments made after the end of the fiscal year?

A. Yes. The final budget should incorporate amendments regardless of when signed into law or otherwise legally authorized.

Chapter 7 Other Guidance

In this last chapter, we will address a variety of topics.

Statement 31, Accounting and Financial Reporting for Certain Investments and External Investment Pools

Statement 31 established fair value standards for the following investments when held by most state and local governments:

- Participating interest earning contracts having a remaining maturity at purchase which exceed a year
- External investment pools
- Open-ended mutual funds
- Debt securities
- Equity securities, option contracts, stock warrants, and stock rights which have readily determinable fair values

Fair value accounting is required for all investments held by external investment pools and for certain investments of defined benefit pension plans.

Entities (other than external investment pools) who hold money market securities and participating interest earning contracts may report those investments at amortized cost, if the remaining maturity is one year or less at purchase. Money market investments are short-term, highly liquid debt instruments including commercial paper, bankers acceptances and U.S. Treasury and Agency obligations.

External investment pools may report short-term investments at amortized cost, if the remaining maturity at the balance sheet date is 90 days or less. Changes in fair value are reported with investment income in the operating statement. Disclosure requirements include:

- Methods and assumptions used to estimate fair value, if it is not readily determinable from market prices
- Policies for determining and reporting investments at amortized cost, if applicable
- Funds that receive investment income from investments recorded in another fund, if applicable

Entities who disclose realized gains and losses should also disclose that the calculation of realized gains and losses is independent of the change in fair values, and that gains and losses related to investments which have been held in more than one period were included in the net change in fair value of investments in the current and prior year.

Although the GASB intended to include basically all investments in Statement 31, a few specific items were not included within its scope:

- Long-term securities placed in an irrevocable trust that meets the requirements of a legal or in-substance defeasance
- Seized debt securities that the government holds as evidence or potential fine
- Equity securities accounted for by the equity method
- Loans receivable arising from real estate lending activities (e.g. mortgage loans)
- Equity securities that do not have readily determinable fair values
- Joint venture investments
- Securities held for purposes other than investments (such as performance deposits)

Questions and answers – Statement 31

Q. How does fair value consider accrued interest?

A. Accrued interest is not considered in fair value; it must be added to a quotation. For example, a bond may be quoted at “105 plus accrued interest”. This means that the price (fair value) is 105% of the face amount, plus interest from the last payment date to the date of purchase.

Q. Can internal accounting records for investments be maintained on the cost basis, with the fair value adjustments made only for financial reporting purposes?

A. Yes. There is no requirement to journalize the fair value. Cost-based records are acceptable, as long as the fair value is presented in the GAAP financial statements.

Q. A government agency has a note maturing in two years with an option that makes the note callable in six months. Is this a money-market instrument that can be reported at amortized cost?

A. No. The call feature makes the investment a structured note, and Statement 31 does not allow any structured notes to be considered a money-market instrument. Accordingly, it must be reported at fair value.

Q. Should investment transactions be recorded on the trade date or the settlement date?

A. Investment transactions should be accounted for as of the trade date, since that is the date on which the valuation for the purchase or sale has been determined.

Q. Can the proprietary funds report the fair value change as nonoperating revenue?

A. Yes, provided investment income is also reported as nonoperating revenue.

Q. How should negative investment income be reported?

A. Negative investment income should be reported as negative revenue, not as an expense.

Q. If an entity discloses realized gains and losses, what disclosures are required?

A. Statement 31 prohibits the separate display of realized gains and losses in the financial statements. However, it does allow the disclosure in the notes provided that the entity indicates the following:

- The calculation of realized gains and losses is independent of a calculation of the net change in the fair value of investments
- Realized gains and losses on investments that had been held in more than one fiscal year were included as a change in the fair value of investments reported in the prior year(s) and the current year.

Q. If a local government has an investment account at a local bank, and the bank pools moneys from other local governments into investments, is this an external investment pool?

A. Yes. A nongovernmental entity may administer an external investment pool.

Q. A county collects property taxes on behalf of the local governments within the county. These moneys are invested in the county's investment pool until the amounts are remitted the next month. Is this an external investment pool?

A. No. The local governments view this arrangement as a receivable from the county and not an investment.

Statement 33, *Accounting and Financial Reporting for Nonexchange Transactions*

GASB Statement 33 provides standards for nonexchange transactions involving financial or capital resources (e.g., most taxes, grants, and private donations). In a nonexchange transaction, a government gives or receives value without directly receiving or giving equal value in return. Statement 33 addresses the *timing* of recognizing nonexchange transactions.

Four types of nonexchange transactions are identified:

- *Derived tax revenues* result from assessments imposed on exchange transactions (income and sales taxes, and other assessments on earnings or consumption)
- *Imposed nonexchange revenues* result from assessments imposed on nongovernmental entities

- *Government-mandated nonexchange transactions* occur when a government at one level provides resources to a government at another level and requires the recipient to use the resources for a specific purpose (federal programs that states or local governments are mandated to carry out)
- *Voluntary nonexchange transactions* result from legislative or contractual agreements entered into willingly by the parties to the agreement (certain grants and private donations)

Statement 33 makes a distinction between:

- *Time requirements*, which specify the period when resources are required to be used, or when use may begin, or whether the resources can be expended at all, and
- *Purpose restrictions*, which specify the purpose for which resources are required to be used.

Under Statement 33, assets, liabilities and expenditures/expenses should be recognized at the same time, regardless of whether the accrual or modified accrual basis of accounting is followed. However, for revenue to be recognized under the modified accrual basis, the *measurable* and *available* criteria must also be met. Timing of recognition criteria for each of the four types of nonexchange transactions are as follows:

Derived tax revenues (such as income or sales taxes):

- Assets should be recognized when the underlying transaction occurs, or the resources are received, whichever occurs first.
- Revenues should be recognized when the underlying transaction occurs, except that under the modified accrual basis, the resources must also be available. If the resources are received *before* the underlying transaction has occurred, deferred inflows of resources should be recognized.

Imposed nonexchange revenues (such as property taxes):

- Assets should be recognized when the government has an enforceable lien or legal claim to the resources, or the resources are received, whichever occurs first.
- Revenues should be recognized in the period when use of the resources is required or first permitted by time requirements (for example, for property taxes, the period *for which* they are levied), or at the same time the assets are recognized, if no time requirements have been established. Resources received or recognized as receivable before the time requirements are met should be recognized as deferred inflows of resources.

Government-mandated and voluntary nonexchange transactions:

- Assets (and liabilities) should be recognized when all applicable eligibility requirements have been met or resources are received, whichever occurs first. Eligibility requirements are established by the resource provider, and may stipulate qualifying characteristics of recipients, time requirements, allowable costs and other requirements.
- Revenues (and expenditures/expenses) should be recognized when all applicable eligibility requirements have been met, except that on the modified accrual basis, the available criteria must also be met. For transactions in which the resource provider requires that the recipient use the resources in or beginning in the following period, resources provided prior to that period should be accounted for as advances (for providers) or deferred inflows (for recipients). For transactions such as permanent endowments, in which the provider stipulates that resources should be maintained intact in perpetuity, for a specified number of years, or until a specific event occurs, resources should be recognized as revenues when received and as expenditures/expenses when paid.

Questions and answers – Statement 33

Q. Are research grants exchange transactions or nonexchange transactions?

A. Some are nonexchange transactions, some are exchange transactions, and some have elements of both exchange and nonexchange transactions. Each grant should be evaluated for elements that qualify as exchanges. Professional judgment is required to determine if the values exchanged are essentially equal. Elements that do not have the characteristics of an exchange transaction should be accounted for as voluntary nonexchange transactions.

Q. Are donated food commodities within the scope of Statement 33?

A. Yes. Statement 33 applies to nonexchange transactions involving capital or financial resources. The fair value of donated commodities should be recognized as revenue in the period when all eligibility requirements have been met (typically, the period in which the commodities are received).

Q. Are governments required to estimate their sales tax accruals if actual data are not known?

A. Yes. Statement 33 discusses situations in which one government administers and collects other governments' local option sales taxes. It states that, because those other governments impose the tax or other revenue source, they should have or can reasonably estimate the accrual basis information necessary to comply with the requirements for derived tax revenues or imposed nonexchange revenues. If accrual information is estimable when another government collects the tax, it also is estimable when a government collects its own tax.

Q. Statement 33 states that “governments should recognize revenues from property taxes, net of estimated refunds and estimated uncollectible amounts, *in the period for which the taxes are levied...*” (subject to the availability criterion in governmental funds). An independent school district files a property tax levy. The levy is processed and collected by a county that has a different fiscal period. The levy is assessed on property owned during yet another fiscal period. What is the period for which the taxes are levied?

A. The laws and regulations governing the levy determine the period for which the taxes are levied. That period will generally coincide with the budget or fiscal period of the entity initiating the levy. All governments subject to the same laws and regulations should use the same period.

Statement 54, *Fund Balance Reporting and Governmental Fund Definitions*

Statement 54 is designed to enhance the usefulness of fund balance information by providing clearer fund balance classifications that can be more consistently applied and clarifying the existing governmental fund type definitions. The standard establishes fund balance classifications that comprise a hierarchy based on the extent to which a government is bound to observe constraints imposed on the use of the resources reported in governmental funds.

An important distinction that is made in reporting fund balance is between amounts that are considered *nonspendable* (i.e., fund balance associated with assets that are *not in spendable form*, such as inventories or prepaid items, long-term portions of loans and notes receivable, or items that are legally required to be maintained intact (such as the corpus of a permanent fund) and those that are *spendable* (such as fund balance associated with cash, investments or receivables).

For purposes of reporting net assets (i.e., in the government-wide financial statements) Statement 34, paragraph 35 requires that amounts that are “required to be retained in perpetuity” be classified as “nonexpendable” within the restricted net assets category. For fund balance reporting (i.e., in the governmental fund financial statements) those amounts should be classified as nonspendable, rather than restricted.

Amounts in the spendable fund balance category are further classified as *restricted*, *committed*, *assigned* or *unassigned*, as appropriate.

Restricted fund balance represents amounts that are constrained:

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

Enabling legislation authorizes the government to assess, levy, charge or otherwise mandate payment of resources (from external resource providers) and includes a *legally*

enforceable requirement that those resources be used only for the specific purposes stipulated in the legislation. *Legal enforceability* means that a government can be compelled by an external party (citizens, public interest groups or the courts) to use resources created by enabling legislation only for the specified purpose.

Committed fund balance represents amounts that are useable only for specific purposes by formal action of the government's highest level of decision-making authority. Such amounts are not subject to legal enforceability (like restricted amounts), but cannot be used for any other purpose unless the government removes or changes the limitation by taking action similar to that which imposed the commitment. Committed fund balance should also incorporate contractual obligations to the extent that existing resources in the fund have been specifically committed for use in satisfying those contractual requirements.

Assigned fund balance represents amounts that are *intended* to be used for specific purposes, but are neither restricted nor committed. Intent should be expressed by:

- The governing body itself, or
- A subordinate high-level body or official which the governing body has delegated the authority to assign amounts to be used for specific purposes.

Assigned fund balance includes:

- All remaining spendable amounts (except for negative balances, discussed below) that are reported in governmental funds *other than the general fund*, that are neither restricted nor committed, and
- Amounts in the general fund that are intended to be used for a specific purpose in accordance with the provisions of the standard.

By deciding to report spendable amounts that are not restricted or committed in a special revenue, capital projects, debt service or permanent fund, the government has *assigned* those amounts to the purposes of the respective funds. Assignment within the general fund conveys that the intended use of those amounts is for a specific purpose that is narrower than the general purposes of the government overall. However, governments should not assign fund balance to a specific purpose if the assignment would result in a deficit in unassigned fund balance.

An appropriation of existing fund balance to eliminate a projected budget deficit in the subsequent year's budget in an amount no more than the excess of appropriations over anticipated revenues meets the criteria to be classified as an assignment of fund balance, but should not result in a deficit in unassigned fund balance.

Unassigned fund balance is the residual classification for the general fund. It represents the amounts that have not been assigned to other funds, and that have not been restricted, committed, or assigned to specific purposes within the general fund. The general fund should be the only fund to present a positive unassigned fund balance. In other governmental funds, if expenditures incurred for specific purposes exceeded the amounts

restricted, committed or assigned to those purposes, it may be necessary to report a negative unassigned fund balance, as discussed below.

An individual governmental fund could include spendable amounts that are restricted, limited, assigned, or any combination of the three classifications. The general fund would also include an unassigned amount.

In a governmental fund other than the general fund, expenditures incurred for a specific purpose might exceed the amounts in the fund that are restricted, committed and assigned to that purpose and a negative residual balance for that purpose may result. If so, amounts assigned to other purposes in that fund should be reduced to eliminate the deficit. If the remaining deficit eliminates all other assigned amounts in the fund, or if there are not amounts assigned to other purposes, the negative residual amounts should be classified as *unassigned*. A negative residual amount should not be reported for restricted, committed or assigned amounts in any fund.

Rainy-Day funds (also known as stabilization funds) may be created and amounts set aside for use in emergencies or when revenue shortages occur or budget imbalances arise. The authority to create or set aside amounts generally comes through statutes, ordinances, resolutions, charters or constitutions. Under the standard, stabilization is a specific purpose, and stabilization amounts should be reported within the general fund as restricted or committed, based on the criteria above. Stabilization amounts that do not meet the criteria to be reported within the restricted or committed fund balance classifications should be reported as unassigned.

Presentation

Both categories of nonspendable fund balance may be presented separately, or they may be presented as one amount in the aggregate. Restricted amounts may be displayed in a manner that distinguishes between the major restricted purposes, or it may be displayed in the aggregate. Similarly, committed and assigned fund balances may be displayed in sufficient detail so that purposes of major commitments and assignments are evident to the reader, or they may be presented in the aggregate.

Questions and answers – Statement 54

Q. Should the classifications of unrestricted fund balance – committed, assigned and unassigned – also be applied to unrestricted net position in proprietary funds and in the government-wide statement of net position?

A. No. The classifications should only be used in the governmental fund financial statements.

Q. Statement 54 states that long-term receivables and property held for resale should not be included in the calculation of nonspendable fund balance if the proceeds from their

collection or sale are restricted, committed or assigned. Does that provision also apply to other nonspendable items, such as inventories and prepaid amounts?

A. No. Inventories and prepaid amounts reported in governmental funds are examples of nonspendable items that are not expected to be converted to cash, so it is expected that there would not be any restricted, committed, or assigned collections or sale proceeds associated with inventories or prepaid amounts.

Q. A government is awarded a transportation study grant with the condition that it is required to provide a 20% match of the grant award. The government receives the grant proceeds and deposits them in a separate special revenue fund. The government's matching amount is transferred in from the general fund. How should the amount transferred in be classified?

A. The government's 20% match, regardless of whether it is transferred to the special revenue fund or retained in the general fund, becomes bound by the same constraints imposed by the grantor agency on the award. Therefore, both the grant proceeds and the government's matching amount would be classified as restricted resources.

Q. A special revenue fund is used to account for the proceeds and use of federal grant money that is restricted to a specified purpose. Does the interest earned on the investment of those resources also constitute a restricted revenue source?

A. If the grant agreement requires that interest earned on invested grant proceeds can be used only for the same purpose as the grant award, the interest should be considered a restricted revenue source. If the grant agreement does not include such a provision, then the interest earned, if retained in the fund, should be classified as assigned to the purpose of the fund.

Q. Should the amount reported in governmental funds as restricted fund balance equal the amount reported as restricted net position for governmental activities in the government-wide statement of net position?

A. There are three reasons why those amounts will generally be different. First, the principal amount of a permanent fund is classified as nonspendable fund balance in the governmental fund financial statements, but is included in restricted net position in the government-wide statement of net position. Second, reconciling items that represent basis of accounting differences may cause the amounts to be different. And finally, internal service fund net position is generally included with governmental activities.

Q. What effect does the legal adoption of budget and appropriation documents for the subsequent year have on fund balance classification?

A. An adopted appropriation ordinance, resolution or similar legislation generally authorizes a government to spend budgeted revenues and other financing sources, and therefore, does not impose constraints on the use of existing resources. However, if a

portion of existing fund balance is included as a budgetary resource in the subsequent year's budget to eliminate a projected excess of expected expenditures over expected revenues, then that portion of fund balance (in an amount no greater than is necessary to eliminate the excess) should be classified as assigned. The amount should not be classified as committed, because the governing body does not have to take formal action to remove or modify that specific use – the purpose assignment expires with the appropriation.

Q. Expenditures have been made in a capital projects fund from resources that were advanced from the general fund, in anticipation of bond proceeds that will be restricted to the purpose for which those expenditures have been made. Should the capital projects fund report negative restricted fund balance?

A. No. Statement 54 provides that a negative fund balance should not be reported for restricted, committed, or assigned fund balance in any fund. The capital projects fund should report negative unassigned fund balance.

Q. How should unassigned fund balance of the general fund of a blended component unit be classified when it is reported as a special revenue fund of the primary government?

A. Unassigned fund balance of the general fund of a blended component unit should be reclassified as assigned, committed, or restricted based on the process through which those resources of the component unit could be used for other purposes of the primary government.

Q. Can the general fund report a deficit in unassigned fund balance if there are assigned fund balances in other governmental funds?

A. Yes. Each fund stands on its own for purposes of fund balance classifications. The focus of the fund balance classifications is on resources within a fund. The provision of Statement 54 that states that assignments should not cause a deficit in unassigned fund balance to occur is limited to assignments made within the same fund.