



PAUL A. COPLEY

Essentials of Accounting for Governmental and Not-for-Profit Organizations

FOURTEENTH EDITION

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Essentials of Accounting for Governmental and Not-for-Profit Organizations

Fourteenth Edition

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ESSENTIALS OF ACCOUNTING FOR GOVERNMENTAL AND NOT-FOR-PROFIT
ORGANIZATIONS, FOURTEENTH EDITION

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Preface

Thank you for considering the fourteenth edition of *Essentials of Accounting for Governmental and Not-for-Profit Organizations*. The focus of the text is on the preparation of external financial statements. The coverage is effective in preparing candidates for the CPA examination. I have used the text with traditional three-semester-hour classes, with half-semester GNP courses, and as a module in advanced accounting classes. It is appropriate for accounting majors or as part of a public administration program. Both the FASB and GASB issued major new standards since the previous edition:

1. *GASB Statement No. 84: Fiduciary Activities* (Chapter 7). This standard changes the categories of fiduciary activities and the reporting requirements of custodial (formerly agency) funds.
2. *FASB Accounting Standards Update 2018-08: Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made* (Chapter 10). This standard clarifies a number of issues including distinguishing exchange transactions from contributions. Additionally, the standard distinguishes between donor conditions and donor restrictions and illustrates the accounting for each. Grant accounting, in particular, is affected by this standard.
3. *FASB Accounting Standards Update 2016-14: Presentation of Financial Statements of Not-for-Profit Entities* (Chapter 10). This standard alters the format of the Activity Statement as well as providing new residual equity account titles. The Statement of Functional Expense is required of all not-for-profits while a reconciliation between the Activity Statement and Cash Flows from Operations is no longer required.

Health care entities, in particular, are affected by *FASB Accounting Standards Update 2014-09: Revenue from Contracts with Customers*. Chapter 12 now summarizes the major elements of this comprehensive standard in the context of accounting for hospitals. The standard requires health care entities to estimate implicit price concessions as part of recognition of revenue.

The fourteenth edition has been updated for other new standards, including

- *GASB Statement No. 83: Certain Asset Retirement Obligations* (Chapter 6)
- *GASB Statement Nos. 87: Leases* (Chapter 9)
- *GASB Statement No. 89: Accounting for Interest Costs Incurred before the End of a Construction Period* (Chapter 6)

The text contains a discussion of the *GASB Codification of Financial Reporting Standards*. References are made throughout the text to specific segments of the Codification. With the implementation of *GASB 54* (Fund Balance Reporting), the last vestige of budgetary accounting is phased out of government financial statements. The fourteenth edition continues to provide budget and encumbrance journal entries, but presents these as distinct accounts that are not commingled with the accounts appearing in the basic financial statements. This approach should reduce confusion sometimes experienced by students, particularly with the recording of encumbrances.

Among the more challenging aspects of state and local government reporting is the preparation of government-wide financial statements. The approach demonstrated in the text is similar to that used in practice. Specifically, day-to-day events are recorded at the fund level using the basis of accounting for fund financial statements. Governmental activities are recorded using the modified accrual basis. The fund-basis statements are then used as input in the preparation of government-wide statements. The preparation of government-wide statements is presented in an Excel worksheet. This approach has two advantages: (1) it is the approach most commonly applied in practice, and (2) it is an approach familiar to students who have studied the process of consolidation in their advanced accounting classes. State and local government reporting is illustrated using an ongoing example integrated throughout Chapters 4 through 8 and 13.



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- **Instructor Guide**
- **PowerPoint Slides**
- **Excel-based Assignments**
- **Additional Practice Set**

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Chapter One

Introduction to Accounting and Financial Reporting for Governmental and Not-for-Profit Organizations

No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law; and a regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time. Article 1, Section 9: The United States Constitution

If men were angels, no government would be necessary. If angels were to govern men, neither external nor internal controls on government would be necessary. James Madison, fourth president of the United States and principal author of the U.S. Constitution

Learning Objectives

- Obtain an overview of financial reporting for nonbusiness entities.
- Distinguish between private and public sector organizations.
- Identify the sources of authoritative accounting standards for various public and private sector organizations.
- Define the 11 fund types used by state and local governments.

In its relatively short existence, the United States has grown to be the largest and most successful economy in history. Why then would a country founded on the principles of free markets and private investment rely on governments to provide many goods and services? The answer lies in understanding the incentives of a free enterprise economy. There are many services that simply cannot be priced in a

way that naturally encourages commercial entrepreneurs to enter the marketplace. Commonly this is because the service is subject to free-riding. For example, public safety and a clean environment benefit all citizens, whether or not they contribute to its cost. In other instances, free market incentives do not align with public interest. For example, society finds it desirable to provide a K–12 education to all its citizens, not just those with the ability to pay. Because there is no practical means for businesses to sell these services, governments are called upon through the political process to provide those services that citizens demand.¹

Although the majority of products and services are provided by either businesses or governments, in some circumstances private organizations are formed to provide goods or services without the intent of earning a profit from these activities. Examples include public charities, trade associations, and civic groups. Again, the goods or services they provide often cannot be priced in a way that encourages commercial entrepreneurship. For example, a public radio broadcast cannot be effectively restricted to only those individuals choosing to support the public radio station. While this explains why the services are not provided by businesses, why aren't governments called upon to provide them?

In some instances, obstacles exist that prevent government involvement. For example, the U.S. Constitution provides for separation of church and state. Therefore, any group that wishes to promote religious activities must do so through private organizations rather than through government. More commonly the reason is lack of political influence. Support for the arts may be important to a group of individuals but unless that group is sufficiently large to influence the political process, it is unlikely that elected officials will use government funds for that purpose. However, support for the arts could still be provided by forming a charitable foundation with no relationship to the government and having the foundation solicit donations from that segment of the public that finds the arts important.

The organizations introduced in the preceding paragraphs are the focus of this book: governmental and not-for-profit organizations. They are distinguished from commercial businesses by the absence of an identifiable individual or group of individuals who hold a legally enforceable residual claim to the net resources. Throughout the text a distinction will be made between **public** and **private** organizations. Public organizations are owned or controlled by governments. Private organizations are not owned or controlled by governments and include businesses as well as private not-for-profit organizations. **Not-for-profit organizations** lack a residual ownership claim and the organization's purpose is something other than to provide goods and services at a profit.

Because significant resources are provided to governments and not-for-profit organizations, financial reporting by these organizations is important. To paraphrase the James Madison quotation provided at the beginning of the chapter, because humans (not angels) operate governments, controls are necessary. Financial reports that reflect the policies and actions of governmental managers are an effective means to control the actions of those entrusted with public resources. To be effective, external financial reports must be guided by a set of generally accepted

¹ The branch of economics that studies the demand for government services is termed *public choice*.

accounting principles. The generally accepted accounting principles for governmental and private not-for-profit organizations are the subject of this book. The first nine chapters of the text deal with public sector (state and local government) organizations and Chapters 10, 11, and 12 deal primarily with private not-for-profit organizations. Chapter 13 discusses auditing and tax-related issues unique to governments and private not-for-profits and also evaluates performance of these entities. Chapter 14 describes financial reporting by the federal government.

GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

Biologists tell us that organisms evolve in response to characteristics of their environment. Similarly, accounting principles evolve over time as people find certain practices useful for decision making. Further, we expect organisms in different environments to evolve differently. Similarly, if the environments in which governments and not-for-profits operate differ in important ways from that of commercial enterprises, we would expect the accounting practices to evolve differently. It is important to understand how governments and not-for-profit organizations differ from commercial businesses if we are to understand why the accounting practices of these nonbusiness organizations have evolved in the manner we will see throughout the remainder of this text.

The Governmental Accounting Standards Board published a document titled *Why Governmental Accounting and Financial Reporting Is—and Should Be—Different* (http://www.gasb.org/white_paper_full.pdf). This white paper identifies five environmental differences between governments and for-profit business enterprises and describes how those differences manifest in differences in the objectives and practice of financial reporting.

1. **Organizational Purposes.** While the purpose of a commercial business is to generate a profit for the benefit of its owners, governments exist for the well-being of citizens by providing public services—whether or not the services are profitable undertakings. The result is that government accounting practices are not focused on the measurement of net income for the purpose of measuring return to investors. Rather they are intended to satisfy the information needs of a variety of users.

While the purpose of government operations differs greatly from commercial businesses, the purpose of governmental accounting is the same—to provide information that is useful to stakeholders in making decisions. However, governments have vastly different sets of users of accounting information. Like businesses, governments have creditors who are interested in assessing the creditworthiness of the government. Citizens and businesses, both within the government's jurisdiction and those considering relocation to the jurisdiction, are also stakeholders who rely on governmental reporting to make economic decisions. In addition, governments receive resources from other governments and grantors who may require financial reports and audits as a condition of the grant. Since this diverse set of resource providers have varying interests, the information needs of one group may not meet the needs of another. The result is that governments report far more disaggregated information than commercial enterprises.

2. **Sources of Revenues.** Net income is a universally accepted measure of business performance. The calculation of net income begins with sales. A sale occurs when an independent party perceives that the service offered both provides value and is fairly priced. Net income then simply determines whether this measure of demand (sales) exceeds the cost of providing the service and is an accepted measure of performance for business organizations. In contrast, governments derive many of their resources from taxes. Individuals and businesses pay taxes to avoid penalty, not voluntarily because they perceive government services to be of value and fairly priced. Since taxes do not involve an earnings process, the timing of the recognition of tax revenue is not always clear.

3. **Potential for Longevity.** Because the U.S. and state constitutions grant state and local governments the ability to tax, governments very rarely go out of business. This long-term view of operations changes the focus of accounting from one of near-term recovery of amounts invested in assets to a longer-term focus on the sustainability of services and the ability to meet future demand. As a result, governments may elect not to depreciate some capital assets but expense improvements that extend an asset's useful life.

4. **Relationship with Stakeholders.** Taxes are levied through the legislative process by officials elected by the citizens. Because citizens and businesses are then required to pay these taxes, governments have an obligation to demonstrate accountability for these public funds. While a business can use its resources as it deems appropriate, governments frequently receive resources that are restricted to a particular purpose. For example, a city may collect a telephone excise tax legally restricted to operating a 911 emergency service. In an effort to provide assurance that resources are used according to legal or donor restrictions, governments use **fund accounting**. A fund represents part of the activities of an organization that is separated from other activities in the accounting records to more easily demonstrate compliance with legal restrictions or limitations.

5. **Role of the Budget.** Many businesses prepare budgets, but these are for planning and control purposes and are rarely made available to creditors or investors. In contrast, government budgets are expressions of public policy and often carry the authority of law, preventing public officials from spending outside their budgetary authority. The increased importance of budgets is reflected in government financial reports by a required report comparing budgeted and actual amounts.

For these and other reasons, the accounting practices of governmental organizations evolved differently from those of businesses. As you will see in later chapters, the accounting practices of not-for-profit organizations more closely resemble those of commercial businesses. However, the not-for-profit environment shares some important characteristics with governments. Similar to governments, not-for-profits do not have residual owners. "Investors" in not-for-profits are diverse and include donors, volunteers, and members. In addition, as with governments, the excess of revenues over expenses is not an effective measure of organizational performance. Finally, like governments, not-for-profits commonly receive resources with donor-imposed restrictions.

Sources of Generally Accepted Accounting Principles

Further complicating accounting issues is the fact that we have three levels of government (federal, state, and local) and not-for-profits may be either publicly or privately owned. This is important because different standards-setting bodies have authority for establishing reporting standards for these groups. Illustration 1-1 summarizes the various organizational types and the bodies with primary standard-setting authority.

Accounting and financial reporting standards for the federal government are published by the **Federal Accounting Standards Advisory Board (FASAB)**. The standards are technically “recommendations” since, as a sovereign nation, the federal government cannot relegate authority to an independent board. Recommendations of the FASAB are reviewed and become effective unless objected to by one of the **principals**, the U.S. Government Accountability Office (GAO), the U.S. Department of the Treasury, or the U.S. Office of Management and Budget. These standards apply to financial reports issued by federal agencies and to the Consolidated Financial Report of the United States Government. Accounting and financial reporting standards for the federal government are illustrated in Chapter 14.

Accounting and financial reporting standards for state and local governments in the United States are set by the **Governmental Accounting Standards Board (GASB)**. The GASB also sets accounting and financial reporting standards for governmentally related not-for-profit organizations, such as colleges and universities, health care entities, museums, libraries, and performing arts organizations that are owned or controlled by governments. Accounting and financial reporting standards for profit-seeking businesses and for nongovernmental not-for-profit organizations are set by the **Financial Accounting Standards Board (FASB)**.

The GASB and the FASB are parallel bodies under the oversight of the **Financial Accounting Foundation (FAF)**. The FAF appoints the members of the two boards and provides financial support to the boards by obtaining contributions from businesses; professional organizations of accountants and financial analysts; CPA firms; debt-rating agencies; and state and local governments. Because of the breadth of support and the lack of ties to any single organization or government, the GASB and the FASB are referred to as “independent standards-setting bodies.” Standards set by the FASAB, GASB, and FASB are the primary sources of **generally accepted accounting principles (GAAP)** as the term is used in accounting and auditing literature.

ILLUSTRATION 1-1 Summary of Standards-Setting Organizations

Reporting Organization	Standards-Setting Board
Federal government	Federal Accounting Standards Advisory Board (FASAB)
State and local governments	Governmental Accounting Standards Board (GASB)
Public not-for-profits	Governmental Accounting Standards Board (GASB)
Private not-for-profits	Financial Accounting Standards Board (FASB)
Investor-owned businesses	Financial Accounting Standards Board (FASB)

GASB standards are set forth in documents called **Statements** of Financial Accounting Standards. Although no longer used, in the past the GASB also issued **Interpretations** that provided guidance on previously issued statements. From time to time, the Board finds it necessary to expand on standards in **Technical Bulletins** and Implementation Guides. The sources of authoritative GAAP for state and local governments therefore are

- Category A: GASB Statements (and Interpretations)
- Category B: GASB Implementation Guides, GASB Technical Bulletins, and literature of the American Institute of Certified Public Accountants (AICPA) specifically cleared by the GASB

If the accounting treatment for a given transaction is not specified by a statement in Category A, a state and local government should consider whether it is covered by one of the sources identified in Category B. If the accounting treatment is not specified within one of these authoritative sources, the government should consider whether the transaction is sufficiently similar to ones covered by one of the authoritative sources that a similar accounting treatment can be applied. If not, the government may use nonauthoritative sources for guidance, including

- GASB Concept Statements,
- FASB, FASAB, or International Standards Board pronouncements,
- AICPA literature not specifically cleared by the GASB,
- Other sources provided by professional organizations, regulatory agencies, textbooks, and published articles, or
- Prevalent practices that evolved among governments without specific authoritative action.

Both the FASB and FASAB have similar hierarchies of GAAP for entities falling within their jurisdictions. The GASB, FASB, and FASAB publish **codifications** (organized versions) of accounting standards. The GASB also publishes a comprehensive collection of its implementation guides. The advantage of using the codified versions of standards is that all relevant standards for a particular topic are presented together and any superseded segments of standards have been removed. Codification references are presented in two parts: the first (section) identifies a topic and the second identifies a paragraph within the codification. Letters typically give a clue as to the topic (e.g., L for leases and Ho for hospitals). Paragraph numbers may be used to determine the level of authority within the GAAP Hierarchy. These are summarized as follows:

Section #s	Topics
1000–1900	General Principles
2000–2900	Broad Financial Reporting Requirements
Letters (A–Z)	Specific Balance Sheet or Operating Accounts
Double letters	Specialized Industries or Reporting Units

Paragraph #s	Level of Authority
100–499	GASB Statements
500–599	Definitions
600–699	GASB Technical Bulletins and AICPA Audit and Accounting Guides and Statements of Position
700–799	AICPA Practice Bulletins
900–999	Nonauthoritative discussions

For example:

Codification Reference	Section	Paragraph
1000.101	Section 1000 indicates this pertains to general principles (in this case GAAP Hierarchy).	Paragraphs 101–104 present the GAAP Hierarchy and since the paragraph number is <500, it comes from a GASB Statement (in this case Statement No. 76).
1700.601	Section 1700 indicates this pertains to reporting of budgetary information.	Paragraph 601 states what to disclose if a government is not legally required to adopt a budget. Since the paragraph number is 600–699, this is Level B GAAP.
F60.101	The single letter (F) identifies a specific account (in this case <u>Food stamps</u>).	The paragraph number (<500) indicates this standard comes from a GASB Statement.
Co5.902	The double letters (Co) identify a specialized industry (<u>Colleges and universities</u>).	The paragraph number (>900) indicates these are nonauthoritative examples of financial statements for a state university.

Definition of Government

Some organizations possess certain characteristics of both governmental and non-governmental not-for-profit organizations. Since there are different standard-setting boards, it is important to identify which board's standards apply to a given entity. For this reason, the FASB and GASB agreed upon a definition of governmental organizations:

Public corporations and bodies corporate and politic are governmental organizations. Other organizations are governmental organizations if they have one or more of the following characteristics:

- Popular election of officers or appointment (or approval) of a controlling majority of the members of the organization's governing body by officials of one or more state or local governments;
- The potential for unilateral dissolution by a government with the net resources reverting to a government; or
- The power to enact and enforce a tax levy.

Furthermore, organizations are presumed to be governmental if they have the ability to issue directly (rather than through a state or municipal authority) debt that pays interest exempt from federal taxation.

OBJECTIVES OF ACCOUNTING AND FINANCIAL REPORTING

All three standards-setting organizations—the Federal Accounting Standards Advisory Board, the Financial Accounting Standards Board, and the Governmental Accounting Standards Board—take the position that the establishment of accounting and financial reporting standards should be guided by conceptual considerations so that the body of standards is internally consistent and the standards address broad issues. The cornerstone of a conceptual framework is said to be a statement of the objectives of financial reporting.

Objectives of Accounting and Financial Reporting for State and Local Governmental Units

GASB has issued six concept statements. *Concepts Statement No. 1* identifies three primary user groups of government accounting information: creditors, citizens, and oversight bodies (including granting agencies and the legislature). The information needs of government creditors are not greatly different from their counterparts in the corporate world, namely to evaluate the likelihood the government will continue to make its debt payments as they come due. Citizens and oversight bodies have a very different purpose, which is to determine whether elected officials have raised and expended the public's money in a manner consistent with law and the public's best interest. Satisfying this citizen "right to know" objective is not easily accomplished and commonly requires government financial reports to provide much greater detail than can be found in corporate annual reports.

One difficulty governments have in meeting the information needs of citizens is that traditional financial statements, which measure events in dollars, are not well designed to evaluate the government's effectiveness in delivering services. For example, consider a public school system. A traditional financial report will show the sources of revenues and amounts expended, but does little to tell the reader whether the schools are doing a good job. In many cases nonfinancial measures are better indicators of performance. These might include the number of students advancing to the next grade, graduation rates, and scores on college entrance exams. *Concepts Statements No. 2* and *No. 5* relate to the reporting of nonfinancial measures, called **service efforts and accomplishments** reporting. Service efforts and accomplishments reporting will be more fully described in Chapter 13.

Concepts Statement No. 3 defines methods of presenting information in financial reports and develops the following disclosure hierarchy:

1. When items (assets, liabilities, revenues, etc.) can be measured with sufficient reliability, they should be reported in the **basic financial statements**.
2. The **notes to the financial statements** are intended to enhance the understanding of items appearing in the financial statements but are not a substitute for recognition when a transaction or event can be measured with sufficient reliability.
3. Occasionally the GASB determines that additional information is necessary to provide context and understanding of information in the statements or notes.

In such cases, the GASB requires the presentation of **required supplementary information (RSI)**. RSI appears most commonly in the form of schedules or tables. Management's Discussion and Analysis is also an example of RSI.

4. The final level of disclosure includes other supplementary information that is not required by GASB standards but which the reporting government feels is useful in understanding the operations of the government.

Concepts Statement No. 4 provides key definitions of items appearing in financial statements. Not surprisingly, assets, liabilities, and net position (residual equity) are each defined. However, GASB utilizes two additional elements that do not appear in the balance sheets of nongovernmental organizations: deferred inflows and deferred outflows of resources. The most common deferred inflows are taxes that have been deferred to a future period when they are expected to be available for operations. Deferred inflows and outflows are also used by GASB to record events and transactions that appear in Accumulated Other Comprehensive Income (AOCI) in commercial organizations. For example, prior service costs resulting from changes in pension terms and changes in the value of hedging derivatives are recognized as AOCI by business organizations and as deferred inflows and outflows by governments.

Finally, *Concepts Statement No. 6* examines the issue of when it is most appropriate to measure assets and liabilities at historical cost and when it is more appropriate to remeasure assets to fair value or settlement amount. In general, remeasurement is appropriate for assets that will be converted to cash and liabilities where there is uncertainty over the timing and amount of payments.

Objectives of Financial Reporting by the Federal Government

The Federal Accounting Standards Advisory Board (FASAB) was established to recommend accounting and financial reporting standards to the principals—the U.S. Office of Management and Budget, the U.S. Department of the Treasury, and the U.S. Government Accountability Office. The FASAB has issued eight **Statements of Federal Financial Accounting Concepts (SFFACs)**. These concepts apply to financial reporting for the federal government as a whole and for individual reporting agencies.

SFFAC 1, *Objectives of Federal Financial Reporting*, outlines four objectives that should be followed in federal financial reporting. The first, budgetary integrity, indicates that financial reporting should demonstrate accountability with regard to the raising and expending of moneys. The second, operating performance, suggests that financial reporting should enable evaluation of the service efforts, costs, and accomplishments of the federal agency. The third, stewardship, reflects the concept that financial reporting should enable an assessment of the impact on the nation of the government's operations and investments. Finally, the fourth, systems and controls, indicates that financial reporting should reveal whether financial systems and controls are adequate.

Other federal government accounting concept statements include

- SFFAC 2—*Entity and Display*,
- SFFAC 3—*Management's Discussion and Analysis*,

- SFFAC 4—*Intended Audience and Qualitative Characteristics for the Consolidated Financial Report of the United States Government*,
- SFFAC 5—*Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements*,
- SFFAC 6—*Distinguishing Basic Information, Required Supplementary Information, and Other Accompanying Information*,
- SFFAC 7—*Measurement of the Elements of Accrual Basis Financial Statements in Periods After Initial Recording*, and
- SFFAC 8—*Federal Financial Reporting*.

Objectives of Financial Reporting by Not-for-Profit Entities

FASB has issued eight concepts statements, including one dedicated to nonbusiness entities. In its *Statement of Financial Accounting Concepts No. 4*, the FASB identifies the information needs of the users of nonbusiness financial statements. These include providing information that is useful to present and potential resource providers who are

- Making decisions about the allocation of resources to those organizations,
- Assessing the services that a nonbusiness organization provides and its ability to continue to provide those services,
- Assessing management's stewardship and performance, and
- Evaluating an organization's economic resources, obligations, and effects of changes in those net resources.

STATE AND LOCAL GOVERNMENT FINANCIAL REPORTING

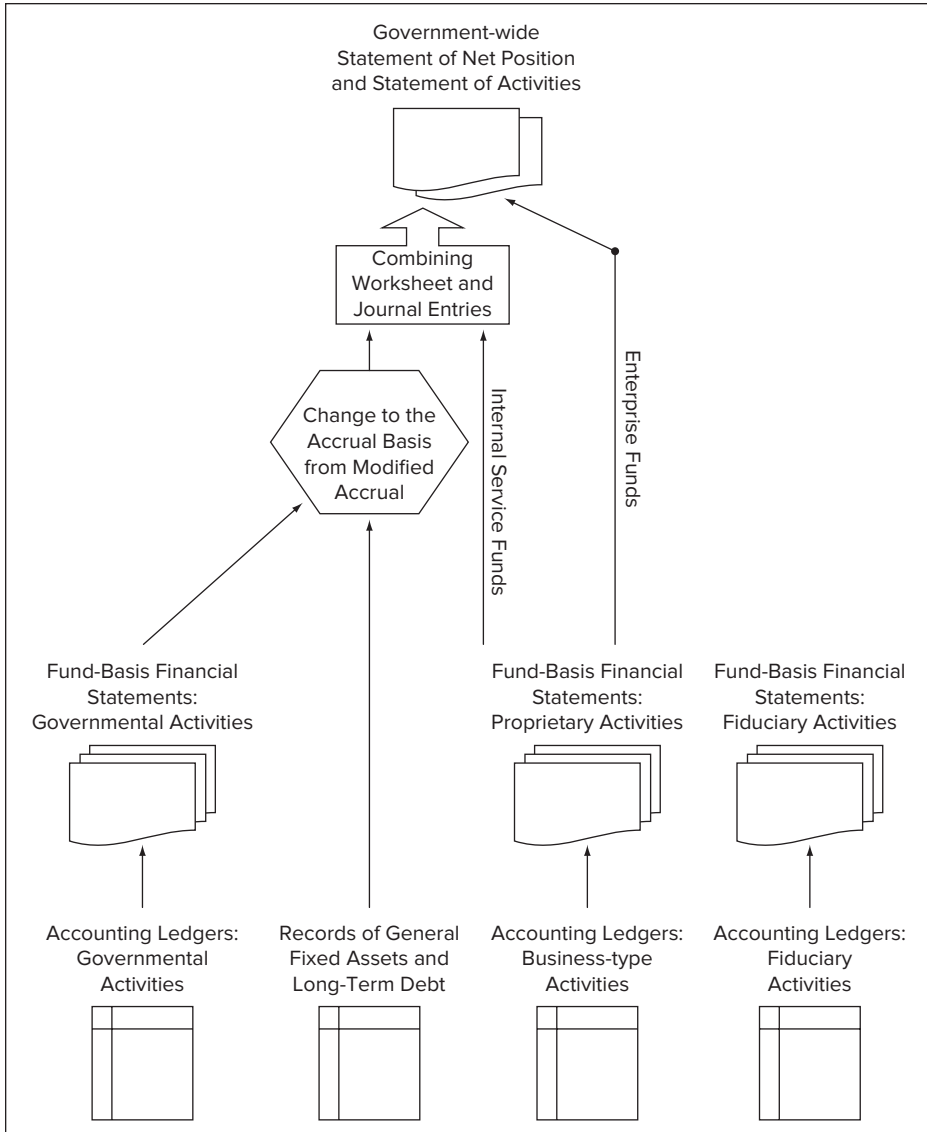
GASB Concepts Statements stress that accounting and reporting standards for state and local governments should meet the financial information needs of many diverse groups: citizen groups, legislative and oversight officials, and investors and creditors. The primary report for meeting these diverse needs is the Comprehensive Annual Financial Report.

Comprehensive Annual Financial Report

GASB Codification Sec. 2200 sets standards for the content of the Comprehensive Annual Financial Report of a state or local government reporting entity. A **Comprehensive Annual Financial Report (CAFR)** is the government's official annual report prepared and published as a matter of public record. In addition to the basic financial statements and other financial statements, the CAFR contains introductory material, an auditor's report, certain RSI, schedules necessary to demonstrate legal compliance, and statistical tables. Chapter 2 presents an extensive discussion and illustration of the basic financial statements and the other major components of the CAFR.

Illustration 1-2 presents an overview of the financial reporting process for state and local governments. While a business will typically have a single general ledger, the activities of governments are broken down into accounting subunits called *funds*. A typical town or county government could have a dozen funds while cities and states generally have many more. Each fund requires its own general ledger and general journal. These are represented at the bottom of Illustration 1-2. In addition, records are kept of general fixed assets and long-term debt.

ILLUSTRATION 1-2 Financial Reporting Process for State and Local Governments



Governments have two levels of financial statement reporting. The first is the fund-basis financial statements. Fund-basis statements are presented for three categories of activities: governmental, proprietary, and fiduciary. These categories and the funds that comprise each category are described in detail later in this chapter. While the fund-basis statements present an in-depth record of individual activities of the government, it is difficult for the financial statement user to pull this disaggregated information together and form an overall view of the government's finances. For that reason, governments are also required to present government-wide financial statements. The government-wide statements combine the governmental and business-type activities of the government for the purpose of presenting an overall picture of the financial position and results of operations of the government. An important feature of the government-wide financial statements is that they are prepared using a common measurement focus and basis of accounting.

Measurement Focus and Basis of Accounting

State and local governments prepare their financial reports using two general accounting methods. One method assumes an economic resources measurement focus and the accrual basis of accounting, and the other method assumes a flow of current financial resources measurement focus and modified accrual accounting. Each of these two methods is discussed below.

Economic Resources Measurement Focus and the Accrual Basis of Accounting

The government-wide statements and the fund statements for proprietary funds and fiduciary funds use the economic resources measurement focus and the accrual basis of accounting. **Measurement focus** refers to *what* items are being reported in the financial statements. An economic resources measurement focus measures both current and long-term assets and liabilities and is the measurement focus used by commercial businesses. A balance sheet prepared on the economic resources focus reports the balances in fixed assets and long-term liabilities. **Basis of accounting** determines *when* transactions and events are recognized in the accounting records. The accrual basis of accounting recognizes revenues when they are earned (and are expected to be realized) and recognizes expenses (including depreciation) when the related goods or services are used up. Accruals are commonly required for interest and other expenses, regardless of when cash is to be transferred. Again, this is the basis of accounting used by commercial businesses.

Current Financial Resources Measurement Focus and the Modified Accrual Basis of Accounting

The fund statements for governmental funds are presented using the current financial resources measurement focus and modified accrual basis of accounting. Many of the transactions in governmental funds are nonexchange in nature; that is, they are activities undertaken in response to the needs of the public. Activities reported in governmental funds are heavily financed by taxes and other involuntary contributions from persons (and organizations) who do not receive services in direct proportion to the contribution they make. GASB standards provide that accounting systems of governmental funds are designed to measure (a) the

extent to which financial resources obtained during a period are sufficient to cover claims incurred during that period against financial resources and (b) the net financial resources available for future periods. Thus, governmental funds are said to have a flow of **current financial resources measurement focus**, as distinguished from the government-wide, proprietary fund, and fiduciary fund statements, which have an **economic resources measurement focus**. Activities of governmental funds are said to be **expendable**; that is, the focus is on the receipt and expenditure of resources. These resources are generally restricted to current assets, investments, and short-term liabilities.

Modified accrual accounting, as the term implies, is a modification of accrual accounting. As will be discussed much more fully in Chapters 3, 4, and 5, revenues are generally recognized when *measurable* and *available* to finance the expenditures of the current period. Expenditures (not expenses) are recognized in the period in which the fund liability is incurred. Long-term assets, with minor exceptions, are not recognized; the same is true of most long-term debt. Capital (fixed) assets and long-term debt are not reported in governmental fund balance sheets. It should be noted that governmental *funds* are reported using the modified accrual basis of accounting; however, governmental-type *activities* are reported in the government-wide statements using the accrual basis of accounting, including fixed assets and long-term debt. As shown in Illustration 1-2, the governmental activities fund-basis financial statements and the records of general fixed assets and long-term debt serve as inputs to the government-wide financial statements. In Chapter 8 we will see that the governmental activities balances are changed through combining worksheets and journal entries to reflect an economic resources measurement focus and the accrual basis of accounting before being presented in the government-wide financial statements.

Fund Structure for State and Local Government Accounting and Reporting

Traditionally, state and local government financial reporting has been based on **fund accounting**. A fund is (1) a self-balancing set of accounts that (2) separately reports the resources and activities of a part of the government and (3) is segregated because of the existence of restrictions or limitations on the use of some resources.

Note that two conditions must be met for a fund to exist: (1) there must be a **fiscal entity**—assets set aside for specific purposes, and (2) there must be a double-entry **accounting entity** created to account for the fiscal entity. This second condition requires that debits equal credits within each fund. Therefore no journal entry may debit an account in one fund and credit an account in another fund. Every journal entry must be within a single fund (debits = credits). If there are transactions between funds, two journal entries are required—one for each of the affected funds.

State and local governments use 11 fund types. These fund types are organized into three categories: governmental funds, proprietary funds, and fiduciary funds. The first issue in recording a transaction is determining where (in which fund) to record the event. Governmental accounting is definition driven; that is, where we account for a transaction is determined by the definition of the 11 fund types.

Governmental Funds Five fund types are classified as **governmental funds**:

1. The **General Fund** accounts for most of the basic services provided by the government. Technically, it accounts for and reports all financial resources not accounted for and reported in another fund.
2. **Capital projects funds** account for and report financial resources that are restricted, committed, or assigned to expenditure for capital outlays. As such, it accounts for the purchase or construction of major capital improvements, except those purchased or constructed by a proprietary (and less commonly, fiduciary) fund.
3. **Debt service funds** account for and report financial resources that are restricted, committed, or assigned to expenditure for principal and interest, other than interest or principal on proprietary or fiduciary activities.
4. **Special revenue funds** account for and report the proceeds of specific revenue sources that are restricted or committed to expenditure for a specified purpose other than debt service or capital projects. These include activities funded by federal or state grants or by taxes specifically restricted to certain activities.
5. **Permanent funds** account for and report resources (typically provided under trust arrangements) that are restricted to the extent that only earnings, and not principal, may be used for purposes that support the reporting government's programs.

Every government will have a single General Fund but may have multiple funds in each of the other categories. Accounting for the General Fund and special revenue funds is discussed in Chapters 3 and 4, while capital project, debt service, and permanent fund accounting is illustrated in Chapter 5.

Proprietary Funds This category of funds is used to account for a government's activities that are businesslike in nature. Specifically they operate to provide services to customers who pay for the services received. **Proprietary funds** are discussed in Chapter 6. There are two types of proprietary funds:

1. **Enterprise funds** are used when resources are provided primarily through the use of sales and service charges to parties external to the government. Examples of enterprise funds include water and other utilities, airports, swimming pools, and transit systems.
2. **Internal service funds** account for services provided by one department of a government to another, generally on a cost-reimbursement basis. In some cases, these services are also provided to other governments. Examples of internal service funds include print shops, motor pools, and self-insurance funds.

Fiduciary Funds **Fiduciary funds** account for resources that are held by the government in a trustee capacity. A fiduciary position exists when one party prudently takes care of money or other assets for another party. Commonly, these funds involve a **trust agreement**, which is a formal agreement through which the government is given custody of assets on behalf of one or more beneficiaries. Under a trust agreement, resources are received and held by the governmental unit as trustee, to be expended or invested in accordance with the conditions of the trust. Fiduciary funds are covered in Chapter 7. Four types of fiduciary funds exist:

1. **Pension (and other employee benefit) trust funds** are used to account for pension and employee benefit funds for which the governmental unit is the trustee.
2. **Investment trust funds** account for the external portion of investment pools governed by a trust agreement in which the sponsoring government is the trustee.
3. **Private-purpose trust funds** report all other fiduciary activities governed by trust arrangements under which principal and income benefit individuals, private organizations, or other governments.
4. **Custodial funds** are used to account for all other fiduciary activities, including activities where a trust agreement is not in effect. An example would be a county tax custodial fund, where the county collects property taxes on behalf of towns located within the county.

Illustration 1-3 summarizes the fund types, basis of accounting, and required fund-basis financial statements for each fund category. The table is presented in reverse order from the earlier presentation to assist in identifying the appropriate fund to record a given transaction. Starting at the top, determine whether a given transaction is a fiduciary activity. If it is, identify which of the four fiduciary fund types is appropriate and do not consider the proprietary or governmental-type funds. If the transaction is not fiduciary, determine whether it is a proprietary activity, and if it is, determine whether it is internal service or enterprise. Any transaction that is not fiduciary or proprietary must be a governmental activity. Again, start at the top of the governmental activity funds and determine first whether the transaction meets the definition of a permanent fund. If it does not, move down through the list. Any transaction that has not been identified as a permanent, debt service, capital projects, or special revenue fund transaction must be accounted for in the General Fund.

ILLUSTRATION 1-3 Summary of Funds Used by State and Local Governments

Fund Category	Fund	Basis of Accounting	Fund-Basis Financial Statements
Fiduciary	Private-Purpose Trust	Accrual	• Statement of Fiduciary Net Position
	Investment Trust		• Statement of Changes in Fiduciary Net Position
	Pension Trust		
	Custodial		
Proprietary	Internal Service	Accrual	• Statement of Net Position
	Enterprise		• Statement of Revenues, Expenses, and Changes in Fund Net Position
			• Statement of Cash Flows
Governmental	Permanent	Modified accrual	• Balance Sheet
	Debt Service		• Statement of Revenues, Expenditures, and Changes in Fund Balances
	Capital Project		
	Special Revenue		
	General		

Number of Funds Required

The GASB Summary Statement of Principles states that *governmental units should establish and maintain those funds required by law and sound financial administration*. If state law and/or agreements with creditors do not require a separate fund for the receipt of revenues that are raised solely for a defined purpose and if administrators do not feel that use of a separate fund is needed to be able to demonstrate that revenues were raised solely for that particular purpose, the General Fund should be used to account for the revenue and related expenditures.

Questions and Exercises

- 1–1. Obtain a copy of a recent Comprehensive Annual Financial Report (CAFR). These may commonly be obtained from the website of a city or county of your choice. It would be best, but not absolutely necessary, to use a CAFR that has a Certificate of Excellence in Financial Reporting from the Government Finance Officers Association. You will be answering questions related to the CAFR in Chapters 1 through 8. Answer the following questions related to your CAFR.
 - a. What are the inclusive dates of the fiscal year?
 - b. Identify the name and address of the independent auditor. Is the auditor's opinion unmodified? If not, describe the modification. Is the opinion limited to the basic financial statements, or does the opinion include combining and individual fund statements?
 - c. Does the report contain an organization chart? A table of contents? A list of principal officials? A letter of transmittal? Is the letter of transmittal dated and signed by the chief financial officer? List the major items of discussion in the letter of transmittal.
 - d. Does the report include a Management's Discussion and Analysis? List the major items of discussion.
 - e. Does the report include the government-wide statements (Statement of Net Position and Statement of Activities)?
 - f. Does the report reflect fund financial statements for governmental, proprietary, and fiduciary funds? List those statements. List the major governmental and proprietary funds (the funds that have separate columns in the governmental and proprietary fund statements).
- 1–2. Identify and describe the five environmental differences between governments and for-profit business enterprises as identified in the Governmental Accounting Standards Board's *Why Governmental Accounting and Financial Reporting Is—and Should Be—Different*.
- 1–3. Identify and briefly describe the three organizations that set standards for state and local governments, the federal government, and nongovernmental not-for-profit organizations.

- 1-4. What is the definition of a government as agreed upon by the FASB and GASB?
- 1-5. Describe the “hierarchy of GAAP” for state and local governments.
- 1-6. Accounting and financial reporting for state and local governments use, in different places, either the economic resources measurement focus and the accrual basis of accounting or the current financial resources measurement focus and the modified accrual basis of accounting. Discuss the differences in measurement focus and basis of accounting related to (a) the conceptual differences, (b) differences in revenue recognition, (c) differences in expense/ expenditure recognition, (d) differences in recognition of fixed assets, and (e) differences in the recording of long-term debt.
- 1-7. Distinguish between private and public sector organization.
- 1-8. Go to the GASB website (www.gasb.org). What is the mission of GASB?
- 1-9. For each of the items below, identify which fund(s) would be used to account for the item and provide a justification for your answer.
 - a. A city government issued general obligation bonds to finance the construction of a new jail.
 - b. A tax of \$1.00 per residential phone number is collected by a city government from the phone company. This amount is required by state law to be used for the operation of the 911 emergency phone system.
 - c. A county government expended \$1 million to expand the water treatment plant.
 - d. A donor signed a trust agreement and provided investments totaling \$4 million to create an endowment, the earnings of which will be used to provide scholarships.
 - e. A donor provided \$50,000 to be used to purchase newspaper and magazine subscriptions for the public library. There is no requirement that the original principal may not be spent.
 - f. A city government sold surplus street maintenance trucks for \$10,000.
 - g. A city government contributed \$500,000 to a pension trust administered by the city for its teachers, public safety employees, and employees of the water department.

Chapter Two

Overview of Financial Reporting for State and Local Governments

Budgets that don't balance, public programs that aren't funded, pension funds that are running out of money, schools that aren't funded—How does that help anyone? Gina Marie Raimondo, a former venture capitalist who was the first woman to serve as the governor of Rhode Island

Detroit's financial challenges—the decline of the American auto industry, the impact of the global economic recession, declining population and an erosion of the municipal tax base—are key to understanding what led this great city to an inability to provide basic city services . . . Ron Dellums, 48th mayor of Oakland, CA, and 13-term congressman from California's 9th Congressional District

Learning Objectives

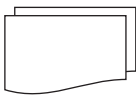
- Obtain an overview of the contents of a governmental financial report.
- Define the governmental reporting entity.
- Illustrate the basic financial statements for a state or local government.

Chapters 3 through 9 of this text describe and illustrate detailed accounting and financial reporting requirements for state and local governments. The purpose of this chapter is to provide an overview so students may better understand the material that follows. This chapter presents a detailed look at financial statements and certain required schedules.

State and local governments are encouraged to prepare a **Comprehensive Annual Financial Report (CAFR)**. In addition to the required financial statements and supplementary information, the CAFR contains additional items, including combining and individual fund statements, schedules, narrative explanations, and a statistical section. While governments are encouraged to prepare a complete CAFR, the GASB has identified a (minimum) set of statements and disclosures that are required to be in compliance with generally accepted accounting principles (GAAP). The required contents of a governmental financial report appear in Illustration 2-1.

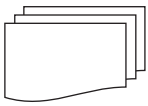
ILLUSTRATION 2-1 Required Contents of Governmental Financial Reports

1. Management's Discussion and Analysis
2. Basic Financial Statements
 - a. Government-wide Financial Statements



Government-wide Statement of Net Position—Illustration 2–5

Government-wide Statement of Activities—Illustration 2–6
 - b. Fund-Basis Financial Statements

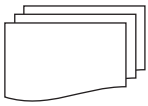


Governmental Type Funds

Balance Sheet—Illustration 2–7b

Statement of Revenues, Expenditures, and Changes in Fund Balances—Illustration 2–8b

Reconciliation of governmental statements to government-wide statements—Illustration 2–7a and Illustration 2–8a

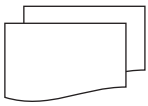


Proprietary Funds

Statement of Net Position—Illustration 2–9

Statement of Revenues, Expenses, and Changes in Fund Net Position—Illustration 2–10

Statement of Cash Flows—Illustration 2–11



Fiduciary Funds

Statement of Fiduciary Net Position—Illustration 2–12

Statement of Changes in Fiduciary Net Position—Illustration 2–13
 - c. Notes to the Financial Statements—Illustration 2–14
3. Required Supplementary Information (other than MD&A)

Information about infrastructure assets using the modified approach—Illustration 2–15

Budgetary comparison schedule (General and major Special Revenue Funds)—Illustration 2–16

Funding schedules required for defined benefit pension plans

Schedules required for external financing pools

The remainder of this chapter presents (1) a discussion of the financial reporting entity, (2) an overview of the CAFR contents, and (3) a detailed presentation of the Comprehensive Annual Financial Report, including illustrative statements.

THE GOVERNMENTAL REPORTING ENTITY

One of the most fundamental issues in accounting for any organization is identifying the accounting entity. This is made more difficult by the fact that general-purpose governments, such as states and large cities and counties, typically are complex organizations

that include semiautonomous boards, commissions, and agencies created to accomplish projects or activities that (for one reason or another), may not be carried out by a government as originally constituted. Very often each legal entity issues a separate annual report. But there are times when it is appropriate to combine these entities with a general-purpose government in order to give an overall picture of government operations. For example, state universities issue separate financial statements but also appear as component units within the state government's annual report.

GASB *Codification* Sec. 2100 establishes that the **financial reporting entity** is the primary government together with its component units. The **primary government** can be a state government, a general-purpose local government such as a city or county, or a special-purpose government such as a school district. **Component units** are legally separate organizations for which the elected officials of the primary government are *financially accountable*. In addition, a component unit can be an organization for which the nature and significance of its relationship with a primary government are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete.

GASB provides guidance for determining when a primary government should include a legally separate organization in its financial report. First, the relationship with the related entity must have one of the following characteristics: (1) the primary government controls a voting majority of the other organization's governing board or otherwise may impose its will on the organization; or (2) the other organization is fiscally dependent upon the primary government. An entity is fiscally dependent on a primary government if that government approves or modifies its budget, sets charges for its services, or if the government's approval is required to issue debt.

Second, the related organization must represent a financial benefit or burden to the primary government. A financial burden exists, for example, if the primary government is responsible for liabilities of the other organization. In contrast, a financial benefit exists if the government is entitled to or may access the other organization's resources.

Governments occasionally acquire a controlling interest in the ownership of a commercial business. A government that holds a controlling equity interest is deemed to be financially accountable for that organization and should report the organization as a component unit. An exception is permitted if the equity interest is an investment (i.e., the purpose is solely to earn income or profit).

Once it is determined that an organization is a component unit of a primary government, the issue becomes how to include its financial information in the primary government's financial reports. GASB standards provide two methods for including component unit financial information with that of the primary government. The first is known as **blending**, because the financial information becomes part of the financial statements of the primary government. Blended organizations are reported as though they were funds of the primary government. Blending is appropriate when the component unit is so intertwined with the primary government that they are in substance the same entity. This may be the case if the two entities have the same governing boards, the primary government is the sole corporate member of the board, or management of the primary government has operational responsibility for the component unit. Additionally, blending is appropriate if the component unit

provides services solely to the primary government or if the component unit's debt is expected to be paid by the primary government.

More commonly, component units are reported using **discrete presentation**. In discrete presentation, the financial information of the component is presented in a column, apart from the primary government and not included in the totals reported for the primary government. Most discretely presented component units appear as separate columns in the government-wide statements. Pension plans that are administered through trusts are frequently legally separate entities from the government. If a primary government has a legal obligation to make contributions to the pension plan, the plan is deemed to be a financial burden to the government and is reported as a component unit. Unlike other component units, these pension trusts are reported as separate columns within the fiduciary fund statements.

REPORTING BY MAJOR FUNDS

In addition to the government-wide statement, governments report fund-level financial statements for each of the three categories of funds: governmental, proprietary, and fiduciary. Because governments may have many governmental and proprietary funds, governments are only required to present separate columns for each **major fund**. The General Fund is always considered a major fund. Other governmental funds are considered major when both of the following conditions exist:

1. total assets, liabilities, revenues, *or* expenditures of that individual governmental fund constitute 10 percent of the total for the governmental funds category, *and*
2. total assets, liabilities, revenues, *or* expenditures of that individual governmental fund are 5 percent of the total of the governmental and enterprise categories, combined.

Deferred outflows are included with assets and deferred inflows are included with liabilities for purposes of applying these criteria. Similar tests are applied to determine major enterprise funds. Additionally, a government may designate any fund as a major fund if reporting that fund separately would be useful. Any funds not reported separately are aggregated and reported in a single column under the label *nonmajor funds*. If the reporting government is preparing a complete CAFR, a schedule showing the detail of nonmajor funds is provided in the other supplementary information section.

OVERVIEW OF THE COMPREHENSIVE ANNUAL FINANCIAL REPORT (CAFR)

The Comprehensive Annual Financial Report has three major sections: introductory, financial, and statistical. An outline of the CAFR was presented in Illustration 2-1. Information appearing in the CAFR is described and illustrated in the following sections, beginning with the Introductory Section, Illustration 2-2.


Example Comprehensive Annual Financial Report
Introductory Section

Introductory Section

The Introductory Section of a CAFR includes the table of contents, a letter of transmittal from the preparer (typically the government’s finance director), a list of government officials, and an organizational chart. If a government received a *Certificate of Achievement for Excellence in Financial Reporting* from the Government Finance Officers Association in the prior year,¹ the introductory section will include a reproduction of that certificate. The introductory section is not audited.

ILLUSTRATION 2-2 Introductory Section of CAFR

Letter of Transmittal from the Finance Director



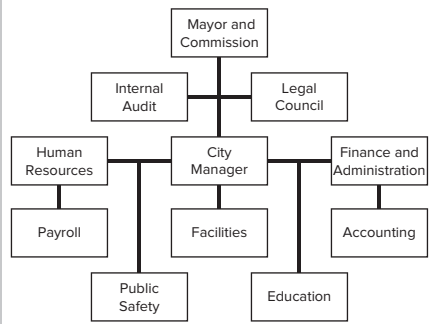
List of Government Officers

CHRISTINE SHADLEY, MAYOR
10 CITY HALL
SALEM CITY


BUTCH KENNEDY, CITY MANAGER
10 CITY HALL
SALEM CITY

CITY COMMISSIONERS
CHARLIE OBAUGH
CHARLENE SHOWALTER
TIM BROWN

Organizational Chart



GFOA Certificate (if awarded)



¹ The Government Finance Officers Association of the United States and Canada sponsors a certificate program to encourage and promote excellent financial reporting. To receive that certificate, a government must have an unmodified audit opinion and have its report reviewed, using an extensive checklist, by independent reviewers who are experienced in financial reporting. See www.gfoa.org

Example Comprehensive Annual Financial Report

Financial Section: Auditor's Report

Financial Section: Auditor's Report

The auditor's report (Illustration 2-3), placed at the beginning of the financial section, normally expresses an opinion on the basic financial statements. Like other audits, government audits must be conducted by CPAs according to auditing standards issued by the American Institute of Certified Public Accountants. In addition, specialized governmental auditing standards must be followed. Governmental auditing standards are discussed in more detail in Chapter 13.

ILLUSTRATION 2-3 Independent Auditor's Report

Independent Auditors

Report on the Financial Statements

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Salem as of and for the year ended December 31, 2020, and the related notes to the financial statements, which collectively comprise the City's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

Additional paragraphs (not presented here) describe the nature of audit procedures and whether the auditor believes they provide an adequate basis.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Salem, Any State, as of June 30, 2020, and the respective changes in financial position, and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Additional paragraphs (not presented here) address required supplementary information and other information contained in the CAFR. Illustration 13-2 provides an example of a complete (unmodified) opinion.

[Auditor's signature], [address], and [date]

Example Comprehensive Annual Financial Report
Financial Section: Required Supplementary Information
Management's Discussion and Analysis

Management's Discussion and Analysis (MD&A)

The MD&A (Illustration 2-4) provides an opportunity for the government to provide, in plain terms, an overview of the government's financial activities. This section is considered **required supplementary information**, which means that it is required and entails some auditor responsibility, but not as much as the basic financial statements. Auditors review the material to establish that it is not misleading in relation to the basic statements but do not include the MD&A in the scope of the audit. A number of specific items must be included:

1. A brief discussion of the financial statements.
2. Condensed financial information derived from the government-wide financial statements, comparing the current year with the prior year. GASB identifies specific items for discussion.
3. An analysis of the government's overall financial position and results of operations to assist users in assessing whether financial position has improved or deteriorated as a result of the year's operations.
4. An analysis of balances and transactions of individual funds.
5. An analysis of significant variations between original and final budget amounts and between final budget amounts and actual results for the General Fund.
6. A description of significant capital asset and long-term debt activity during the year.
7. A discussion by governments that use the modified approach to report infrastructure assets (discussed in Chapter 8), which includes: discussion of changes in the condition of infrastructure assets, comparison of assessed condition with the condition level established by the government, and disclosure of the difference between the amount needed to maintain infrastructure assets and the amount actually expended.
8. A description of any known facts, decisions, or conditions that would have a significant effect on the government's financial position or results of operations.

GASB *Codification* Sec. 2200.109 makes it clear that MD&A is limited to the preceding eight items. However, governments may expand the discussion of these items if deemed appropriate.

Example Comprehensive Annual Financial Report
Financial Section: Required Supplementary Information
Management's Discussion and Analysis

ILLUSTRATION 2-4 Management's Discussion and Analysis

Financial Highlights

Highlights for the City of Salem's Government-wide Financial Statements

- The City's total net position of governmental activities was \$38.4 million at December 31, 2020. Net position for the business-type activities was \$47.9 million.
- Total revenues of governmental activities exceeded total expenses by \$3.25 million.
- The City's total debt at December 31, 2020, was \$62.2 million, a net increase of \$6.5 million. The City issued \$9.7 million in general obligation bonds during 2020 to renovate the courthouse.

Overview of the Financial Statements

The financial section of this annual report consists of four parts: (1) management's discussion and analysis, (2) the basic financial statements, (3) required supplementary information, and (4) other supplementary information.

The basic financial statements include two kinds of statements that present different views of the City:

- The government-wide financial statements provide readers with a broad overview of the City's finances, including long-term and short-term information about the City's overall financial status.
- The fund financial statements focus on the individual parts of the City government, reporting the City's operations in more detail than the government-wide statements.

Government-wide Financial Statements

The government-wide financial statements report information about the City of Salem as a whole using accounting methods similar to those used by private sector companies. The Statement of Net Position and the Statement of Activities are the government-wide statements. These statements include all of the government's assets and liabilities using the accrual basis of accounting. All revenues and expenses are reported, regardless of when cash is received or paid.

The City's total assets exceeded liabilities by \$86 million at December 31, 2020. The largest portion of the City's net position (63 percent) reflects its investments in capital assets, less accumulated depreciation and any related outstanding debt used to acquire those assets. The City uses these assets to provide services to its citizens and customers; therefore these assets are not available for future spending. Presented below is a table comparing the three categories of net position for the City's governmental, business-type, and component unit activities for fiscal years 2019 and 2020.

Management's Discussion and Analysis typically continues for 10 or more pages.

Example Comprehensive Annual Financial Report
Financial Section: Basic Financial Statements
Government-wide Financial Statements: Statement of Net Position

Statement of Net Position

The Statement of Net Position (Illustration 2-5) presents the government-wide asset, liability, and net position balances (measured on the accrual basis and economic resources measurement focus). Notice there are two columns, one for the entity's governmental activities and another for the business-type activities. Together, the governmental and business activities constitute the primary government. Similar information is presented in a separate column for the government's discretely presented component units. Fiduciary activities, however, are not included in the government-wide statements. Prior year balances may be presented but are not required.

Assets are generally reported in order of liquidity. A classified approach (presenting separate totals for current assets and current liabilities) may be used but is not required. Note in particular that capital assets (property and equipment) are presented in the governmental activities column. This will not be the case when we examine the governmental fund-basis financial statements. The capital assets include infrastructure (roads, bridges, sewers, etc.) and are reported net of accumulated depreciation. Similarly, long-term debt is presented in the governmental activities column of the government-wide Statement of Net Position but is not presented for governmental funds in the fund-basis balance sheet.

The difference between assets and liabilities is called *net position* and is reported in three categories. **Net investment in capital assets** is computed by taking the capital assets, less accumulated depreciation, and deducting outstanding debt that is related to the financing of capital assets. Liabilities incurred to finance operations (including long-term liabilities for compensated absences or employee benefits) would not be deducted. **Restricted net position** includes resources that are restricted by (a) external parties, including creditors, grantors, contributors, or by laws or regulations of other governments; or (b) laws or constitutional provisions of the reporting government. The remaining amount, **unrestricted net position**, is a "plug" figure that is determined by deducting the balances of the other two net position categories from the overall excess of assets over liabilities.

Example Comprehensive Annual Financial Report
Financial Section: Basic Financial Statements
Government-wide Financial Statements: Statement of Net Position

ILLUSTRATION 2-5 **Statement of Net Position**

CITY OF SALEM				
Statement of Net Position				
As of December 31, 2020				
Primary Government				
	Governmental Activities	Business-type Activities	Primary Government	Component Units
Assets				
Cash and cash equivalents	\$ 8,242,998	\$ 4,814,724	\$13,057,722	\$ 84,733
Investments	3,312,992	10,350,334	13,663,326	_____
Inventory	1,072,963	30,779	1,103,742	_____
Receivables (net):				
Taxes receivable	2,872,611	_____	2,872,611	_____
Accounts receivable	722,215	2,657,326	3,379,541	27,085
Due from other governments	1,328,448	_____	1,328,448	_____
Restricted assets	3,933,126	2,295,043	6,228,169	_____
Capital assets (net of accumulated depreciation)	65,690,373	48,894,402	114,584,775	11,170,900
Total assets	87,175,726	69,042,608	156,218,334	11,282,718
Liabilities				
Accounts payable	2,425,447	493,849	2,919,296	710
Accrued liabilities	4,340,108	473,168	4,813,276	_____
Bonds payable due within one year	2,164,521	1,342,717	3,507,238	_____
Bonds payable due in more than one year	39,834,882	18,858,187	58,693,069	_____
Total liabilities	48,764,958	21,167,921	69,932,879	710
Net position				
Net investment in capital assets	23,690,970	30,757,135	54,448,105	11,197,985
Restricted	3,933,126	2,295,043	6,228,169	_____
Unrestricted	10,786,672	14,822,509	25,609,181	84,023
Total net position	\$38,410,768	\$47,874,687	\$86,285,455	\$11,282,008

Example Comprehensive Annual Financial Report
Financial Section: Basic Financial Statements
Government-wide Financial Statements: Statement of Activities

Government-wide Statement of Activities

Note the general format of the Statement of Activities (Illustration 2-6). Expenses are measured on the accrual basis and reported first. Expenses for governmental activities are reported initially, followed by the business-type activities and the component units (reading from top to bottom). Direct expenses, including depreciation, are required to be reported by function (General Government, Judicial Administration, etc.). Although rarely done, governments may allocate indirect expenses to functions. However, the government is required to show a separate column for these allocated amounts.

Depreciation that relates to assets serving multiple functions may be allocated as an indirect expense, charged in total to general government, or displayed in a separate line. Interest on long-term debt would be included in direct expenses if the interest related to a single function. Most interest, however, cannot be identified with a single function and should be shown separately.

Revenues that can be directly associated with functions are deducted, and a net expense (or revenue) is presented. Examples include garbage collection fees, museum admissions, and parking fines. Charges for services include charges by enterprise funds, such as fees for water used by homeowners and businesses. Grants and contributions are typically resources provided by other governments.

In contrast, general revenues are presented in the lower right-hand section of the statement. General revenues are not associated directly with a particular function or program. All taxes levied by the government, including those restricted to a particular purpose, are reported as general revenues. Contributions to endowments and extraordinary items (items that are both unusual *and* infrequent) are reported separately after general revenues. However, **special items** (items within the control of management but which are unusual in nature *or* infrequent in occurrence) are shown in a separate line within general revenues.

The Statement of Activities is a consolidated statement within columns (governmental activities, business-type activities, and component units), which means that interfund services provided and used and transfers between two governmental funds are eliminated. Transfers between governmental and business-type activities (\$615,062) are displayed in the general revenues section and offset. Notice that the bottom line, *Net position, ending*, agrees with the balances appearing in the Statement of Net Position (Illustration 2-5).

Financial Section: Basic Financial Statements
Government-wide Financial Statements: Statement of Activities

ILLUSTRATION 2-6 Statement of Activities

CITY OF SALEM Statement of Activities For the Year Ended December 31, 2020									
Primary Government				Net (Expense) Revenue and Change in Net Position					
Program Revenues									
Functions/Programs	Expenses	Charges for Services	Operational Grants and Contributions	Capital Grants and Contributions	Governmental Activities	Business-type Activities	Total	Component Units	
Governmental activities									
General government	\$ 3,734,068	\$1,144,018	\$ 263,178	\$ —	(\$2,326,872)	\$ —	(\$2,326,872)	\$ —	
Judicial administration	1,433,650	56,497	1,002,525	—	(374,628)	—	(374,628)	—	
Public safety	9,265,997	275,492	750,109	277,700	(7,962,696)	—	(7,962,696)	—	
Public works	6,167,650	—	2,903,982	1,853,091	(1,410,577)	—	(1,410,577)	—	
Health and welfare	4,436,534	—	2,861,389	4,203	(1,570,942)	—	(1,570,942)	—	
Education	9,292,427	—	73,300	—	(9,219,127)	—	(9,219,127)	—	
Parks and recreation	3,217,236	604,359	302,672	500	(2,309,705)	—	(2,309,705)	—	
Community development	1,720,121	51,611	298,495	156,361	(1,213,654)	—	(1,213,654)	—	
Interest on long-term debt	1,422,428	—	—	—	(1,422,428)	—	(1,422,428)	—	
Total governmental activities	40,690,111	2,131,977	8,455,650	2,291,855	(27,810,629)	—	(27,810,629)	—	
Business-type activities									
Water	6,041,987	6,385,233	—	3,109,692	—	3,452,938	3,452,938	—	
Solid waste	2,556,633	2,351,433	6,594	2,085,064	—	1,886,458	1,886,458	—	
Parking	481,869	261,107	—	—	—	(220,762)	(220,762)	—	
Total business-type activities	9,080,489	8,997,773	6,594	5,194,756	—	5,118,634	5,118,634	—	
Total primary government	49,770,600	11,129,750	8,462,244	7,486,611	(27,810,629)	5,118,634	(22,691,995)	—	
Component units									
Industrial development authority	4,322,849	9,979	20,000	4,193,964	—	—	—	(98,906)	
General revenues									
Property taxes					15,382,482	—	15,382,482	—	
Sales taxes					5,729,224	—	5,729,224	—	
Hotel and meals taxes					4,998,045	—	4,998,045	—	
Grants					2,724,725	—	2,724,725	—	
Miscellaneous					1,611,886	729,488	2,341,374	1,172	
Transfers					615,062	(615,062)	—	—	
Total general revenues					31,061,424	114,426	31,175,850	1,172	
Change in net position					3,250,795	5,233,060	8,483,855	(97,734)	
Net position, beginning					35,159,973	42,641,627	77,801,600	11,379,742	
Net position, ending					\$38,410,768	\$47,874,687	\$86,285,455	\$11,282,008	

Example Comprehensive Annual Financial Report

Financial Section: Basic Financial Statements

Governmental Funds Statements: Balance Sheet

Governmental Funds: Balance Sheet

Illustration 2-7b presents a Balance Sheet for the governmental funds, including the General, special revenue, capital projects, and debt service funds. The City of Salem does not have a permanent fund or it would be presented here as well. Each of the city’s governmental funds is considered a major fund and is presented separately. If the city had multiple smaller funds, they would be combined and reported in a single column labeled *nonmajor funds*.

The governmental fund statements are prepared using the current financial resources measurement focus and the modified accrual basis of accounting. For this reason, capital assets and long-term debt do not appear on the Balance Sheet. The excess of assets and deferred outflows over liabilities and deferred inflows is labeled *fund balance*, an account title used only in the governmental funds. All other funds and the government-wide statements label residual equity as *net position*.

Several features of the Balance Sheet should be noted. First, a total column is required. Second, fund balance is displayed within the categories of nonspendable, restricted, committed, assigned, and unassigned. These will be more fully described in later chapters, but represent varying degrees of constraint placed on the use of the (net) resources of governmental funds.

Finally, total fund balances reported in the total column (\$12,922,626) must be reconciled to total net position (\$38,410,768) presented in the governmental activities column of the government-wide Statement of Net Position. The reconciliation is presented separately in Illustration 2-7a. These amounts differ because the two statements have different bases of accounting and because internal service funds are generally included in the governmental activities column on the government-wide statements.

ILLUSTRATION 2-7a Reconciliation to (Government-wide) Statement of Net Position

Fund balance reported in the Governmental Funds Balance Sheet	\$12,992,626
Amounts reported for governmental activities in the Statement of Net Position are different because	
• Capital assets used in government operations are not financial resources and therefore are not reported in the funds.	65,690,373
• Some liabilities are not due and payable in the current period and are not reported in fund liabilities.	(41,999,403)
• The assets and liabilities of internal service funds are included in governmental activities for the Statement of Net Position.	436,475
• Accrued liabilities that are not to be paid from current financial resources are not recognized in the funds.	(3,117,390)
• Receivables on the Statement of Net Position that do not provide current financial resources are reported as deferred inflows in the funds.	4,408,087
Net position of governmental activities in the Statement of Net Position	<u>\$38,410,768</u>

Example Comprehensive Annual Financial Report
Financial Section: Basic Financial Statements
Governmental Funds Statements: Balance Sheet

ILLUSTRATION 2-7b Governmental Funds Balance Sheet

CITY OF SALEM Balance Sheet Governmental Funds As of December 31, 2020					
	General Fund	Special Revenue Fund	Courthouse Renovation Fund	Debt Service Fund	Total Governmental Funds
Assets					
Cash and cash equivalents	\$ 6,408,214	\$627,837	\$ 895,300	\$230,000	\$ 8,161,351
Investments	3,312,992	—	—	—	3,312,992
Receivables (net)					
Taxes receivable	2,872,611	—	—	—	2,872,611
Accounts receivable	679,215	14,177	—	—	693,392
Due from other governments	1,085,184	—	243,264	—	1,328,448
Supplies inventory	23,747	—	—	—	23,747
Restricted assets	3,933,126	—	—	—	3,933,126
TOTAL ASSETS	\$18,315,089	\$642,014	\$1,138,564	\$230,000	\$20,325,667
Liabilities					
Accounts payable	2,085,358	70,000	207,134	—	2,362,492
Accrued liabilities	543,064	—	19,398	—	562,462
TOTAL LIABILITIES	2,628,422	70,000	226,532	—	2,924,954
Deferred Inflows of Resources					
Property Taxes	4,408,087	—	—	—	4,408,087
TOTAL DEFERRED INFLOWS	4,408,087	—	—	—	4,408,087
Fund Balance					
Nonspendable					
- Supplies inventory	23,747	—	—	—	23,747
Restricted					
- Intergovernmental grants	—	312,000	500,000	—	812,000
- Bond sinking fund	—	—	—	230,000	230,000
Committed					
- Rainy day fund	4,500,000	—	—	—	4,500,000
- Courthouse renovation	—	—	380,000	—	380,000
Assigned					
- School lunch program	—	260,014	—	—	260,014
- Other capital projects	917,300	—	32,032	—	949,332
Unassigned	5,837,533	—	—	—	5,837,533
TOTAL FUND BALANCE	11,278,580	572,014	912,032	230,000	12,992,626
TOTAL LIABILITIES, DEFERRED INFLOWS AND FUND BALANCE	\$18,315,089	\$642,014	\$1,138,564	\$230,000	\$20,325,667

Example Comprehensive Annual Financial Report
Financial Section: Basic Financial Statements
Governmental Funds Statements: Statement of Revenues,
Expenditures, and Changes in Fund Balance

Governmental Funds: Statement of Revenues, Expenditures, and Changes in Fund Balance

Illustration 2-8b presents the operating statement for the same governmental funds appearing in Illustration 2-7b (the Balance Sheet). Again, the statement is prepared using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are reported by source, and expenditures (not expenses) are reported by character: current, capital outlay, and debt service. Within the current category, expenditures are presented by function: general government, judicial administration, public safety, and so on. Within the debt service category, expenditures are displayed as interest or principal.

Following revenues and expenses, the statement reports *other financing sources and uses*. These reflect interfund transfers and the proceeds of issuing debt. Most of the items appearing in this section are eliminated when preparing the government-wide financial statements. Like all operating statements, reconciliations to the Balance Sheet are required. In this case, the operating statement is reconciled to total fund balances by adding the beginning of year fund balances.

The excess of revenues and other sources over expenditures and other uses (negative \$1,485,357) is reconciled to the change in net position (positive \$3,250,795) for the governmental activities column in the government-wide Statement of Activities. This reconciliation would normally appear at the bottom of the Statement of Revenues, Expenditures, and Changes in Fund Balance but is presented in Illustration 2-8a due to space considerations.

ILLUSTRATION 2-8a Reconciliation to (Government-wide) Statement of Activities

Excess of revenues and other sources over expenditures and other uses reported in the Governmental Funds Statement of Revenues, Expenditures, and Changes in Fund Balance.	\$ (1,485,357)
Amounts reported for governmental activities in the Statement of Activities are different because	
• Governmental funds report the cost of capital assets as expenditures, while they are capital assets in the government-wide statements.	10,924,818
• Debt proceeds provide current financial resources to the governmental funds but are liabilities in the government-wide statements.	(9,675,400)
• Depreciation is not recorded in the governmental funds but is expensed in the Statement of Activities.	(1,691,116)
• Income earned by internal service funds is included in governmental activities on government-wide statements.	23,964
• Payments of principal on long-term debt are expenditures in the governmental funds but reduce the liability in the government-wide statements.	1,155,326
• Property taxes expected to be collected more than 60 days after year-end are deferred in the governmental funds.	3,998,560
Change in net position of governmental activities (government-wide)	<u>\$3,250,795</u>

Example Comprehensive Annual Financial Report
Financial Section: Basic Financial Statements
Governmental Funds Statements: Statement of Revenues,
Expenditures, and Changes in Fund Balance

ILLUSTRATION 2-8b **Governmental Funds Statement of Revenues, Expenditures,**
and Changes in Fund Balance

CITY OF SALEM					
Statement of Revenues, Expenditures, and Changes					
in Fund Balances—Governmental Funds					
For the Year Ended December 31, 2020					
	General	Special Revenue	Courthouse Renovation	Debt Service	Total Governmental
Revenues					
Property taxes	\$15,361,830	\$ —	\$ —	\$ —	\$15,361,830
Other local taxes	11,761,522	—	—	—	11,761,522
Charges for services	1,601,435	291,243	—	—	1,892,678
Intergovernmental	7,098,698	3,456,194	441,548	—	10,996,440
Miscellaneous	1,262,549	—	—	—	1,262,549
Total revenues	37,086,034	3,747,437	441,548	—	41,275,019
Expenditures					
Current:					
General government	3,353,502	—	—	—	3,353,502
Judicial administration	1,456,734	1,981,144	—	—	3,437,878
Public safety	8,216,347	—	—	—	8,216,347
Public works	4,602,273	—	—	—	4,602,273
Health and welfare	4,418,294	—	—	—	4,418,294
Education	8,887,834	—	—	—	8,887,834
Parks and recreation	3,055,325	—	—	—	3,055,325
Community development	899,209	1,093,804	—	—	1,993,013
Capital outlay	—	—	10,924,818	—	10,924,818
Debt service:					
Principal	—	—	—	1,155,326	1,155,326
Interest	—	—	—	924,818	924,818
Total expenditures	34,889,518	3,074,948	10,924,818	2,080,144	50,969,428
Revenues over (under) expenditures	2,196,516	672,489	(10,483,270)	(2,080,144)	(9,694,409)
Other financing sources (uses)					
Issuance of debt	—	—	9,675,400	—	9,675,400
Transfers from other funds	—	—	—	2,080,144	2,080,144
Transfers (to) other funds	(3,256,899)	(289,593)	—	—	(3,546,492)
Total other financing sources (uses)	(3,256,899)	(289,593)	9,675,400	2,080,144	8,209,052
Excess of revenues and other sources over (under) expenditures and other uses	(1,060,383)	382,896	(807,870)	—	(1,485,357)
Fund balance—beginning of year	12,338,963	189,118	1,719,902	230,000	14,477,983
Fund balance—end of year	\$11,278,580	\$572,014	\$912,032	\$230,000	\$12,992,626

Example Comprehensive Annual Financial Report
Financial Section: Basic Financial Statements
Proprietary Funds Statements: Statement of Net Position

Proprietary Funds: Statement of Net Position

Illustration 2-9 presents a Statement of Net Position for the proprietary funds. Again, major funds must be presented in separate columns. An enterprise fund is considered major if (a) assets, liabilities, revenues, *or* expenses are 10 percent or more of the total for all enterprise funds, *and* (b) its assets, liabilities, revenues, *or* expenses are 5 percent or more of the total of the governmental and enterprise categories, combined. In this case, the parking enterprise fund does not meet the requirements, but the government chooses to display it separately rather than label it a nonmajor fund.

Internal service funds are also presented in a separate column in the proprietary fund Statement of Net Position. However, internal service funds do not follow the procedures described for major funds. Governments with more than one internal service fund combine the funds into one column for the Statement of Net Position. Detailed financial statements for each internal service fund are included in the other supplementary information.

The proprietary funds use the economic resources measurement focus and the accrual basis of accounting. Since this is the same as the government-wide statements, reconciliations between the two sets of statements are typically not needed. In this example, you should be able to trace amounts reported in the total column for the enterprise funds to the business activities column of the Statement of Net Position. The internal service fund, however, is included in the governmental activities column in the government-wide statements since it primarily serves departments reported in the General Fund, such as police, fire, parks, and maintenance.

GASB requires a classified balance sheet where separate totals are reported for current assets and current liabilities. Both noncurrent assets and long-term liabilities are presented. The excess of assets over liabilities is reported as net position, in the same manner as the government-wide Statement of Net Position. In particular, net position is reported as (1) net investment in capital assets, (2) restricted, or (3) unrestricted. Illustration 2-9 uses a “net position” format (assets minus liabilities equal net position), but a balance sheet format is also acceptable (assets equal liabilities plus net position).

Example Comprehensive Annual Financial Report
Financial Section: Basic Financial Statements
Proprietary Funds Statements: Statement of Net Position

ILLUSTRATION 2-9 Proprietary Funds: Statement of Net Position

CITY OF SALEM					
Statement of Net Position—Proprietary Funds					
As of December 31, 2020					
	Business-type Activities—Enterprise Funds				Governmental Activities— Internal Service Fund
Assets	Water	Solid Waste	Parking	Total	
Current assets:					
Cash and cash equivalents	\$ 3,801,978	\$ 847,889	\$ 164,857	\$ 4,814,724	\$ 81,647
Investments	4,433,039	5,917,295	—	10,350,334	—
Inventory	30,779	—	—	30,779	330,759
Receivables (net)	—	—	—	—	—
Accounts receivable	2,307,643	342,394	7,289	2,657,326	—
Due from other funds	—	—	—	—	28,824
Restricted assets	1,394,787	900,256	—	2,295,043	—
Total current assets	11,968,226	8,007,834	172,146	20,148,206	441,230
Noncurrent assets:					
Capital assets (net of accumulated depreciation)	37,975,852	4,611,754	6,306,796	48,894,402	68,603
Total assets	<u>\$49,944,078</u>	<u>\$12,619,588</u>	<u>\$6,478,942</u>	<u>\$69,042,608</u>	<u>\$509,833</u>
Liabilities					
Current liabilities:					
Accounts payable	317,131	174,087	2,631	493,849	62,958
Accrued liabilities	437,363	25,854	9,951	473,168	3,309
Total current liabilities	754,494	199,941	12,582	967,017	66,267
Liability for landfill closure and postclosure care costs	—	2,063,637	—	2,063,637	—
Capital leases payable					7,091
Bonds payable	16,114,097	—	2,023,170	18,137,267	—
Total noncurrent liabilities	16,114,097	2,063,637	2,023,170	20,200,904	7,091
Total liabilities	16,868,591	2,263,578	2,035,752	21,167,921	73,358
Net position					
Net investment in capital assets	21,861,755	4,611,754	4,283,626	30,757,135	61,512
Restricted	1,394,787	900,256	—	2,295,043	—
Unrestricted	9,818,945	4,844,000	159,564	14,822,509	374,963
Total net position	<u>\$33,075,487</u>	<u>\$10,356,010</u>	<u>\$4,443,190</u>	<u>\$47,874,687</u>	<u>\$436,475</u>

Example Comprehensive Annual Financial Report
Financial Section: Basic Financial Statements
Proprietary Funds Statements: Statement of Revenues, Expenses,
and Changes in Fund Net Position

Proprietary Funds: Statement of Revenues, Expenses, and Changes in Fund Net Position

Illustration 2-10 presents a Statement of Revenues, Expenses, and Changes in Fund Net Position for the proprietary funds. GASB requires that operating revenues and expenses be reported first, followed by operating income or loss. Note that depreciation expense is separately displayed as an operating expense. Nonoperating revenues and expenses are reported after operating income. Interest revenue and expense are nonoperating.

Capital contributions, additions to endowments, special and extraordinary items, and transfers appear after the nonoperating revenues and expenses. Capital contributions frequently represent contributions of capital assets by neighborhood and commercial property developers. The change in net position is reconciled to the Statement of Net Position by adding the beginning balance of net position for the period.

Note that the \$436,475 total net position appearing at the bottom of the Internal Service Fund columns in this statement and the Statement of Net Position (Illustration 2-9) appears in the reconciliation of the Governmental Funds Balance Sheet with the government-wide Statement of Net Position (Illustration 2-7a). That is because the internal service fund's assets and liabilities are reported within governmental activities in the government-wide Statement of Net Position.

Example Comprehensive Annual Financial Report
Financial Section: Basic Financial Statements
Proprietary Funds Statements: Statement of Revenues, Expenses,
and Changes in Fund Net Position

ILLUSTRATION 2-10 **Proprietary Funds: Statement of Revenues, Expenses,**
and Changes in Fund Net Position

CITY OF SALEM					
Statement of Revenues, Expenses, and Changes					
in Fund Net Position—Proprietary Funds					
For the Year Ended December 31, 2020					
	Business-type Activities—Enterprise Funds			Governmental Activities— Internal Service Fund	
	Water	Solid Waste	Parking	Total	
Operating revenues					
Charges for services	\$ 6,335,022	\$ 2,292,322	\$ 261,088	\$ 8,888,432	\$663,162
Miscellaneous	45,499	58,827	—	104,326	—
Total revenues	6,380,521	2,351,149	261,088	8,992,758	663,162
Operating expenses					
Personnel services	1,576,088	1,164,629	126,466	2,867,183	591,010
Repairs and maintenance	389,271	50,296	—	439,567	2,698
Contractual services	1,107,169	439,355	—	1,546,524	34,622
Depreciation	1,374,214	353,411	153,097	1,880,722	6,654
Utilities	186,195	1,173	40,619	227,987	100
Other	699,009	332,110	63,766	1,094,885	4,256
Landfill closure costs	—	215,659	—	215,659	—
Total operating expenses	5,331,946	2,556,633	383,948	8,272,527	639,340
Operating income (loss)	1,048,575	(205,484)	(122,860)	720,231	23,822
Nonoperating revenues (expenses)					
Interest income	452,718	279,924	1,558	734,200	700
State aid	23,746	6,878	—	30,624	—
Interest expense	(710,042)	—	(97,901)	(807,943)	(558)
Total nonoperating revenue	(233,578)	286,802	(96,343)	(43,119)	142
Income before contributions and transfers	814,997	81,318	(219,203)	677,112	23,964
Capital contributions	3,085,946	2,085,064	—	5,171,010	—
Transfers in	—	—	179,440	179,440	—
Transfers out	(92,300)	(702,202)	—	(794,502)	—
Change in net position	3,808,643	1,464,180	(39,763)	5,233,060	23,964
Net position—beginning of year	29,266,844	8,891,830	4,482,953	42,641,627	412,511
Net position—end of year	\$33,075,487	\$10,356,010	\$4,443,190	\$47,874,687	\$436,475

Example Comprehensive Annual Financial Report
Financial Section: Basic Financial Statements
Proprietary Funds Statements: Statement of Cash Flows

Proprietary Funds: Statement of Cash Flows

Proprietary funds are the only funds that report a Statement of Cash Flows, presented here in Illustration 2-11. Several differences exist between the GASB format cash flow statement and the FASB format required of commercial businesses:

1. GASB requires governments to prepare cash flows from operating activities using the direct method.
2. The reconciliation of income to cash flows from operating activities of the proprietary fund, which appears in the bottom section of the statement, begins with operating income, not total change in net position (or net income for a private sector business).
3. The statement has four sections, rather than the three observed in FASB format statements:
 - Operating activities are those associated with operating income. As a result, cash flows from interest expense, interest revenue, and investment income do not appear in the operating activities section.
 - Noncapital-related financing activities involve the borrowing and payment (including interest) of loans for purposes other than financing capital additions, chiefly, borrowing for operations.
 - Capital and related financing include grants and debt transactions (including interest) used to finance capital additions.
 - Investing activities involve the acquisition and sale of investments as well as cash received from investment income.

One purpose of a cash flow statement is to help in explaining changes between the beginning and ending balances of assets and liabilities. Differences resulting in cash inflows and outflows are reflected in the body of the statement. However, some investing, and financing activities may not affect cash. For example, developers commonly install streets and sidewalks in new developments and contribute these to city governments. The contribution is a noncash capital transaction. Noncash activities such as these are disclosed below the cash flow statement.

In some cases, a portion of the government’s cash may be classified on the Statement of Net Position as *restricted assets*. Therefore, *cash and cash equivalents* appearing on the Statement of Cash Flows will include several balances. For the City of Salem example, these two statements are reconciled as follows:

Total Enterprise Funds		
Cash and cash equivalents	\$4,814,724	Statement of Net Position
Restricted assets	2,295,043	Statement of Net Position
Cash and cash equivalents	\$7,109,767	Statement of Cash Flows

Example Comprehensive Annual Financial Report
Financial Section: Basic Financial Statements
Proprietary Funds Statements: Statement of Cash Flows

ILLUSTRATION 2-11 Proprietary Funds: Statement of Cash Flows

CITY OF SALEM Statement of Cash Flows Proprietary Funds For the Year Ended December 31, 2020					
	Business-type Activities—Enterprise Funds				Governmental Activities— Internal Service Fund
	Water	Solid Waste	Parking	Total	
Cash flows from operating activities					
Cash received from customers	\$6,388,018	\$2,343,431	\$259,946	\$8,991,395	\$649,426
Cash paid to suppliers	(2,490,241)	(822,363)	(80,137)	(3,392,741)	(630,437)
Cash paid to employees	(948,035)	(764,032)	(99,517)	(1,811,584)	—
Other	(588,974)	(322,472)	(50,430)	(961,876)	—
Net cash provided by operating activities	2,360,768	434,564	29,862	2,825,194	18,989
Cash flows from noncapital financing activities					
Operating grants received	—	6,594	—	6,594	—
Transfers from other funds	—	—	179,440	179,440	—
Transfers to other funds	(92,300)	(702,202)	—	(794,502)	—
Net cash provided by noncapital financing activities	(92,300)	(695,608)	179,440	(608,468)	—
Cash flows from capital and related financing activities					
Acquisition of capital assets	(543,169)	(456,179)	—	(999,348)	—
Principal paid on long-term debt	(1,014,887)	—	(128,420)	(1,143,307)	(3,719)
Interest paid	(535,567)	—	(95,961)	(631,528)	—
Net cash provided from capital and related financing activities	(2,093,623)	(456,179)	(224,381)	(2,774,183)	(3,719)
Cash flows from investing activities					
Interest received	287,725	279,924	1,558	569,207	700
Net cash provided from investing activities	287,725	279,924	1,558	569,207	700
Increase in cash	462,570	(437,299)	(13,521)	11,750	15,970
Cash and cash equivalents—beginning of year	4,734,195	2,185,444	178,378	7,098,017	65,677
Cash and cash equivalents—end of year	\$5,196,765	\$1,748,145	\$164,857	\$7,109,767	\$ 81,647
Reconciliation of operating income to net cash provided by operating activities:					
Operating income	1,048,575	(205,484)	(122,860)	720,231	23,822
Depreciation	1,374,214	353,411	153,097	1,880,722	6,654
(Increase) decrease in receivables	21,097	122,828	(375)	143,550	(13,736)
(Increase) decrease in inventory	—	—	—	—	(46,535)
Increase (decrease) in accounts payable	(83,118)	—	—	(83,118)	48,784
Increase in landfill closure liability	—	163,809	—	163,809	—
Net cash provided by operating activities	\$2,360,768	\$ 434,564	\$ 29,862	\$2,825,194	\$ 18,989
Noncash investing, capital, and financing activities:					
Contributions of capital assets from developers	\$3,085,946	\$2,085,064	\$ —	\$5,171,010	\$ —

Example Comprehensive Annual Financial Report
Financial Section: Basic Financial Statements
Fiduciary Funds Statements: Statement of Fiduciary Net Position;
Statement of Changes in Fiduciary Net Position

Fiduciary: Statement of Fiduciary Net Position

Illustration 2-12 presents a Statement of Fiduciary Net Position. Fiduciary funds are reported by fund type, rather than individual major funds. GASB requires that fiduciary fund statements be included for all trust and custodial fund types and for component units that are fiduciary in nature. GASB also requires that if separate GAAP basis financial statements are not issued for individual pension and other employee benefit plans, those reports must be included in the notes to the basic financial statements. The fiduciary funds use the economic resources measurement focus and may include noncurrent assets and long-term liabilities. Note in Illustration 2-12 that the excess of assets over liabilities is labeled *net position* and the statement indicates that the resources are restricted for varying purposes.

Fiduciary: Statement of Changes in Fiduciary Net Position

Illustration 2-13 presents a Statement of Changes in Fiduciary Net Position. Although fiduciary funds use accrual accounting, the activity accounts are not labeled Revenues and Expenses. Rather the terms *additions* and *deductions* are used to reflect the fact that the government only has custody of the resources. Recall also that fiduciary funds are not included in the government-wide financial statements.

Custodial funds are a relatively new category (effective in 2019) that include resources held by a government in a fiduciary arrangement but may not have been created through a formal trust agreement. Tax collection funds are a common custodial fund. These are established when one government collects sales or property taxes for another government. Note that the tax collections are reported as additions and the amounts due the other government are reported as deductions in the Statement of Changes in Fiduciary Net Position.

Trust funds frequently have substantial investments activities. GASB requires that investments be reported at fair value. Changes in the value of investments are reflected in the Statement of Changes in Fiduciary Net Position as *increase (decrease) in the fair value of investments*. In the case of the City of Salem, this totals \$163,050.