

# APPENDIX C – Selected Pronouncements of the Governmental Accounting Standards Board

## Table of Contents

|  | <b>Section - Page</b> |
|--|-----------------------|
| <b><u>THE FINANCIAL REPORTING ENTITY</u></b>   | <b><u>1 – 1</u></b>   |
| Impact on the School District’s Financial Statements .....   | 1                     |
| Notes to Financial Reporting Entity Flowchart .....  | 2                     |
| Notes to Financial Reporting Entity Flowchart .....  | 3                     |
| Interlocal Cooperation: Activities With Other Governments .....  | 5                     |
| Interlocal Agreements .....  | 5                     |
| Joint Ventures .....   | 6                     |
| Jointly Governed Organizations .....   | 7                     |
| Related Organizations .....  | 7                     |
| Joint Operations or Undivided Interests .....  | 8                     |
| Cost-Sharing Arrangements .....  | 8                     |
| Pools .....  | 8                     |
| Unilaterally Controlled Joint Organizations .....  | 8                     |
| <b>Illustrative Examples .....</b>   | <b>9</b>              |
| Educational Service District .....   | 9                     |
| Purchasing Cooperative: King County Directors’ Association .....                                       | 9                     |
| Transportation Cooperatives .....  | 9                     |
| Vocational Skills Centers .....  | 9                     |
| Parent Teacher Associations and Booster Clubs .....  | 10                    |
| Foundations .....  | 10                    |
| Insurance Pools .....  | 10                    |
| WSIPC Data Processing Cooperative .....  | 10                    |
| <b><u>ACCOUNTING FOR COMPENSATED ABSENCES</u></b>  | <b><u>2 – 1</u></b>   |
| Introduction .....   | 1                     |
| Vacation Leave .....   | 1                     |
| Sick Leave .....   | 2                     |
| <b>Termination Method Calculations .....</b>   | <b>3</b>              |
| “Ratio” Approach .....   | 3                     |
| “Days Paid” Approach .....   | 4                     |
| “Amount Paid” Approach .....   | 5                     |
| Vesting Method Calculation .....   | 6                     |
| <b><u>ACCOUNTING AND FINANCIAL REPORTING FOR CERTAIN GRANTS AND OTHER<br/>FINANCIAL ASSISTANCE</u></b> | <b><u>3 – 1</u></b>   |
| Introduction .....   | 1                     |
| Pass-Through Grants .....  | 1                     |
| Food Stamps .....  | 1                     |

|   |               |
|---|---------------|
| On Behalf Payments for Fringe Benefits and Salaries .....   | 1             |
| <b><u>INVESTMENTS AND INVESTMENT POOLS</u></b> .....  | <b>4 – 1</b>  |
| Introduction .....  | 1             |
| Revenue Recognition .....   | 1             |
| Budgeting Changes in Fair Value of Investments .....  | 1             |
| Reporting .....   | 1             |
| F-195 and F-196 Treatment of GASB Statement 31 .....  | 1             |
| <b><u>DEFERRED COMPENSATION PLANS</u></b> .....   | <b>5 – 1</b>  |
| Introduction .....  | 1             |
| Reporting .....   | 1             |
| Valuation .....   | 1             |
| Application and Effective Dates .....   | 1             |
| <b><u>ACCOUNTING AND FINANCIAL REPORTING FOR NONEXCHANGE TRANSACTIONS</u></b> .....   | <b>6 – 1</b>  |
| Introduction .....  | 1             |
| Classes of Nonexchange Transactions .....   | 1             |
| Time Requirements and Purpose Restrictions .....  | 1             |
| Recognition Standards .....   | 2             |
| Effective Date .....  | 3             |
| <b><u>BASIC FINANCIAL STATEMENTS-AND MANAGEMENT’S DISCUSSION AND ANALYSIS-FOR STATE AND LOCAL GOVERNMENTS</u></b> .....   | <b>7 – 1</b>  |
| Summary .....   | 1             |
| Important Aspects of MD&A .....   | 2             |
| Important Aspects of the Government-Wide Financial Statements .....   | 2             |
| Important Aspects of the Fund Financial Statements .....  | 2             |
| Required Supplementary Information .....  | 3             |
| Effective Date and Transition .....   | 4             |
| <b><u>RECIPIENT REPORTING FOR CERTAIN SHARED NONEXCHANGE REVENUES—(AN AMENDMENT OF GASB STATEMENT 33)</u></b> .....   | <b>8 – 1</b>  |
| <b><u>BASIC FINANCIAL STATEMENTS-AND MANAGEMENT’S DISCUSSION AND ANALYSIS-FOR STATE AND LOCAL GOVERNMENTS: OMNIBUS—(AMENDMENT OF GASB STATEMENTS 21 AND 34)</u></b> ..... | <b>9 – 1</b>  |
| <b><u>CERTAIN FINANCIAL STATEMENT NOTE DISCLOSURES</u></b> .....  | <b>10 – 1</b> |
| <b><u>IMPAIRMENT OF CAPITAL ASSETS</u></b> .....  | <b>11 – 1</b> |

## **THE FINANCIAL REPORTING ENTITY** **(GASB STATEMENT 14)**

GASB Statement 14, *The Financial Reporting Entity*, establishes standards for defining and reporting on the **financial reporting entity**. It defines the financial reporting entity as consisting of (1) the primary government, (2) organizations for which the primary government is financially accountable, and (3) other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the reporting entity's financial statements to be misleading or incomplete.

The primary government is financially accountable for those organizations that make up its legal entity as well as legally separate organizations if (1) the primary government appoints a voting majority of an organization's governing body, and (2) either it can impose its will on that organization, or (3) there is a potential for the organization to provide specific financial benefits to, or to impose specific financial burdens on, the primary government.

Organizations determined to be **component units** of the primary government under Statement 14 should be included in the financial reporting entity either by blending (see below\*) into the financial data of the primary government or by discrete presentation in one or more columns separate from the financial data of the primary government.

Many districts participate in joint ventures or cost-sharing arrangements. Presentation of such related organizations present special issues. Statement 14 and its model financial statements should be consulted for an in-depth discussion.

The flowchart on the following page will help determine an organizations reporting status. The reader should start with the flowchart and accompanying notes. The next section addresses organizations for which the answer to Question No. 7 (Is there a financial benefit/burden relationship?) on the Financial Reporting Entity flowchart is "no."

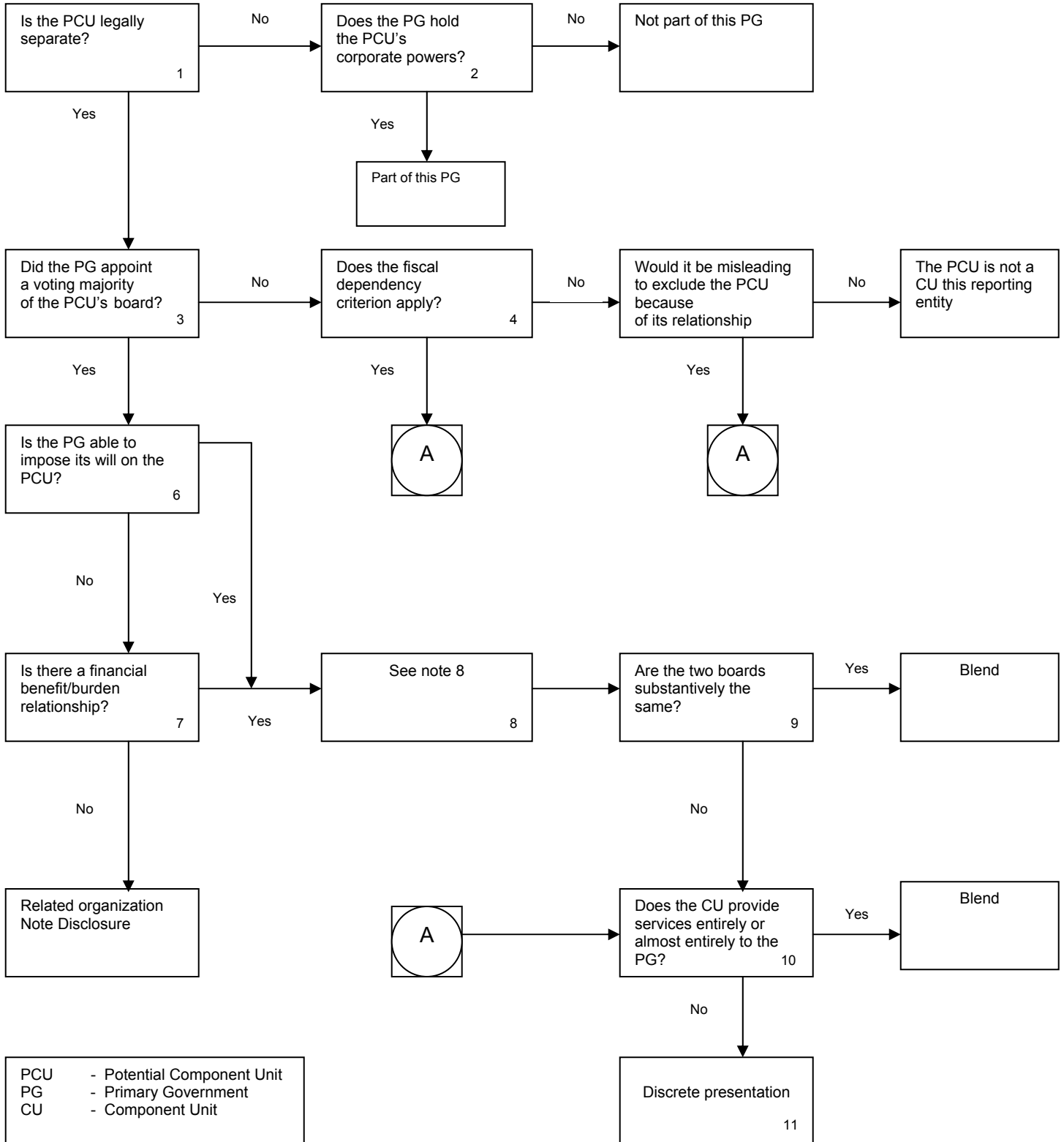
### **Impact on the School District's Financial Statements**

**It is expected most school districts in the state of Washington do not have a relationship with a component unit. In addition, school districts are not component units of the state of Washington.**

If a district does have a relationship with a component unit or a related organization, the following apply:

1. \*For F-196 Annual Financial Statements for School Districts, financial information relating to component units should not be blended into the district's financial statements, even if such presentation is appropriate under Statement 14. Component units and related organizations should be reported in any notes accompanying the F-196.
2. For school districts Comprehensive Annual Financial Reports (CAFR) the reporting should be as follows:
  - a. Related Organization: requires note disclosure.
  - b. Component Units: requires either blending or discrete presentation depending on the circumstances indicated in this appendix.

**Financial Reporting Entity Flowchart**  
(See notes on following page.)



## **Notes to Financial Reporting Entity Flowchart**

1. An organization has separate legal standing if it is created as a body corporate or a body corporate and politic, or if it otherwise possesses corporate powers.
2. Corporate powers give an organization the capacity to have a name; the right to sue and be sued in its own name without recourse to the state or local government; and the right to buy, sell, lease, and mortgage property in its own name.
3. The primary government's appointment authority should be substantive. This excludes selections from lists of candidates or confirmations. The requirements apply also to the situation in which the voting majority consists of a primary government official serving as required by law (and not technically appointed). The primary government is accountable also if it can unilaterally abolish an organization or it has continuing appointment authority.
4. Fiscal dependence does not necessarily mean financial benefit or burden for a primary government. An organization is fiscally dependent if it cannot meet all three of the following requirements without substantive approval of a primary government:
  - a. Determine its budget.
  - b. Levy taxes or set rates or charges.
  - c. Issue bonded debt.

It is also important to make a distinction between substantive and ministerial (compliance) approval. Ministerial approval is often a result of the general oversight of the respective state or local governments. This may include evaluation of programs, review for compliance with the statutory requirements, etc. Being subject to ministerial approval does not qualify an organization as fiscally dependent. Also, a primary government that is temporarily under the fiscal control of another government continues to be fiscally independent.

5. Some component units, despite being legally or fiscally independent from the primary government, are so intertwined with the primary government that they are, in substance, the same as primary government. For example, they have substantially identical governing body, or they exclusively or almost exclusively provide services or benefit the primary government.

6. A primary government has the ability to impose its will on an organization if it can significantly influence the programs, projects, activities, or level of services performed or provided by the organization. The existence of any one of the following conditions indicates that the primary government has the ability to impose its will on an organization:
- a. The ability to remove the appointed members of the organization's governing body at will.
  - b. The ability to modify or approve the budget of the organization.
  - c. The ability to modify or approve the rate or fee changes affecting revenues, such as water usage rate increases.
  - d. The ability to veto, overrule, or modify the decisions (other than those in b. and c.) of the organization's governing body.
  - e. The ability to appoint, hire, reassign, or dismiss those persons responsible for the day-to-day operations (management) of the organization.

There may be other conditions indicating the possibility of imposing will. When assessing them, remember to make the distinction between substantive and ministerial approvals.

7. The benefit or burden may result from legal entitlements or obligations, or it may be less formalized and exist because of a decision made by the primary government or agreements between the primary government and component unit.

An organization has a financial benefit or burden relationship with the primary government if any one of these conditions exists:

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

Exchange transactions between organizations and the primary government are not considered a financial benefit or burden relationship.

The effect of the financial benefits or burdens on the primary government can be either direct or indirect. A direct effect occurs when the primary government itself is entitled to the resources or obligated for the deficits or debts of the organization. An indirect relationship occurs when one or more of the primary government's component units is entitled to the resources and obligated for the deficits or debts of the organization. In both cases the primary government has the benefit/burden relationship with the organization.

8. A potential component unit for which a primary government is financially accountable may be fiscally dependent on another government. An organization should be included as a component unit of only one reporting entity. Professional judgment should be used to determine the most appropriate reporting entity. A primary government that appoints a voting majority of the governing board of a component unit of another government should make the disclosures required for related organizations.
9. “Substantively the same” means sufficient representation of the primary government’s entire governing body on the component unit’s governing body to allow complete control of the component unit’s activities.
10. The essence of this type of arrangement is much the same as an internal service fund—the goods or services are provided to the government itself rather than to the citizenry.
11. GASB Statement 14 allows flexibility in displaying the component unit’s financial data.

### **Interlocal Cooperation: Activities With Other Governments**

Organizations not included as component units in the primary government’s reporting entity, but for which the primary government may appoint some or all of the governing board members, may need to be disclosed. These are organizations that the answer to Question No. 7 on the Financial Reporting Entity flowchart is “no.” These related organizations are discussed in the following sections.

School districts may cooperate under certain conditions with other local governments. The basis is mutual advantage to provide services and facilities. This is accomplished in a manner and pursuant to forms of governmental organization that will best accord with geographic, economic, population, and other factors influencing the needs and development of local communities.

### **Interlocal Agreements**

An interlocal agreement is a contract entered into by two or more public agencies for joint or cooperative action. This action must be a power, privilege, or authority already capable of being exercised by the public agencies involved, and the manner of financing shall be as provided by law. The agreement could establish a separate entity as described below.

If the interlocal agreement does establish a separate legal or administrative entity, this entity must be legally created (insurance boards, RCW 48.62.040 through 48.62.100; irrigation districts, RCW 87.03.018; hydroelectric resources, RCW 87.03.828). The agreement must specify duration, organization, purpose, manner of financing and methods of termination. Funds of this separate entity would be subject to audit in the manner provided by law for the auditing of public funds.

If the interlocal agreement does not establish a separate legal entity by law, the agreement must specify the criteria listed above and must also provide for an administrator or a joint board responsible for administering the cooperative undertaking. Provisions are also required to detail the manner of the joint board in acquiring, holding, and disposing of real and personal property used in the joint undertaking. The joint board is also authorized to establish an operating fund with a county, city, or district treasurer of one of the involved public agencies.

The interlocal agreement is filed with the city clerk, county auditor, secretary of state and, if applicable, a state officer or agency with statutory powers of control.

Chapter 39.34 RCW issues various guidelines and requirements applicable to interlocal agreements.

For reporting treatment, an interlocal agreement must be evaluated for each member agency to determine whether “joint venture” treatment is applicable. If joint venture treatment is applicable, see the reporting treatment as recommended in the joint venture section. If joint venture treatment is not applicable, the existence of the interlocal agreement should be footnoted and the transactions should be accounted for in the appropriate fund. Contractual requirements take precedence over accounting requirements; for example, a contract may require one member to be the reporting entity when it does not exercise “oversight responsibility.”

## **Joint Ventures**

### **Characteristics**

A joint venture is a legal entity or other organization that results from a contractual arrangement and that is owned, operated, or governed by two or more participants as a separate and specific activity. To qualify as a joint venture, an arrangement must involve both (1) joint control and (2) an ongoing financial interest **or** an ongoing financial responsibility.

Joint control—No single participant has the ability to unilaterally control the financial or operating policies of the joint venture.

Ongoing financial responsibility—A participant is obligated in some manner for the debt of the joint venture, or the joint venture depends upon the participant’s continued funding. (This criterion is subject to professional judgment. A general rule: a joint venture’s dependability on the many participants is likely to decrease as the number of participants increase.)

Ongoing financial interest—A participant has access to the joint venture’s resources. Such access can be either direct (e.g., a right to surplus) or indirect (e.g., the ability to cause the joint venture to undertake projects of benefit to the participant).

A lack of ongoing financial interest or ongoing financial responsibility designates the entity as a jointly governed organization subject to different disclosure requirements.

When the number of participants in a joint venture increases, their financial responsibility may decrease. GASB Statement 14 does not establish any breaking point for determining when the participant is financially responsible. A decision, in the marginal cases, is left to the professional judgment of the government.

### **Financial Reporting**

For financial reporting purposes there are two types of joint ventures:

- Joint ventures whose participants have an equity interest.
- Joint ventures whose participants do not have an equity interest.

The indication of an equity interest is an ownership of shares of the joint venture’s stock or other explicit and measurable rights to net resources (usually based on investment of

financial or capital resources in the joint venture). To be considered explicit and measurable, the rights to the present or future claims to the joint venture's resources and the methods to determine the amounts have to be clearly defined in the joint venture agreement. If equity interest in the joint venture is implied rather than explicitly stated, the joint venture participants should consider modifying the agreement to clarify its intent.

Because the equity interest primarily represents equity in capital assets, it should be reported in the General Fixed Assets Account Group. The amount reported is the total equity adjusted for any portion of the equity interest that is included in the balance sheet of the governmental fund (net investment in joint venture account). The operating statement should include the changes in the joint venture's equity only if the amounts received or receivable from the joint venture or the amounts paid or payable to the joint venture meet the revenue and expenditures recognition criteria.

### Disclosure

1. A general description of the joint venture that includes:
  - A description of any ongoing financial interests.
  - A description of any ongoing financial responsibility.
  - Information to allow the reader to evaluate whether the joint venture is accumulating significant financial resources or is experiencing fiscal stress that may cause an additional financial benefit to or burden on the participant in the future, and information about the availability of separate financial statements of the joint venture.
2. Information on related party transactions.

## **Jointly Governed Organizations**

### Characteristics

A regional organization or multiorganizational arrangement that is governed by representatives from each of the organizations that create it, but that is not a joint venture because the participants do not retain an ongoing financial interest or responsibilities.

### Disclosure

Limited to related party transaction information.

## **Related Organizations**

### Characteristics

The primary government appoints a voting majority of the board but is not financially accountable (there is no financial benefit or burden relationship). There is no substantive budget approval authority or imposition of will.

### Disclosure

The primary government should disclose in the notes to financial statements the nature of its accountability. Groups of related organizations with similar relationships may be summarized. Also, information regarding related party transactions should be disclosed.

## **Joint Operations or Undivided Interests**

### **Characteristics**

A joint operation or undivided interest is an ownership arrangement in which two or more participants retain equity rights in specific assets and are liable for specific obligations. No separate legal entity or organization is created.

### **Disclosure**

The participant should report assets, liabilities, revenues, and expenditures/expenses associated with the joint operations in appropriate financial statements. If there is a hybrid arrangement, i.e., the activity possesses characteristics of both a joint venture and joint operation, the joint venture and joint operation components should be distinguished and disclosed separately.

## **Cost-Sharing Arrangements**

GASB Statement 14 lists other arrangements that should not be considered joint ventures. Examples are jointly financed projects such as highway construction, joint purchasing agreements, and PERS.

## **Pools**

### **Characteristics**

Pools have many characteristics of joint ventures, but they possess other features that differ. Typically, pools have “open” membership; that is, other entities are free to join, resign, increase or decrease their participation in the pool without the knowledge or consent of the other participants.

### **Disclosure**

Guidance on the accounting and reporting for pools is set by GASB Statement 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*.

## **Unilaterally Controlled Joint Organizations**

### **Characteristics**

An organization may have several participants (like a joint venture) but only one participant appoints voting majority of the organization’s governing body (so there is no joint control). If the participant is also financially accountable for the organization (e.g., imposition of will, fiscal benefit or burden, or fiscal dependence) or it would be misleading to exclude the organization from reporting entity, the joint organization should be reported as a component unit. But, if there is no financial accountability, the joint organization should be disclosed as a related organization.

### **Disclosure**

See disclosure requirements for component units or related organizations. A minority participant in a joint organization would treat participation as either a joint venture or a jointly governed organization, depending upon the degree of ongoing financial interest or responsibility and make appropriate disclosures.

## **Illustrative Examples**

**The following examples illustrate how the provisions of the GASB Statement 14 would be applied to a particular set of hypothetical circumstances.**

### **Example 1:**

#### **Educational Service District**

Model note disclosure:

Investment in Joint Venture. The school district is served by Educational Service District No. \_\_\_\_\_. The ESD is a regional service entity organized to serve the educational needs of all school districts in \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_ Counties. All school districts in the ESD's service area collectively elect \_\_\_ directors to the ESD. Participating school districts have neither an ongoing financial interest nor responsibility. The ESD's relationship to the school district is one of a jointly governed organization.

**Other Disclosure:** Related party transactions need to be disclosed.

### **Example 2:**

#### **Purchasing Cooperative: King County Directors' Association**

Model Note disclosure:

Investment in Joint Venture. The school district is a member of King County Directors' Association (KCDA). KCDA is a purchasing cooperative designed to pool member districts' purchasing power. The district initially made an investment of \$\_\_\_\_\_ in 19\_\_ and has remained in the joint venture ever since. The district's current equity of \$\_\_\_\_\_ is based upon KCDA's total sales with the district compared to all other districts applied pro-rata to the net profit of KCDA. The district may withdraw from the investment group and will receive its equity in ten annual payments.

**The following examples are designed to be illustrative and depend upon the facts of the example.**

### **Example 3:**

#### **Transportation Cooperatives**

RCW 28A.160.120 authorizes school districts to enter into agreements with other local governments, including school districts, to provide student transportation. This statute provides that these agreements will be formed under the Interlocal Cooperation Act (chapter 39.34 RCW) or chapter 35.58 RCW.

Three school districts have formed a transportation cooperative. The cooperative is organized on a cost-sharing basis. There is no separate entity established. ABC School District is the lead/host district. Participating districts have an equity interest in all equipment. Accounting and disclosure procedures for cost-sharing arrangements of joint operations should be followed. Model note disclosure for the lead district is contained under "Other Disclosures" in Appendix C.

### **Example 4:**

#### **Vocational Skills Centers**

Vocational skills centers are organized under RCW 28A.630.860 through RCW 28A.630.880. The statute does not mandate any organization structure. Accordingly, each structure should be evaluated in the context of this bulletin. Model note disclosure for the lead district is contained under "Other Disclosures" in Appendix C.

**Example 5:**

**Parent Teacher Associations and Booster Clubs**

Parent teacher associations and booster clubs require no accounting treatment or disclosure, provided the district does not appoint board members to these groups. If the district does appoint board members, the district may need to disclose or account for the group. See the financial reporting entity flowchart on page 2.

**Example 6:**

**Foundations**

Since districts may not form foundations (see Chapter 9, Section 10), no accounting or disclosure is required.

**Example 7:**

**Insurance Pools**

The participation in insurance pools is covered in GASB codification C50, "Claims and Judgments." See also the "Risk Management" model note disclosure in Appendix C.

**Example 8:**

**WSIPC Data Processing Cooperative**

Most school districts participate in the WSIPC data processing cooperative under the authority of the Interlocal Cooperation Act (chapter 39.34 RCW). The relationship with WSIPC is as a "jointly governed organization." Payments are made on a fee-for-service basis with no ongoing financial obligation on the part of participating districts. Unless there is a related party transaction, no note disclosure is necessary.

## **ACCOUNTING FOR COMPENSATED ABSENCES** **(GASB STATEMENT 16)**

### **Introduction**

School districts are required to report a liability on their balance sheet for leave earned by employees. GASB Statement 16, Accounting for Compensated Absences, provides specific guidance on how this leave liability should be calculated. Statement 16 does not deal with presentation issues, such as whether the compensated absences liability should be reported in governmental funds or in the General Long-Term Debt Account Group (GLTDAG).

The effective date of Statement 16 was for financial statement fiscal years beginning 1993–94.

Statement 16 provides separate guidance for vacation leave and unused sick leave to be paid at termination.

Decision trees showing key elements for each type of leave follow at the end of this section.

Reference related journal entries No. 1 and 16 in Chapter 7, Section 7–General Long-Term Debt Account Group Journal Entries.

Additional information is found in the Government Finance Officers' Association publications: *1993 Cumulative GAAFR Supplement*, *GAAFR Supplement Study Guide*, and the November 1992 issue of *GAAFR Review*.

### **Vacation Leave**

Statement 16 requires employers to report a liability for vacation leave earned by employees when both the following two criteria have been met:

- The vacation leave is related to employee services already rendered.
- Eventual payment to the employee is considered probable.

“Payment” means compensation through paid time off or some other means, such as cash payments at termination or retirement. Consequently, accumulated vacation leave at fiscal year-end should be accrued for time that will be taken off by the employee in a subsequent fiscal year and paid through the employee’s regular pay. This issue often confuses employers because they do not see a cost increase when vacation time paid is included in next year’s salary. GASB, however, considers there to be an imbedded cost because less work is accomplished in the next year.

The amount of vacation leave liability should be valued using current salary costs (that is, pay rates in effect as of fiscal year-end). This rule does not apply if employees are compensated for leave at some other rate. For example, the salary rate in effect at the time leave was earned by the employee. In this case, the liability should be valued using this other rate.

The liability should also reflect any salary-related payments **directly and incrementally** connected with leave payments to employees (employer FICA, employer Medicare, eligible contributions to the state retirement system) and are applicable to payments made upon termination. For example, a retirement contribution is made for accrued vacation paid upon termination for employees in TRS 1 and PERS 1, but not for employees in TRS 2 and PERS

2. Statement 16 requires inclusion of retirement for all TRS 1 and PERS 1 accrued vacation, but **none** is to be included for TRS 2 or PERS 2 accrued vacation. (Note: Salary-related benefit rates should take into account factors such as employees whose salaries exceed the maximum social security withholding. Salary-related payments would **not** include life insurance premiums and health care premiums paid on behalf of employees.)

The liability for vacation leave should include nonvested leave earned by employees that is expected to vest. For example, assume new employees earn one day of vacation leave per month, but may not take any leave prior to completing a six-month probationary period. Further assume that employees not completing the probationary period forfeit any leave earned during that period. The employer would then accrue leave earned by new employees to the extent those employees are expected to successfully complete the probationary period.

Conversely, the liability for vacation leave should not include accumulated amounts expected to lapse. When determining the effect of lapsing vacation leave on the amount of the vacation leave liability reported at fiscal year-end, it is important to pay attention to the “flow assumption,” that is, whether employees are considered to use their most recently earned vacation days first or last.

### **Sick Leave**

Statement 16 prohibits the accrual of sick leave payments made to employees for time taken off on account of illness or other medical-related reasons because this is not considered a true liability since it is contingent upon a future event beyond the control of both the employer and employee. It does, however, require that employers report a liability for unused sick leave to be paid at termination.

Statement 16 sets forth the following two different approaches for measuring this liability:

1. Termination Payments Method: Under this approach, a district calculates the amount of sick leave to be paid upon termination based upon past experience in making such payments.
2. Vesting Method: Under this approach, a district estimates the liability for sick leave payouts by calculating the amount of sick leave expected to become eligible for payout at termination.

Using either method, the liability includes salary-related payments (benefits) connected with termination payouts for unused sick leave. Also, both methods require the use of current salary rates unless compensation is at some other rate. For example, the salary rate in effect at the time the leave was earned by the employee, in which case that rate is used instead.

Further, if any unused sick leave is applied to an employee’s service credits to qualify the employee for retirement, that unused sick leave must be removed from the amount available to be paid out at termination.

In choosing which method to use, several observations must be made. For example, the vesting method may be the more practical approach in situations where a district does not have adequate historical data to establish past sick leave payout patterns. Larger districts may choose to use samples to avoid the need to collect and manipulate data for numerous employees. Similarly, past sick leave payout patterns (termination payments method) may be of limited benefit for districts with a relatively small number of employees.

Some leave eligible for payout upon termination may eventually be used for illness. Consequently, the liability calculated using the vesting method is likely to include an amount for sick leave that will be used to compensate employees for time taken off on account of illness. In this case, GASB allows the leave within the liability based upon cost-benefit considerations.

Note also the time focus of the two methods. The termination payments method focuses on several past periods. The vesting method focuses primarily on data as of the balance sheet date.

It should be observed that the termination payment method automatically reflects the amount of currently unvested sick leave that will eventually vest. Under the vesting method, a district should adopt a policy for determining that amount.

Normal accounting treatment applies when recording the compensated absences liability. Use the appropriate governmental fund to record the liability if the employee will be paid with current available resources (as would occur when the employee has retired by August 31 and will receive payment for accrued vacation and unused sick leave by October 31). Use the General Long-Term Debt Account Group (GLTDAG) to record the liability when there is uncertainty as to when the employee will retire and/or receive payment or when current available resources will not be used to liquidate the liability.

### **Termination Method Calculations**

There are at least three different ways the termination payments method for sick leave can be applied in practice: (1) The “ratio” approach, (2) the “days paid” approach, and (3) the “amount paid” approach.

#### **“Ratio” Approach**

This approach appears to be one of the simpler calculation methods. The liability for unused sick leave is calculated using the historical ratio of sick leave paid to sick leave accumulated. Refer to Exhibit A when considering the following steps:

1. The employer prepares a list of sick leave payouts for the past several years (in this example, a previous five-year period) as well as a list of year-end sick leave balances in dollars for those same years.  
  
(See Exhibit A: This amount includes vesting and nonvesting sick leave.\*)
2. The employer then totals the sum of sick leave payouts (\$8,026) and the sum of year-end sick leave balances (\$167,840) for the five-year period.
3. The employer then calculates the ratio of sick leave payouts to year-end sick leave balances ( $\$8,026/\$167,840 = 4.8\%$ ).

4. This rate can then be applied to the current sick leave balance (\$42,710) and adjusted for salary-related payments (7.65% of payroll) to calculate the liability for payouts of unused sick leave at termination ( $4.8\% \times \$42,710 \times 1.0765 = \$2,207$ ).

| <b>EXHIBIT A</b>                              |                           |                                  |
|---|---------------------------|----------------------------------|
| <b>Assumptions Underlying "Ratio" Example</b> |                           |                                  |
| <b>Year</b>                                   | <b>Sick Leave Payouts</b> | <b>Total Sick Leave Balance*</b> |
| 20X1  | \$1,075                   | \$21,500                         |
| 20X2  | 1,266                     | 28,133                           |
| 20X3  | 1,650                     | 36,000                           |
| 20X4  | 2,010                     | 40,020                           |
| 20X5  | 2,025                     | 42,187                           |
|   | \$8,026                   | \$167,840                        |
| 20X6  | ?                         | \$42,710                         |

**“Days Paid” Approach**

Under this approach, the sick leave liability is calculated on the basis of sick leave days paid in the past. Refer to Exhibits B and C (illustrative examples shown are from these exhibits) when considering the following steps:

1. The employer prepares a list of employees who have terminated during the past several years (in this example, the preceding five-year period as illustrated in Exhibit C).
2. For each employee terminated during that five-year period, the employer lists (1) the number of unused sick leave days payout at termination, (2) the total years worked, and (3) the total sick leave payout amount. These amounts are then totaled (70 days of paid unused sick leave, 60 years of service, and \$2,208 sick leave payout for terminated employees).
3. State of Washington employees are paid at 25 percent of their regular pay rate for unused sick leave. Accordingly, the total number of paid unused sick days (70 days) is first multiplied by the average daily pay rate for current employees (\$96/day) and then reduced to the pay rate in effect for termination payments (70 days x \$96/day x 25% = \$1,680).
4. The adjusted value of sick leave (\$1,680) is divided by the total service years of terminated employees to calculate the sick leave payout per year of service ( $\$1,680/60$  years of service = \$28/year of service).

5. Once the sick leave payout per year of service has been calculated, it is applied to the years of service of current employees (in this example, 38 years) and adjusted to reflect salary-related payments (7.65 percent of payroll). The result is the liability for unused sick leave payouts at termination (38 years of current employee service x \$28/year of service x 1.0765 = \$1,145).

Larger districts may consider using samples to eliminate the need to provide detailed information for numerous employees.

### **“Amount Paid” Approach**

Under this method, the sick leave liability is calculated on the dollar value basis of sick leave paid in the past. Refer to Exhibits B and C when considering the following steps (illustrative amounts are from those exhibits):

1. The employer prepares a list of employees who terminated during the past several years (in this example, the preceding five-year period as illustrated in Exhibit C).
2. For each employee terminated during that period, the employer lists both (1) the total years worked and (2) the amount of unused sick leave payout at termination. The number of years worked for terminated employees is then totaled (60 years).
3. The amount of sick leave paid in each of the preceding years must then be converted into current year dollars. The rate used reflects the average yearly rate of pay increases during the five-year period. The district then calculates the sum of sick leave payouts in current year dollars (\$2,494).
4. Because of their seniority, terminating employees are often paid at a higher daily pay rate than other employees. For example, the average daily pay rate for current employees may be 80 percent of the average daily pay rate of terminating employees. Therefore, the sum of sick leave payouts must be adjusted accordingly ( $\$2,494 \times 80\% = \$1,995$ ).
5. The \$1,995 is then divided by the total years of service of terminated employees to calculate the sick leave payout rate per year of service ( $\$1,995/60$  years of service = \$33.25/year of service).
6. Once the sick leave payout per year of service has been calculated, it is applied to the years of service of current employees (38 years) and adjusted to reflect salary-related payments (7.65 percent of payroll). The result is the liability for unused sick leave payouts upon termination (38 years of current employee service x \$33.25/year of service x 1.0765 = \$1,360).

Again, larger districts may consider using samples to eliminate the need to provide detailed information on numerous employees.

| <b>EXHIBIT B</b>   |                 |                          |
|--|-----------------|--------------------------|
| <b>Assumptions Underlying “Days Paid” and “Amount Paid” Examples</b> |                 |                          |
| <b>Pay rate for termination payments:</b>                            |                 | <b>25%</b>               |
| <b>Salary-related payment ratio:</b>                                 |                 | <b>7.65%</b>             |
| <b>Current average daily salary:</b>                                 |                 | <b>\$96</b>              |
| <b>Current Employees:</b>  | <b>Employee</b> | <b>Length of Service</b> |
|  | 1               | 8 years                  |
|  | 2               | 1 year                   |
|  | 3               | 10 years                 |
|  | 4               | 16 years                 |
|  | 5               | 3 years                  |
|  | <b>TOTAL</b>    | <b>38 years</b>          |

| <b>EXHIBIT C</b>  |                            |                        |                     |                          |                                 |
|---|----------------------------|------------------------|---------------------|--------------------------|---------------------------------|
| <b>Schedule of Employee Terminations Last Five Fiscal Years</b> |                            |                        |                     |                          |                                 |
| <b>Employee</b>   | <b>Year of Termination</b> | <b>Sick Day Payout</b> | <b>Years Worked</b> | <b>Sick Leave Payout</b> | <b>Adjusted Payout (4%/yr.)</b> |
| A   | 20X1                       | 15                     | 13                  | \$567                    | \$690                           |
| B   | 20X2                       | 0                      | 7                   | 0                        | 0                               |
| C   | 20X3                       | 25                     | 14                  | 660                      | 743                             |
| D   | 20X4                       | 30                     | 20                  | 981                      | 1,061                           |
| E   | 20X5                       | 0                      | 6                   | 0                        | 0                               |
| <b>TOTALS</b>   |                            | <b>70</b>              | <b>60</b>           | <b>\$2,208</b>           | <b>\$2,494</b>                  |

### Vesting Method Calculation

Under the vesting method, the sick leave liability is based upon leave balances for current employees that are likely to become eligible for termination payments. Refer to Exhibits D and E when considering the following steps (amounts used are from those exhibits):

1. Typically, employees obtain the right to be compensated for unused sick leave upon completing a certain number of service years. In that case, the district should establish an eligibility policy. It must decide at what point it becomes probable an employee will, in fact, complete the required service period. Turnover is often different for various classes of employees; therefore, the milestone selected may be different for each class of employees (for example, kitchen employees—ten years; professional/technical employees—eight years).
2. The sick leave balance for each current employee who has met the appropriate milestone (for example, kitchen employees—with more than ten years of service) should then be reduced to reflect any cap on sick leave payouts (for example, 180-day maximum).

3. State of Washington employees are paid at 25 percent of their regular pay rate for sick leave payouts on a maximum of 180 accrued days. Accordingly, the sick leave balance for an employee (180 days) is first multiplied by the employee's daily pay rate (\$65/day) and then reduced to the pay rate in effect for termination payments (180 days x \$65/day x 25% = \$2,925).
4. The employer then calculates the sum of these amounts for all employees and adjusts it to reflect salary-related payments (for example, employer FICA and Medicare) to determine the total liability for unused sick leave payouts (\$13,823).

| <b>EXHIBIT D</b>                                     |                     |                       |                        |                       |
|--|---------------------|-----------------------|------------------------|-----------------------|
| <b>Assumption for Illustration of Vesting Method</b> |                     |                       |                        |                       |
| <b><u>Employee</u></b>                               | <b><u>Class</u></b> | <b><u>Balance</u></b> | <b><u>Pay Rate</u></b> | <b><u>Service</u></b> |
| 1  | A                   | 182 days              | \$65/day               | 20 years              |
| 2  | B                   | 84 days               | \$85/day               | 7 years               |
| 3  | A                   | 122 days              | \$50/day               | 17 years              |
| 4  | C                   | 300 days              | \$95/day               | 22 years              |
| 5  | A                   | 20 days               | \$45/day               | 10 years              |
| 6  | C                   | 70 days               | \$90/day               | 6 years               |
| 7  | C                   | 40 days               | \$95/day               | 27 years              |
| 8  | B                   | 34 days               | \$80/day               | 22 years              |
| 9  | A                   | 12 days               | \$55/day               | 5 years               |
| 10   | A                   | 490 days              | \$50/day               | 31 years              |

Service required to be eligible for sick leave payout: 20 years.  
 Limitations on sick leave payouts: 25% pay/180-day maximum.  
 Salary-related payments rate: 7.65%.

Likely to complete 20 years of service:

|         | <b><u>Milestone</u></b> |
|---------|-------------------------|
| Class A | 10 years                |
| Class B | 8 years                 |
| Class C | 12 years                |

| <b>EXHIBIT E</b>                                     |                 |                |                |             |                            |                            |
|--|-----------------|----------------|----------------|-------------|----------------------------|----------------------------|
| <b>Assumption for Illustration of Vesting Method</b> |                 |                |                |             |                            |                            |
| <b>Emp.</b>  | <b>Eligible</b> | <b>Service</b> | <b>Accrue?</b> | <b>Days</b> | <b>Sick Pay Pay Rate**</b> | <b>Liability</b>           |
| 1  | 10 years        | 20 years       | Yes            | 180*        | \$16.25/day                | \$2,925                    |
| 2  | 8 years         | 7 years        | No             | 84          | N/A                        | 0                          |
| 3  | 10 years        | 17 years       | Yes            | 122         | \$12.50/day                | 1,525                      |
| 4  | 12 years        | 22 years       | Yes            | 180*        | \$23.75/day                | 4,275                      |
| 5  | 10 years        | 10 years       | Yes            | 20          | \$11.25/day                | 236                        |
| 6  | 12 years        | 6 years        | No             | 70          | N/A                        | 0                          |
| 7  | 12 years        | 27 years       | Yes            | 40          | \$23.75/day                | 950                        |
| 8  | 8 years         | 22 years       | Yes            | 34          | \$20.00/day                | 680                        |
| 9  | 10 years        | 5 years        | No             | 12          | N/A                        | 0                          |
| 10   | 10 years        | 31 years       | Yes            | 180*        | \$12.50/day                | 2,250                      |
|  |                 |                |                |             |                            | 12,841                     |
|  |                 |                |                |             |                            | Salary-related payments*** |
|  |                 |                |                |             |                            | 982                        |
|  |                 |                |                |             |                            | \$13,823                   |

\*Sick leave payouts limited to 180-day maximum.  
 \*\*25% of regular pay rate.  
 \*\*\*7.65%.

## **ACCOUNTING AND FINANCIAL REPORTING FOR CERTAIN GRANTS AND OTHER FINANCIAL ASSISTANCE (GASB STATEMENT 24)**

### **Introduction**

GASB Statement 24 establishes accounting and financial reporting standards for (1) pass-through grants, (2) food stamps, and (3) on-behalf payments for fringe benefits and salaries.

The purpose of this document is to explain the impact of each of these areas on school district financial operations.

The effective date of Statement 24 is for financial statement periods beginning after June 15, 1995 (FY 1995–96).

### **Pass-Through Grants**

Pass-through grants are those grants received by a recipient government to transfer to or spend on behalf of a secondary recipient.

As a rule, recipient governments should recognize all cash pass-through grants as revenue and expenditures or expenses in a governmental, proprietary, or trust fund.

In those infrequent cases in which a recipient government serves only as a cash conduit, the grant would be reported in an agency fund. It is anticipated that no school district would be considered as a cash conduit only and required to report any grant operations into an agency fund.

A recipient government serves as a cash conduit only when it has no administrative or direct financial involvement in the program. A recipient government has administrative involvement if, for example, it (1) monitors secondary recipients for compliance with program-specific requirements; or (2) determines eligible secondary recipients or projects, even if using grantor-established criteria; or (3) has the ability to exercise discretion in how the funds are allocated.

A recipient government has direct financial involvement if, for example, it finances some direct program costs because of a grantor-imposed matching requirement or is liable for disallowed costs.

### **Food Stamps**

This section applies to the financial operations at the state government level for food stamp coupon distribution and therefore has no impact on school district financial operations.

### **On Behalf Payments for Fringe Benefits and Salaries**

This section applies where the state makes the payment for fringe benefits and salaries on behalf of the local governments. Because school districts in Washington make their own fringe benefit and salary payments directly, this section will not have an impact on current financial operations and does not apply.

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## **INVESTMENTS AND INVESTMENT POOLS** **(GASB STATEMENT 31)**

### **Introduction**

GASB Statement 31 requires governmental entities like school districts to recognize as revenue unrealized gains and losses on certain types of investments of maturity of more than one year at time of purchase. This process is sometimes referred to as “marking to market.” Until the implementation of Statement 31, investments were recorded at cost.

Most school districts can normally expect to receive a communication from their county treasurer after the end of the school year informing them of the amount of unrealized investment gains or losses on investments the county treasurer has made on their behalf.

Districts implementing this statement to be in compliance with generally accepted accounting principles (GAAP) will need to implement the following aspects of GASB 31, which are relevant to school districts in the State of Washington.

### **Revenue Recognition**

“All investment income, including changes in the fair value of investments, should be recognized as revenue in the operating statement.” (GASB 31, paragraph 13, sentence 1.)

### **Budgeting Changes in Fair Value of Investments**

“The board believes that governmental fund investments—changes in the fair value of those investments—are appropriately “available,” thus meriting recognition under the modified accrual basis of accounting.” (GASB Statement 31, paragraph 57, sentence 1.)

### **Reporting**

“Realized gains and losses should not be displayed separately from the net increase (decrease) in the fair value of investments in the financial statements ...” (GASB Statement 31, paragraph 13, sentence 3.)

“When identified separately as an element of investment income, the change in the fair value of investments should be captioned *net increase (decrease) in the fair value of investments.*” (GASB Statement 31, paragraph 13, sentence 2.)

### **F-195 and F-196 Treatment of GASB Statement 31**

Districts should be aware that GASB Statement 31 unrealized investment gains and losses are reported differently for school district budgeting and financial reporting in the State of Washington.

Amounts of unrealized gains and losses should be reported as General Ledger Account 750 Deferred Revenue. This is because these amounts do not represent revenues because they are not available for expenditure in the current fiscal year, but which will be recognized as revenue when they become available for expenditure. (See WAC 392-123-047.)

Districts desiring to report their financial statements in accordance with GAAP will need to convert their F-196 to a GAAP basis through postclosing entries to their F-196. For example, deferred revenues attributable to GASB 31 will need to be reclassified as revenues.

## **DEFERRED COMPENSATION PLANS** **(GASB STATEMENT 32)**

### **Introduction**

GASB Statement 32, *Accounting and Financial Reporting For Internal Revenue Code Section 457 Deferred Compensation Plans*, rescinds GASB Statement 2 and amends GASB Statement 31 and is amended by GASB Statement 34. This is in response to August 1996 changes to Internal Revenue Code (IRC) Section 457.

Prior to the 1996 changes, the assets of the plan remained the property of the government and were required to be reported in the financial statements of the governmental entity sponsoring the plan, even if a third party administered the assets. GASB Statement 2, *Financial Reporting of Deferred Compensation Plans Adopted under the Provisions of Internal Revenue Code Section 457*, therefore required the amounts contractually owed to plan participants be reported as a liability in an agency fund.

The 1996 revision states, “A plan ... shall not be treated as an eligible deferred compensation plan unless all assets and income of the plan described in subsection (b)(6) are held in trust for the exclusive benefit of participants and their beneficiaries...” Under the new requirements, the government no longer owns the amounts deferred by employees or related income on these amounts.

### **Reporting**

“An IRC Section 457 deferred compensation plan that meets the criteria in NCGA Statement 1, *Governmental Accounting and Financial Reporting Principles*, (paragraph 26[3][8]), for inclusion in the fiduciary funds of a government should be reported as a **pension (and other employee benefit) trust fund** in the financial statement of that government.” (GASB 32, paragraph 4.) Emphasis ours.

### **Valuation**

“Governments that report IRC Section 457 plans should apply the valuation provisions of Statement 31 to plan investments listed in subparagraphs 2a through 2e of the statement. All other plan investments should be reported at fair value.

If it is impractical to obtain investment valuation information from the plan administrator as of the reporting government’s balance sheet date, the most recent report of the administrator should be used. For example, reports ending within the reporting government’s fiscal year or shortly thereafter, adjusted for interim contributions and withdrawals.” (GASB 32, paragraphs 5–6.)

### **Application and Effective Dates**

GASB Statement 32 is effective for financial statements for periods beginning after December 31, 1998. The cumulative effect of applying this statement, if any, should be reported as a restatement of beginning fund balance of the current period. The nature of the change and its effect should be disclosed in the notes to the financial statements. (GASB 32, paragraph 7.)

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# **ACCOUNTING AND FINANCIAL REPORTING FOR NONEXCHANGE TRANSACTIONS**

## **(GASB STATEMENT 33)**

### **Introduction**

This Statement establishes accounting and financial reporting standards for nonexchange transactions involving financial or capital resources (for example, most taxes, grants, and private donations). In a *nonexchange* transaction, a government gives (or receives) value without directly receiving (or giving) equal value in return. This is different from an *exchange* transaction, in which each party receives and gives up essentially equal values. The principal issue addressed in this Statement is the *timing of recognition* of nonexchange transactions—that is, when should governments recognize them in the financial statements?

### **Classes of Nonexchange Transactions**

This Statement identifies four classes of nonexchange transactions based on shared characteristics that affect the timing of recognition:

1. *Derived tax revenues*, which result from assessments imposed on exchange transactions (for example, income taxes, sales taxes, and other assessments on earnings or consumption)
2. *Imposed nonexchange revenues*, which result from assessments imposed on nongovernmental entities, including individuals, other than assessments on exchange transactions (for example, property taxes and fines)
3. *Government-mandated nonexchange transactions*, which occur when a government at one level provides resources to a government at another level and requires the recipient to use the resources for a specific purpose (for example, federal programs that state or local governments are mandated to perform)
4. *Voluntary nonexchange transactions*, which result from legislative or contractual agreements, other than exchanges, entered into willingly by the parties to the agreement (for example, certain grants and private donations).

### **Time Requirements and Purpose Restrictions**

This Statement distinguishes between two kinds of stipulations on the use of resources: time requirements and purpose restrictions. Different standards apply for each kind of stipulation.

- *Time requirements* specify (a) the period when resources are required to be used (sold, disbursed, or consumed) or when use may begin (for example, operating or capital grants for a specific period) or (b) that the resources are required to be maintained intact in perpetuity or until a specified date or event has occurred (for example, permanent endowments, term endowments, and similar agreements). Time requirements affect the timing of recognition of nonexchange transactions.
- *Purpose restrictions* specify the purpose for which resources are required to be used. Purpose restrictions should not affect when a nonexchange transaction is recognized. However, governments that receive resources with purpose restrictions should report

resulting net assets, equity, or fund balance as restricted (or a reservation of fund balance for governmental funds).

## **Recognition Standards**

The timing of recognition of, respectively, *assets*, *liabilities*, and *expenses/expenditures* resulting from nonexchange transactions should be the same whether the accrual or the modified accrual (current financial resources) basis of accounting is required. However, for *revenue* recognition to occur on the modified accrual basis, the criteria established in this Statement for accrual-basis recognition should have been met *and* the revenues should be available. "Available" means that the government has collected the revenues in the current period or expects to collect them soon enough after the end of the period to use them to pay liabilities of the current period. Also, this Statement continues the guidance in NCGA Interpretation 3, *Revenue Recognition—Property Taxes*, as amended, for recognizing property taxes on the modified accrual basis of accounting.

The timing of recognition for each class of nonexchange transactions is outlined below. (The accrual basis of accounting is assumed, except where indicated for revenue recognition.)

- **Derived tax revenues**
  - *Assets*—when the underlying exchange transaction occurs or resources are received, whichever is first.
  - *Revenues*—when the underlying exchange transaction occurs. (On the modified accrual basis of accounting, revenues should be recognized when the underlying exchange has occurred *and* the resources are available.) Resources received before the underlying exchange has occurred should be reported as deferred revenues (liabilities).
- **Imposed nonexchange revenues**
  - *Assets*—when the government has an enforceable legal claim to the resources or resources are received, whichever is first.
  - *Revenues*—in the period when use of the resources is required or first permitted by time requirements (for example, for property taxes, the period for which they are levied), or at the same time as the assets if the government has not established time requirements. Resources received or recognized as receivable before the time requirements are met should be reported as deferred revenues. (For property taxes on the modified accrual basis, governments should apply NCGA Interpretation 3, as amended.)
- **Government-mandated and voluntary nonexchange transactions**
  - *Assets* (recipients) and *liabilities* (providers)—when all applicable eligibility requirements are met or resources are received, whichever is first. Eligibility requirements are established by the provider and may stipulate the qualifying characteristics of recipients, time requirements, allowable costs, and other contingencies.

- *Revenues* (recipients) and *expenses/expenditures* (providers)—when all applicable eligibility requirements are met. (On the modified accrual basis, revenues should be recognized when all applicable eligibility requirements are met *and* the resources are available.) For transactions in which the provider requires the recipient to use (sell, disburse, or consume) the resources in or beginning in the following period, resources provided before that period should be recognized as advances (providers) and deferred revenues (recipients). For transactions, such as permanent or term endowments, in which the provider stipulates that resources should be maintained intact in perpetuity, for a specified number of years, or until a specific event has occurred, resources should be recognized as revenues when received and as expenses/expenditures when paid.

**Effective Date**

The provisions of this Statement are effective for financial statements for periods beginning after June 15, 2000.

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# **BASIC FINANCIAL STATEMENTS-AND MANAGEMENT'S DISCUSSION AND ANALYSIS-FOR STATE AND LOCAL GOVERNMENTS** **(GASB STATEMENT 34)**

## **Summary**

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

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

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

### **Important Aspects of MD&A**

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

### **Important Aspects of the Government-Wide Financial Statements**

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

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

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

### **Important Aspects of the Fund Financial Statements**

To report additional and detailed information about the primary government, separate fund financial statements should be presented for governmental and proprietary funds. Required governmental fund statements are a balance sheet and a statement of revenues, expenditures, and changes in fund balances. Required proprietary fund statements are a statement of net assets; a statement of revenues, expenses, and changes in fund net assets;

and a statement of cash flows. To allow users to assess the relationship between fund and government-wide financial statements, governments should present a summary reconciliation to the government-wide financial statements at the bottom of the fund financial statements or in an accompanying schedule.

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

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

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

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

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

### **Required Supplementary Information**

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

## **Effective Date and Transition**

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

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

**RECIPIENT REPORTING FOR CERTAIN SHARED NONEXCHANGE REVENUES—(AN AMENDMENT OF GASB STATEMENT 33)**  
**(GASB STATEMENT 36)**

This Statement provides symmetrical accounting treatment for certain shared revenues by superseding paragraph 28 of GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*. Statement 33 requires governments that share portions of their derived tax or imposed nonexchange revenues to account for the sharing as a voluntary or government-mandated nonexchange transaction, as appropriate. However, paragraph 28 of that Statement required governments that receive those shared portions to account for the sharing as a derived tax or imposed nonexchange transaction—that is, differently than the provider government. As a result, in certain circumstances, the provider and recipient governments would recognize the sharing of revenues at different times. This Statement eliminates that timing difference by requiring recipient governments to account for the sharing of revenues in the same manner as provider governments.

Additionally, this Statement removes the prior guidance in paragraph 28 that required recipient governments to accrue revenues equal to cash received if notification of the amount was not available in a timely manner. This Statement allows other estimation methods by requiring recipient governments to use a reasonable estimate of the amount to be accrued.

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**BASIC FINANCIAL STATEMENTS-AND MANAGEMENT'S  
DISCUSSION AND ANALYSIS-FOR STATE AND LOCAL  
GOVERNMENTS: OMNIBUS—(AMENDMENT OF GASB STATEMENTS 21  
AND 34)  
(GASB STATEMENT 37)**

This Statement amends Statement No. 21, Accounting for Escheat Property, and Statement No. 34, Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments.

The amendments to Statement 21 are necessary because of the changes to the fiduciary fund structure required by Statement 34. Generally, escheat property that was reported in an expendable trust fund in the previous model should be reported in a private-purpose trust fund under Statement 34. This Statement explains the effects of that change.

The amendments to Statement 34 either (1) clarify certain provisions that, in retrospect, may not be sufficiently clear for consistent application or (2) modify other provisions that the Board believes may have unintended consequences in some circumstances. The provisions *clarified* by this Statement include:

- *MD&A requirements.* Governments should confine the topics discussed in MD&A to those listed in paragraph 11 of Statement 34, rather than consider those topics as "minimum requirements."
- *Modified approach.* Adopting the modified approach for infrastructure assets that have previously been depreciated is considered a change in an accounting estimate. The effect of the change is accounted for prospectively, rather than as a restatement of prior periods.
- *Program revenue classifications.* Fines and forfeitures should be included in the broad charges for services category. Also, additional guidance is provided to aid in determining to which function certain program revenues pertain.
- *Major fund criteria.* Major fund reporting requirements apply to a governmental or enterprise fund if the same element (for example, revenues) exceeds both the 10 and 5 percent criteria.

*Modifications* to the requirements of Statement 34 include:

- Eliminating the requirement to capitalize construction-period interest for governmental activities.
- Changing the minimum level of detail required for business-type activities in the statement of activities from segments to different identifiable activities.

The provisions of this Statement should be simultaneously implemented with Statement 34. For governments that implemented Statement 34 prior to the issuance of this Statement, this Statement's requirements are effective for financial statements for periods beginning after June 15, 2000.

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## **CERTAIN FINANCIAL STATEMENT NOTE DISCLOSURES** **(GASB STATEMENT 38)**

This Statement modifies, establishes, and rescinds certain financial statement disclosure requirements.

Existing disclosure requirements are modified to include the following:

- a. Descriptions of the activities accounted for in the major funds, internal service fund type, and fiduciary fund types.
- b. The length of time used to define *available* for purposes of revenue recognition in the governmental fund financial statements.
- c. Actions taken to address significant violations of finance-related legal or contractual provisions.
- d. Debt service requirements to maturity, separately identifying principal and interest for each of the subsequent five years and in five-year increments thereafter.
- e. Obligations under leases for each of the five subsequent years and in five-year increments thereafter.
- f. A schedule of changes in short-term debt and the purpose for which short-term debt was issued
- g. For interfund balances, amounts due from other funds *by* individual major fund, nonmajor governmental funds in the aggregate, nonmajor enterprise funds in the aggregate, internal service funds in the aggregate, and fiduciary fund type; the purpose for those balances; and amounts that are not expected to be repaid within one year..

Governments should provide the following additional note disclosures:

- a. Interest requirements for variable-rate debt computed using the rate effective at year-end.
- b. Terms of interest rate changes for variable-rate debt.
- c. Details about major components of receivable and payable balances when obscured by aggregation and identification of receivable balances not expected to be collected within one year.
- d. For interfund transfers, amounts transferred from other funds *by* individual major fund, nonmajor governmental funds in the aggregate, non-major enterprise funds in the aggregate, internal service funds in the aggregate, and fiduciary fund type; a general description of the principal purposes of interfund transfers; and purposes for and amounts of certain transfers.

This Statement rescinds the requirement in National Council of Governmental Accounting Statement 1, *Governmental Accounting and Financial Reporting Principles*, to disclose the accounting policy for encumbrances.

The provisions of this Statement are generally effective when the provisions of GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, are required to be implemented, except that requirements related to short-term debt, receivable and payable balances, interfund balances, and interfund transfers may be implemented one year later by phase 1 governments. Earlier application is encouraged.

## **IMPAIRMENT OF CAPITAL ASSETS** **(GASB STATEMENT 42)**

GASB Statement 42 requires that capital assets that have the potential for being considered impaired, a decline in the service utility of the capital asset so that its book value is not equal to its prominent be tested for impairment. This Statement requires that the events or changes in circumstances affecting a capital asset that may indicate impairment be prominent, the district is not required to perform additional procedures to identify potential impairment of assets beyond those already performed as part of normal operations. If the impairment is determined to be permanent then the loss should be reported as an expense in the period that the impairment occurs. Impairment losses reported as program expenses should be reported as a direct expense of the program that uses or used the impaired capital asset. Impaired assets that are significant should be disclosed in the notes to the financial statements as to a general description, the amount, and the financial statement classification.

### **Indicators of impairment**

Common indicators of impairment include:

1. Evidence of physical damage, such as for a building damaged by fire or flood, when the level of damage is such that restoration efforts are needed to restore service utility.
2. Enactment or approval of laws or regulations or other changes in environmental factors, such as new water quality standards that a water treatment plant does not meet (and cannot be modified to meet).
3. Technological development or evidence of obsolescence, such as, related to a major piece of diagnostic or research equipment (for example a magnetic resonance imaging machine or a scanning electron microscope) that is rarely used because newer equipment provides better service.
4. A change in the manner or expected duration of use of a capital asset, such as closure of a school prior to the end of its useful life.
5. Construction stoppage, such as stoppage of construction of a building due to lack of funding.

### **The test for impairment consists of two factors:**

1. The magnitude of the decline in service utility is significant – the expenses related to the capital asset are greater than its current service utility.
2. The decline in service utility is unexpected.

### **Measurement of impairment:**

For impaired capital assets that will continue to be in use the amount of impairment (the portion of the net book value of the asset that should be written off) should be measured by one of the following methods that most appropriately reflects the decline in service utility of the capital asset:

1. *Restoration cost approach* – The amount of impairment is derived from the estimated expenses to restore the service utility of the capital asset. The estimated restoration cost can be converted to historical cost by restating the estimated restoration cost by a

- cost index or by applying a ratio of estimated restoration cost over estimated replacement cost to the carrying value of the capital asset.
2. *Service units approach* – The amount of impairment is determined by evaluating the service provided by the capital asset, either maximum estimated service units or total estimated service units throughout the life of the capital asset – before and after the change in circumstance/event.
  3. *Deflated depreciated replacement cost approach* – A current cost for a capital asset to replace the current level of service is estimated. The estimated current cost is depreciated to reflect the fact that the capital asset is not new and then it is decreased to convert it to historical dollars.

**Requirements – Insurance Recoveries**

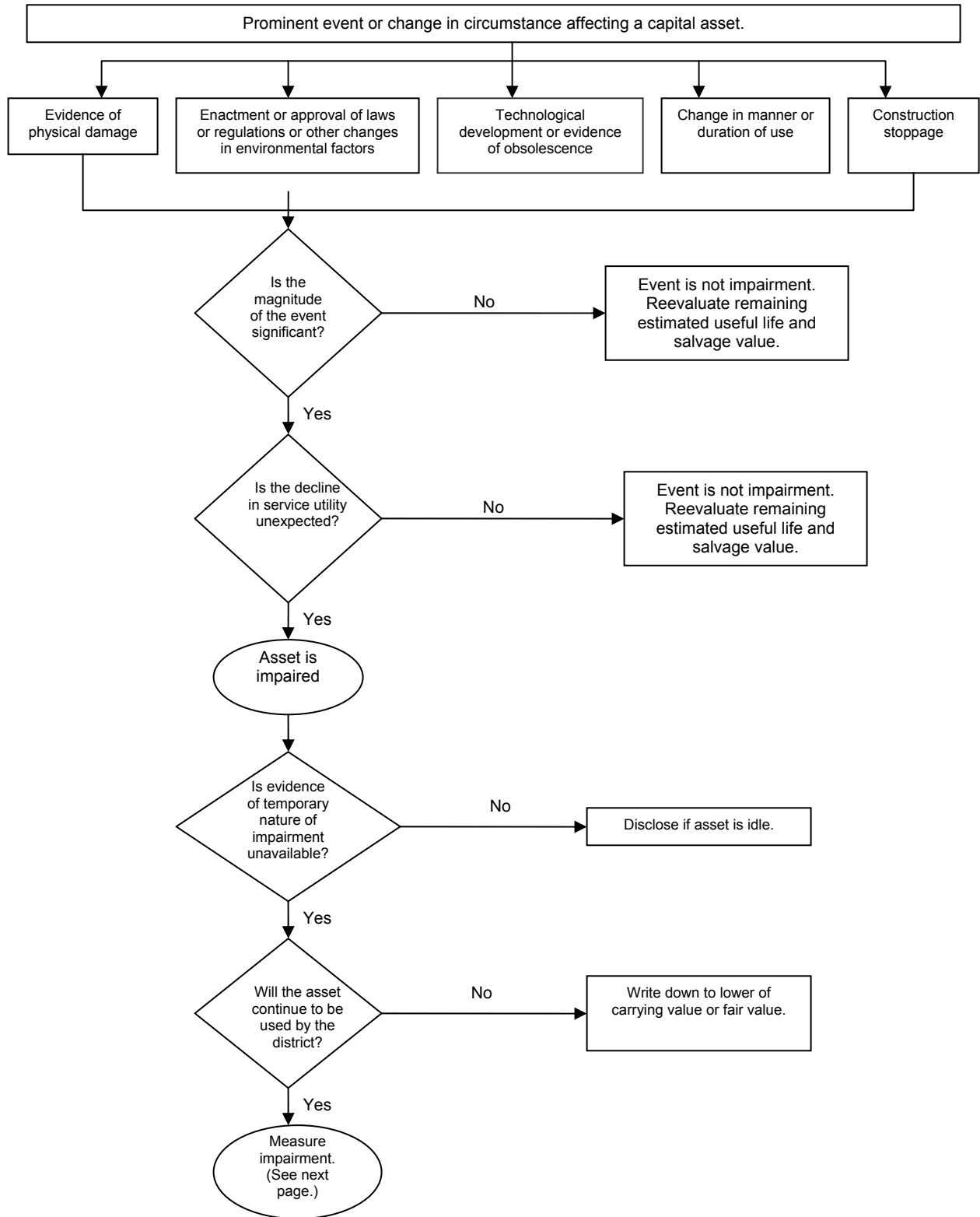
Insurance recoveries should be reported as an other financing source or extraordinary item as appropriate. Restoration or replacement of an impaired capital asset should be reported as a separate transaction from the associated insurance recovery. The impairment loss related to a capital asset should be reported net of the associated insurance recovery when the recovery and loss occur in the same year. The amount and financial statement classification of insurance recoveries should be disclosed if not otherwise apparent.

**Summary of Indicators and Methods of Measurement**

The specific method used will depend upon the indicators of the impairment.

| <b>Selection of Methods of Measuring Impairment</b>                                    |  |
|--|--|
| <b>Indicator of Impairment</b>   | <b>Method Generally Used in Measuring Impairment</b>   |
| Evidence of physical damage  | If the capital asset will continue to be used by the district (or will be upon restoration of the capital asset), use the restoration cost approach.   |
| Enactment or approval of laws or regulations or other changes in environmental factors | If the capital asset will continue to be used by the district, use service units approach.<br><br>If the capital asset will no longer be used by the district, use lower of carrying value or fair value.  |
| Technological development or evidence of obsolescence                                  | If the capital asset will continue to be used by the district, use service units approach.<br><br>If the capital asset will no longer be used by the district, use lower of carrying value or fair value   |
| Change in manner or duration of use  | If the capital asset will continue to be used by the district, use deflated depreciated replacement cost or service units approach.<br><br>If the capital asset will no longer be used by the district, use lower of carrying value or fair value. |
| Construction stoppage  | Use lower of carrying value or fair value.   |

**Flowchart for evaluating and measuring impairment of capital assets.**



## Measurement of Asset Impairment

