

How to Read Governmental Financial Statements, Part 2

Gregory S. Allison

In its Spring 2000 issue, *Popular Government* published “How to Read Governmental Financial Statements, Part 1.” That article described the general format and meaning of governmental financial statements for elected officials, managers, and others without an accounting or financial reporting background. It also described generally accepted accounting principles, or GAAP, and their role in establishing consistency in financial reporting among governmental entities across the country.¹ The article noted that GAAP reporting requirements for governments would be changing in future years. This article introduces readers to the new governmental financial reporting requirements.²

Governmental GAAP are promulgated by the Governmental Accounting Standards Board, or GASB. The GASB has been the primary standard-setting body for governmental GAAP since its inception in 1984. Current reporting requirements for governments have been in place for decades, amended in various ways by the GASB. The current reporting model, as described in Part 1 of this article, has served users well, but early on, the GASB indicated its intention to thoroughly research ways to improve the usefulness of governmental reports. The new reporting standards summarized in this article are the culmination of a fifteen-year project.

In June 1999 the GASB issued *Basic*

64,575	27,429,796	7,42
3,609,615	16,442,747	4,04
(313,768)		
126,674	448,823	8
6,408,150	34,843,175	75
144,980,601	786,842,286	13,662,286
151,388,751	321,411,511	1,37,74
165,392,667	389,847,596	49,60
4,426,286	13,662,286	1,42
74,482,273	157,784,651	27,10
79,695,401	181,207,921	30,37

Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments (GASB Statement No. 34). This standard is designed to expand the usefulness of governmental reports by addressing operational as well as fiscal accountability. Operational accountability “requires that a government demonstrate the extent to which it has met its operating objectives efficiently and effectively . . . and whether it can continue to do so.”³ Fiscal accountability “requires that governments demonstrate compliance with public decisions concerning the raising and spending of public monies in the short term (usually on budgetary cycle or one year).”⁴ Current financial reporting requirements always have focused on fiscal accountability, with an emphasis on various compliance issues, such as budgetary and statutory requirements. In truth, that is the focus

of most governmental entities, as the adoption of annual budgets and the evaluation and establishment of tax rates on an annual basis confirm. Although most users of governmental financial statements agree that this focus is very important in the government environment, there has long been a consensus that users also need to assess operational accountability.

Operational accountability is obviously the focus in the private sector. Again, although most users agree that the vast differences in objectives between the public and private sectors prohibit a one-size-fits-all model of financial reporting, the GASB does believe that governmental financial reporting also should include elements of operational accountability. The challenge is to include them without compromising or diminishing the usefulness of the current model’s strengths, specifically its fund-based information. The GASB has attempted to achieve this balance by adding an additional level of financial reporting to the GAAP-mandated external financial statements that is specifically designed to focus on a government’s operational accountability.

Even though the GASB released the pronouncement establishing the new standards in June 1999, it readily recognized that the changes in external financial reporting requirements would be time-consuming to implement and, in some cases, costly. Therefore it established a schedule that takes into account the perceived readiness of governmental entities to implement the new standards. The GASB generally believed that large governments would be in a better position to implement the standards earlier

The author is an Institute of Government faculty member who specializes in governmental accounting and financial reporting. Contact him at allison@iogmail.io.g.unc.edu.

than the small entities, and the schedule reflects this belief. Thus, depending on the size of their revenue base,⁵ governments in North Carolina must implement the new standards as follows:

Phase 1—Revenue base of \$100 million or more

Financial reports for fiscal years ended June 30, 2002

Phase 2—Revenue base of between \$10 million and \$100 million

Financial reports for fiscal years ended June 30, 2003

Phase 3—Revenue base under \$10 million

Financial reports for fiscal years ended June 30, 2004

Financial Reporting Requirements

The combined financial statements and note disclosures discussed in Part 1 of this series make up what is currently known as the general purpose financial statements. These financial statements represent the minimum necessary to be in accordance with GAAP. The new financial reporting model replaces the concept of general purpose financial statements with a somewhat different reporting structure, as follows:

- Management’s Discussion and Analysis (MD&A)
- Basic Financial Statements
 - Government-wide Financial Statements
 - Statement of Net Assets
 - Statement of Activities
 - Fund Financial Statements
 - Note Disclosures
- Other Required Supplementary Information

In general, the fund financial statements, note disclosures, and other required supplementary information are very similar to what is currently required, and accordingly they are the focus of Part 1 of this series. This article focuses on the MD&A and the government-wide financial statements, which basically are new reporting requirements. Notable changes to the fund financial statements and the note disclosures are highlighted.

Management’s Discussion and Analysis

The MD&A has its roots in private-sector reporting. Its primary purpose is to “provide the narrative introduction and overview that users need to interpret the basic financial statements.”⁶ Considered required supplementary information, the MD&A should prove to be a useful document to accountants and nonaccountants alike for a summary of key data reported in the financial statements themselves.⁷ This document represents management’s opportunity to present both a short- and a long-term analysis of its entity’s activities and financial condition. The MD&A is not the proper forum for subjective information, such as goals, objectives, forecasts, and the like. Rather, it is a summary and analysis of currently known facts and financial data.

The general information required to be reported in the MD&A is as follows:

- A brief discussion of the basic financial statements of the government, highlighting their relationship to one another and the information that each is intended to provide
- Condensed financial information based on the government-wide financial statements, as well as the fund financial statements
- An analysis that informs users whether the government’s financial situation has improved or deteriorated
- A discussion of relevant budgetary events, such as significant amendments to the original budget and significant differences between budgeted and actual amounts
- Any currently known facts or other information that would or could have a direct bearing on the government’s financial condition

The MD&A focuses on the current year and generally provides a comparison with the previous year’s operations. Although relevant charts, graphs, or other visual aids are not required, enhancing the narrative with them is useful.

Most managers and elected officials are familiar with a comprehensive annual financial report (CAFR). Entities that prepare CAFRs include a letter of trans-

mittal in its introductory section. A letter of transmittal is not the same as an MD&A, nor is the MD&A designed to replicate or replace the letter of transmittal. A letter of transmittal is generally a formal transmission of the CAFR to the users and describes the format of the document, the broad policies of the government, and any other subjective information (for example, goals, objectives, and forecasts) deemed useful by management. Governmental entities that prepare CAFRs must continue to include a letter of transmittal, in addition to an MD&A. Governmental entities that do not prepare CAFRs still will be required to prepare an MD&A. The two documents should not duplicate information. The limited financial analysis that currently appears in many letters of transmittal will be moved to the MD&A when the new reporting standards are implemented. Otherwise, the general information included in the letter will remain the same.

Basic Financial Statements

Governmental entities report their financial information in three broad categories of funds: governmental, proprietary, and fiduciary. Within each category, several fund types are available to account for all the government’s activities and services (see Table 1). The basic financial statements provide two different perspectives on the government’s financial situation: government-wide information and fund financial information, both of which are supported by a single set of note disclosures (notes containing critical details about important financial issues—for example, significant accounting policies, components of investment portfolios, capital assets information, and specifics about the types of long-term indebtedness the government has incurred). Government-wide information basically represents the new reporting requirements, whereas the fund financial information represents information similar to what is currently required by GAAP. In broad terms the government-wide financial information presents a picture of the government as a whole, focusing on the governmental funds and enterprise funds only, and including all their respective assets and liabilities. In contrast, the fund financial

Table 1. Fund Types

General fund	Accounts for general operations of government (e.g., legislative, administrative, public safety, sanitation, and recreation)
Special revenue fund	Accounts for legally restricted revenue sources, those that must be used for particular activities (e.g., E-911 taxes and community development block grants)
Debt service fund	Accounts for resources that governments are required to accumulate to pay debt service in future years
Capital projects fund	Accounts for major capital activities or construction that is being financed by governmental resources (e.g., taxes) or by bonds that will be repaid by governmental resources
Permanent fund	Accounts for resources that are legally restricted by a trust agreement according to which the earnings, but not the principal, are to be used for services or activities that benefit the government or its citizenry as a whole (e.g., perpetual care funds for government-owned cemeteries)
Enterprise fund	Accounts for activities that are usually supported by user fees (e.g., water, wastewater, electricity, and natural gas services)
Internal service fund	Accounts for internal activities that provide service to other departments (e.g., government motor pools, in-house print shops, and warehousing for utility activities)
Fiduciary funds	Account for various activities for which government acts as fiduciary (e.g., pension plans, execution of private-purpose trusts, and taxes collected on behalf of other governments)

information focuses on all the major funds of a government, including the fiduciary funds, and it retains the traditional measurement focuses (that is, current financial resources for governmental funds and total economic resources for proprietary funds, described in more detail later in this article) required by current GAAP.

Government-wide Financial Statements

The primary feature of the new reporting requirements is the government-wide financial statements. These statements are similar to private-sector financial information in that they are designed to present a picture of an entity as a whole, as opposed to by fund. These statements focus on two broad types of activities: governmental and business-type.

Under current GAAP, balance sheets

of governmental funds (that is, general, special revenue, capital projects, debt service, and permanent funds) focus on financial assets and financial liabilities.⁸ A “financial asset” is an asset that either is in cash form or will convert to cash in its natural course. A “financial liability” is a very short-term liability, to be paid off soon, presumably with cash that is on hand or will be received in the near future. This focus is consistent with the budgetary approach to management that is characteristic of the governmental environment. Also, for assessing the short-term financial liquidity of a government (for example, the resources available to finance current activities), this limited focus serves a useful purpose.

However, governmental funds also own “nonfinancial assets,” assets that cannot be spent but are used by the gov-

ernment for their intended purpose. These are capital assets such as land, buildings, equipment, and vehicles. Although not spendable, they are of significant worth and cannot be ignored when assessing an entity’s overall net worth. Likewise, governmental funds also have “long-term liabilities,” those that are not due immediately but will be paid back in future periods. Although the government is not currently using resources to repay these long-term liabilities, it needs to accumulate resources to do so in the future. Accordingly, all short- and long-term liabilities must be taken into account when assessing the overall net worth of an entity.

Operating statements of governmental funds report their revenues and expenditures. Per current GAAP, governmental funds focus on current financial resources. Thus, revenues are recognized only when they are considered available, as opposed to when they are earned. Governmental fund operating statements are similar to a checkbook register. Revenues are like deposits; expenditures are like withdrawals. Again, this is useful information when focusing on spendable resources only, but it falls short when assessing the overall earnings (that is, revenue earned but not necessarily available) of the fund and thus its total economic picture.

The government-wide statements provide the total economic picture for governmental activities and business-type activities. Specifically, governmental funds are aggregated. The financial and nonfinancial assets of the funds are reported, as are the financial liabilities and long-term liabilities. Revenues for the aggregated funds are reported when earned, not just when available in cash. The aggregation results in a single columnar presentation known as “governmental activities.”

Proprietary funds, which include enterprise and internal service funds, currently focus on all assets and liabilities in their individual fund presentations, as well as on all revenue that is earned, not just that which is available. However, for purposes of assessing the government as a whole, the activities of an internal service fund should not be considered. Internal service funds are simply an internal accounting and reporting

mechanism for internal services (for example, in-house print shops). They do not enhance or limit the government's financial condition as a whole. The business-type activities column therefore represents only the entity's enterprise funds.

The government-wide financial statements do not include the fiduciary activities of a government. This information is reported in the fund financial statements. Since fiduciary activities are controlled by trust agreements and independent parties, they do not enhance or limit the governmental entity's economic picture as a whole.

Statement of Net Assets

The standard accounting equation of "assets = liabilities + equity" also can be stated as "assets – liabilities = net assets." The statement of net assets (see Exhibit 1) reports the total assets, the total liabilities, and, accordingly, the net assets of both the governmental and the business-type activities of a government. The statement can be used to answer the following questions:

- What does each activity (that is, governmental and business-type) of the governmental entity *own* as of June 30?

- What does each activity of the governmental entity *owe* as of June 30?
- What is each activity's *net worth* as of June 30?

Again, the uniqueness of the governmental activities column on the government-wide statement of net assets is that all assets, not just financial assets, are reported, as are all liabilities, not just short-term liabilities. Thus the net worth (that is, the net assets) reflects the total economic picture of the governmental activities, not just the spendable net worth, as the fund balance reflects in the fund

Exhibit 1

Sample City Statement of Net Assets December 31, 2002				
	Primary Government			Component Units
	Governmental Activities	Business-type Activities	Total	
ASSETS				
Cash and cash equivalents	\$ 13,597,899	\$ 10,516,820	\$ 24,114,719	\$ 303,935
Investments	27,365,221	64,575	27,429,796	7,428,952
Receivables (net)	12,833,132	3,609,615	16,442,747	4,042,290
Internal balances	313,768	(313,768)	—	—
Inventories	322,149	126,674	448,823	83,697
Capital assets				
Land, improvements, and construction in progress	28,435,025	6,408,150	34,843,175	751,239
Other capital assets, net of depreciation	141,587,735	144,980,601	286,568,336	36,993,547
Total capital assets	<u>170,022,760</u>	<u>151,388,751</u>	<u>321,411,511</u>	<u>37,744,786</u>
Total assets	<u>224,454,929</u>	<u>165,392,667</u>	<u>389,847,596</u>	<u>49,603,660</u>
LIABILITIES				
Accounts payable and accrued expenses	7,538,543	786,842	8,325,385	1,803,332
Deferred revenue	1,435,599	—	1,435,599	38,911
Long-term liabilities				
Due within one year	9,236,000	4,426,286	13,662,286	1,426,639
Due in more than one year	83,302,378	74,482,273	157,784,651	27,106,151
Total liabilities	<u>101,512,520</u>	<u>79,695,401</u>	<u>181,207,921</u>	<u>30,375,033</u>
NET ASSETS				
Invested in capital assets, net of related debt	103,711,386	73,088,574	176,799,960	15,906,392
Restricted for:				
Capital projects	11,290,079	—	11,290,079	492,445
Debt service	3,076,829	1,451,996	4,528,825	—
Community development projects	6,886,663	—	6,886,663	—
Other purposes	3,874,736	—	3,874,736	—
Unrestricted (deficit)	(5,897,284)	11,156,696	5,259,412	2,829,790
Total net assets	<u>\$122,942,409</u>	<u>\$ 85,697,266</u>	<u>\$208,639,675</u>	<u>\$19,228,627</u>

Alternatively, the internal balances could be reported on separate lines as assets and liabilities. (See Appendix 3, Exhibit 1.)

Source: Portions of GASB's Guide to Implementation of GASB Statement 34 on Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Questions and Answers, copyrighted by the Governmental Accounting Standards Board, 401 Merritt 7, P.O. Box 5116, Norwalk, Connecticut 06856-5116, are reprinted with permission. Complete copies of this publication are available from the GASB.

financial statements. In contrast, the business-type activities column is basically the same as the total enterprise funds reported in the fund financial statements.

Part 1 of this series provides a detailed overview of the types of assets and liabilities that are common to a balance sheet, as well as the terminology used for equity (that is, “fund balance” for governmental funds and “retained earnings” for proprietary funds). With the exception of the equity terminology, these same types of assets and liabilities are generally found on the statement of net assets. Accordingly, this article focuses on the specific differences between the statement of net assets and the aforementioned balance sheet.

Infrastructure. As stated earlier, the government-wide statement of net assets will include all assets of the governmental and business-type activities. Included, however, for the first time will be infrastructure assets of the governmental activities. These are roads, bridges, sidewalks, and the like—assets that are certainly significant in value but of use only to the government. Heretofore these assets have not been included on the balance sheet of governmental entities. However, the GASB believes that it is important to include this information in order to give users a complete economic picture of the government. Governments will be required to include infrastructure as an asset as it is procured, but they also will have to include infrastructure acquired within approximately the last twenty years.⁹

This requirement will be time-consuming to implement and could be costly in some jurisdictions. Although procuring professional services to help with the identification and the capitalization of these assets is certainly not required, many entities may have to do so. Realizing the difficulties that governments might encounter, the GASB is allowing additional time for implementation of the retroactive portion of infrastructure capitalization. Specifically, Phase 1 and Phase 2 governments have an additional four years from the required implementation date of the new standards to get this piece into place.¹⁰ However, new infrastructure will have to be included when the initial implementation of the standard is required.

Net assets. In the new government-wide financial statements, equity terminology for both the governmental and the business-type activities will be “net assets.” This terminology reflects the restatement of the accounting equation:

$$\text{Assets} - \text{Liabilities} = \text{Net Assets}$$

As described earlier, both governmental and business-type activities focus on total economic resources. Each activity reports all assets, not just those that are liquid, and all liabilities, not just those that are current. Thus their net worth (that is, assets minus liabilities) results in a net assets figure that includes both expendable and nonexpendable pieces. This may be best illustrated with an example. Assume that a governmental fund has the following financial assets and financial liabilities:

Financial Assets	
Cash	\$ 65,000
Investments	576,400
Taxes receivable	243,500
Due from other funds	<u>25,000</u>
Total assets	\$909,900

Financial Liabilities	
Accounts payable	\$ 46,899
Salaries payable	15,750
Due to other funds	95,000
Due to other governments	<u>188,000</u>
Total liabilities	\$345,649

Using the accounting equation, the net assets, or net worth, of this entity would be \$564,251. Since all the assets are financial assets (that is, cash or assets that will convert to cash) and all the liabilities are short-term, the net assets of \$564,251 reflect an amount that will eventually be available to spend for other items, assuming that there are no specific restrictions on it. Per current governmental GAAP, this reflects how governmental funds are reported: the measurement focus is on current financial resources. Also, the net assets are simply known as the “fund balance.”

However, using the same assumptions yet introducing nonfinancial assets (for example, capital assets) and long-term liabilities results in a significant difference in the information being revealed by the net assets amount:

Financial Assets	
Cash	\$65,000
Investments	576,400
Taxes receivable	243,500
Due from other funds	25,000
Capital assets	<u>2,250,000</u>
Total assets	\$3,159,900

Financial Liabilities	
Accounts payable	\$46,899
Salaries payable	15,750
Due to other funds	95,000
Due to other governments	188,000
Bonds payable	<u>2,550,000</u>
Total liabilities	\$2,895,649

Although the entity has the same amount of liquid assets and short-term debt, net assets are only \$264,251. From a total economic perspective, considering all spendable and nonspendable assets, as well as all liabilities that the entity will eventually have to pay, its net worth is significantly less. The first calculation answers a limited question: What are net spendable resources for the current period? The second calculation answers a much broader question: What is the entity’s net worth overall? Each calculation is equally valuable, but the information is used for different purposes. For example, the latter calculation of net worth cannot be used simply to identify what is spendable. Likewise, the former calculation does not assess an entity’s total net worth.

The GASB believes that both types of information are useful and should be available to users of governmental financial statements to assess both spendable net worth and total economic net worth. Current GAAP provide only spendable net worth information for governmental funds. The net assets calculated on the new government-wide financial statements for governmental activities provide the total economic perspective.

Net assets are divided into three classifications, as follows:

- *Invested in capital assets, net of related debt*

This amount is calculated by subtracting any outstanding debt incurred to procure capital assets from the value of the assets themselves. Obviously this category of net assets does not reflect a spendable

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

Functions/Programs	Program Revenues			Net (Expense) Revenue and Changes in Net Assets			
	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities	Primary Government Business-type Activities	Total	Component Units
Primary government:							
Governmental activities:							
General government	\$ 9,709,509	\$ 843,617	\$ —	\$ (5,532,627)		\$ (5,532,627)	
Public safety	34,782,144	1,307,693	62,300	(32,213,296)		(32,213,296)	
Public works	10,131,928	850,000	2,252,615	(7,029,313)		(7,029,313)	
Engineering services	1,299,645	704,793	—	(594,852)		(594,852)	
Health and sanitation	6,705,675	575,000	—	(518,408)		(518,408)	
Cemetery	735,866	212,496	—	(450,681)		(450,681)	
Culture and recreation	11,534,045	3,995,199	2,580,000	(5,088,846)		(5,088,846)	
Community development	2,994,389	—	—	(414,389)		(414,389)	
Education (payment to school district)	21,893,273	—	—	(21,893,273)		(21,893,273)	
Interest on long-term debt	6,242,893	—	—	(6,242,893)		(6,242,893)	
Total governmental activities	106,029,367	15,906,875	4,894,915	(79,978,578)		(79,978,578)	
Business-type activities:							
Water	3,643,315	4,159,350	1,159,909	—	\$ 1,675,944	1,675,944	
Sewer	4,909,885	7,170,533	486,010	—	2,746,658	2,746,658	
Parking facilities	2,824,368	1,449,012	—	—	(1,375,356)	(1,375,356)	
Total business-type activities	11,377,568	12,778,895	1,645,919	—	3,047,246	3,047,246	
Total primary government	\$117,406,935	\$28,685,770	\$6,540,834	(79,978,578)	3,047,246	(76,931,332)	
Component units:							
Landfill	\$ 3,382,157	\$ 3,857,858	\$ 11,397	—	—	—	\$ 487,098
Public school system	31,186,498	705,765	3,937,083	—	—	—	(26,543,650)
Total component units	\$ 34,568,655	\$ 4,563,623	\$ 3,937,083	—	—	—	(26,056,552)
General revenues:							
Taxes:							
Property taxes, levied for general purposes				51,693,573		51,693,573	
Property taxes, levied for debt service				4,726,244		4,726,244	
Franchise taxes				4,055,505		4,055,505	
Public service taxes				8,969,887		8,969,887	
Payment from Sample City				—		—	21,893,273
Grants and contributions not restricted to specific programs				1,457,820		1,457,820	6,461,708
Unrestricted investment earnings				1,885,455	619,987	2,505,442	884,277
Miscellaneous				884,907		884,907	19,950
Special item—gain on sale of park land				2,653,488		2,653,488	—
Transfers				501,409	(501,409)	—	—
Total general revenues, special items, and transfers				76,828,288	118,578	76,946,866	29,259,208
Change in net assets				(3,150,290)	3,165,824	15,534	3,202,656
Net assets—beginning				126,092,699	82,531,442	208,624,141	16,025,971
Net assets—ending				\$122,942,409	\$85,697,266	\$208,639,675	\$ 19,228,627

Source: Portions of GASB's Guide to Implementation of GASB Statement 34 on Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Questions and Answers, copyrighted by the Governmental Accounting Standards Board, 401 Merritt 7, P.O. Box 5116, Norwalk, Connecticut 06856-5116, are reprinted with permission. Complete copies of this publication are available from the GASB.

portion. For most governmental jurisdictions in North Carolina, this will be a positive amount.

- *Restricted net assets*

This amount reflects net assets whose use is restricted by independent external third parties. Assets that would be part of this calculation are cash, investments, or receivables related to grants or restricted shared revenues. A common North Carolina example is Powell Bill assets held by a municipality but not yet spent. The state restricts use of those assets to specific street construction and maintenance projects. Again, for most governmental jurisdictions, this will be a positive amount unless there are significant outstanding restricted liabilities.

- *Unrestricted net assets*

In short, this amount reflects all net assets that were not classified into one of the other two categories. This would typically be all noncapital or unrestricted assets, such as cash, investments, and receivables, minus all noncapital liabilities, such as accounts payable. There are numerous scenarios in which this amount could actually be negative, though that does not necessarily indicate a problem. It could simply mean that at present, certain long-term liabilities exceed the currently available spendable assets. Assets will need to be accumulated to repay these liabilities as they come due in the future. (For a further discussion of potentially negative unrestricted net assets in North Carolina governments, see the sidebar on this page.)

Statement of Activities

The new government-wide operating statement is referred to as the “statement of activities” (see Exhibit 2). This statement reports the changes in a government’s net assets during the year. As with the statement of net assets, the focus is on the entity’s governmental and business-type activities. The statement of activities reports the revenues earned and the expenses incurred during the year. The terminology used in the statement remains generally consistent with the current reporting model, which is explained in Part

NEGATIVE UNRESTRICTED NET ASSETS

Any of the three classifications of net assets (that is, invested in capital assets, restricted net assets, and unrestricted net assets) may be negative amounts. However, negative amounts are going to be most common in the “unrestricted net assets” classification. For North Carolina counties, negative amounts in “unrestricted net assets” will not be unusual because the North Carolina General Statutes require counties to issue debt on behalf of the schools. This debt remains a legal liability of the county, while the assets procured by the proceeds (school buildings, school equipment, and so on) become the property of the school district. In short, the county has debt but no assets to offset it; the schools have assets but no debt to offset them. Even though the debt proceeds will be used for capital procurement, the capital is not that of the county. Therefore the outstanding liability is an offset not in the “invested in capital assets” classification but in the “unrestricted net assets” classification. With no asset offset, the liability often will result in a negative “unrestricted net assets” calculation.

Ironically, counties where explosive growth is occurring will actually be more negatively affected. These counties are issuing more and more debt to keep up with the need for additional school facilities. Managers and elected officials should not interpret these negative amounts as an indication of financial difficulties. Similarly, large positive “invested in capital assets” amounts in the school systems’ financial statements should not be considered an indication of spendable net worth.

1 of this series. The focus here is on the unique aspects of the new government-wide statement.

The most noticeable difference in the new statement is its format. The focus is actually expenses, followed by various types of revenues. This reflects the fact that, in the public sector, “the goal is to provide needed services, not maximize revenue.”¹¹ Information is broken down by functional categories in both the governmental and the business-type activities. For governmental activities these functional categories include, but are not limited to, general governmental services, public safety, public works, recreation, and sanitation. Examples of business-type functional categories are water, wastewater, and electric operations.

Program revenues. The statement of activities is actually read horizontally. An expense column is presented first, followed by three categories of program revenues. Program revenues are defined by GASB Statement No. 34 as revenues derived “directly from the program itself or from parties outside the reporting government’s taxpayers or citizenry, as a whole; they reduce the net cost of the function to be financed from the government’s general revenues.”¹² Program revenues are reported in three categories:

- Charges for services
- Program-specific operating grants and contributions
- Program-specific capital grants and contributions

Charges for services typically include user fees such as garbage collection fees or water charges. Grants and contributions are resources received by the government whose grantors or contributors require use for either operating or capital purposes in specified functional areas. Common examples for North Carolina governments are Powell Bill funds and community development block grants.

These revenues are reported in columns following the expense column. Net columns are then presented for governmental activities or business-type activities. For most of the functional categories, especially for the governmental activities, this net amount will reflect a deficit. This does not indicate financial difficulties or any type of loss. It simply reflects the fact that governmental entities do not fund the majority of their functional services with charges, grants, or contributions intended to cover the

full cost of those services. Instead, general, unrestricted revenues such as taxes subsidize these activities.

Below these amounts, the statement of net assets includes all the governmental entity's general revenues. General revenues include, but are not limited to, taxes (for example, property taxes, sales taxes, and income taxes), interest, unrestricted grants and contributions, and transfers between governmental and business-type activities. Again, this format visually represents how governmental entities are generally structured. Taxation and revenue sources of a similar type subsidize public-purpose functions that rarely could be considered self-sufficient.

The net effect of expenses, program revenues, and general revenues is either an increase or a decrease in net assets of both the governmental and the business-type activities. The ending net assets for each activity should agree with the net assets reported on the statement of net assets. In summary, the statement of net assets is a snapshot of all assets, liabilities, and net assets at the end of the fiscal year (June 30 for North Carolina governments). The statement of activities reports all the transactions for the governmental or business-type activities throughout the year that either increase or decrease the applicable activities' net assets.

Fund Financial Statements and Note Disclosures

As noted earlier, the new financial reporting model presents financial information from two different perspectives. The government-wide financial statements provide information on the governmental and business-type activities as a whole, and the fund financial statements focus on the individual funds. Specifically the governmental fund information focuses on current financial resources, while the proprietary and fiduciary fund information focuses on total economic resources. The reporting requirements for the fund financial statements are adequately summarized in Part 1 of this series and thus are not repeated in this article. In short, balance sheets, operating statements, and statements of cash flow (for proprietary funds) for each major fund are included in the fund financial statements.¹³

The new reporting requirements include a reconciliation between the government-wide and the fund financial statements. This reconciliation should prove invaluable for users to understand why certain information is included on one statement but not on another, or how a transaction can be viewed from the perspective of either current financial resources or total economic resources.

Another required element of the basic financial statements is the note disclosures. Obviously, some changes were necessary to incorporate explanations of the new government-wide financial statements (for example, describing the measurement focus used and the inclusion of infrastructure assets). Generally, though, the form and the content of the note disclosures have remained unchanged.

North Carolina governments are required to adopt budgets for each of their funds except internal service and fiduciary. Budgetary comparisons must be presented in the fund financial section. GASB Statement No. 34 gives governmental entities the option to include budgetary information as other required supplementary information. Making budgetary information required supplementary information lessens the audit coverage to which it is subject. However, since this information is critical to exhibiting compliance with state budgetary statutes, North Carolina governments will be required to include these budgetary presentations as basic financial statements.

Conclusion

This article is intended to provide managers and elected officials with an overview of the new financial reporting requirements that will be affecting governments all across the nation. It is impossible to teach governmental GAAP in the context of an article like this. However, Parts 1 and 2 of this series highlight for managers and elected officials the fundamental information included in the new financial reporting model, in the hope that these officials will better understand how to interpret financial information and ultimately better fulfill their fiduciary responsibilities.

Notes

1. For purposes of this article and in terms of the scope of jurisdiction of the Governmental Accounting Standards Board (GASB), "governmental entities" are state and local governmental entities only. They include, but are not limited to, counties, municipalities, public school systems, public authorities, public colleges and universities, and similar entities. The federal government is not subject to the GASB's reporting requirements.

2. This article does not review the current governmental reporting requirements. Refer to the Spring 2000 issue of POPULAR GOVERNMENT, page 23, for that information.

3. STEPHEN J. GAUTHIER, AN ELECTED OFFICIAL'S GUIDE TO THE NEW GOVERNMENTAL FINANCIAL REPORTING MODEL 13 (Chicago: Gov't Finance Officers Ass'n, 2000).

4. GAUTHIER, AN ELECTED OFFICIAL'S GUIDE, at 13.

5. The "revenue base" is defined as total governmental fund revenues (that is, general, special revenue, debt service, and capital projects) and enterprise funds (for example, utility funds). For North Carolina governments, the revenue base is as of June 30, 1999.

6. GAUTHIER, AN ELECTED OFFICIAL'S GUIDE, at 23.

7. "Required supplementary information" is information required to be included in the financial statements to be in accordance with GAAP but not subject to the same level of audit coverage as the basic financial statements.

8. A balance sheet reports the assets, the liabilities, and the equity (that is, the net worth) of a governmental entity. Refer to Part 1 of this series in the Spring 2000 issue of POPULAR GOVERNMENT for a complete description of a balance sheet.

9. The reporting standards actually require governments in Phase 1 or 2 of implementation to include major infrastructure assets acquired in the fiscal years ending after June 30, 1980. For North Carolina governments, this is for infrastructure acquired since July 1, 1980.

10. Phase 1 North Carolina governments will have until the fiscal year ending June 30, 2006, to implement the *retroactive* portion of the infrastructure reporting requirement; Phase 2 North Carolina governments will have until the fiscal year ending June 30, 2007.

11. GAUTHIER, AN ELECTED OFFICIAL'S GUIDE, at 28.

12. General Accounting Standards Board, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, Statement No. 34, ¶ 48 (Norwalk, Conn.: GASB, June 1999).

13. GASB Statement No. 34 requires governments to report by major fund. Government officials can determine major funds by a calculation based on materiality, or they have the discretion to declare any or all of their funds "major."