

Principles Used in the Preparation of the Illustrative Financial Statements

I. General

The illustrative financial statements included in the *Audit Manual for Governmental Auditors in North Carolina* (Audit Manual) reflect all applicable statements of the Governmental Accounting Standards Board (GASB). Illustrative financial statements for a county, city, board of education, public housing authority, and a charter school are included in the manual. In addition, the Local Government Commission and the Institute of Government (IOG) prepare an illustrative CAFR that is updated annually by the IOG. A governmental unit that is considering issuing a CAFR should also refer to Sections 2200 and 2800 of the GASB Codification for a discussion of the required components of a CAFR. Also, LGC Bulletin #5 contains a discussion of the procedures necessary to obtain a GFOA Certificate of Achievement for Excellence in Financial Reporting.

A. Reporting Entity

GASB Statement No. 14, *The Financial Reporting Entity*, defines a reporting entity as the primary government, its component units, and other organizations for which the nature and significance of their relationships with the primary government are such that their exclusion would cause the reporting entity's financial statements to be misleading or incomplete. A primary government is any state or general purpose local government (i.e., county or municipality) or a special purpose government that meets all of the following criteria: 1) has a separately elected governing body, 2) is legally separate, and 3) is fiscally independent of other state and local governments. Component units are legally separate organizations for which the elected officials of the primary government are financially accountable. A primary government is financially accountable if it appoints a voting majority of the organization's governing body; and a) it is able to impose its will on that organization, or b) there is a potential for the organization to provide specific financial benefits to, or impose specific financial burdens upon, the primary government.

Note disclosures describing the component units of the financial reporting entity and their relationship to the primary government are required by GASB Statement No. 14. In addition, discussions of the criteria for inclusion of the component units in the financial reporting entity, the methods used to present the component units, and information on how to obtain the separate financial statements of the individual component units are required. For a summary of this statement and guidance on how it impacts local governments in North Carolina, refer to our Memorandum #771, dated July 21, 1993.

Both discretely presented and blended component units are included in the illustrative financial statements of the City of Dogwood and Carolina County. For the City of Dogwood illustrative financial statements, the City of Dogwood ABC Board, a discretely presented component unit, is the only component unit included. Carolina County ABC Board, Carolina County Industrial Facility and Pollution Control Financing Authority, and Carolina County Hospital are reported as discrete component units in the illustrative financial statements for Carolina County. The Authority, included as a component unit for the County has no financial transactions or account balances; therefore, it is not presented in the combined financial statements of the County. The discretely presented component

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units presented in the illustrative statements use full accrual accounting only, and an individual column is used in the combined statements to reflect the financial data of each component unit. In addition, a blended component unit, Carolina County Water District, is included in Carolina County illustrative statements. The blended component unit uses proprietary accounting; therefore, it is presented as an enterprise fund of the County.

Reporting component unit relationships can become complicated if blended component units are presented, if numerous discretely presented component units are presented, or if numerous component units which use different bases of accounting are presented. If a reporting entity presents a blended component unit, then the fund types and account groups of the component unit are blended with the fund types and account groups of the primary government and included with the combining schedules. The General Fund of a blended component unit should be presented as a Special Revenue Fund since, by definition, there should only be one General Fund within the reporting entity.

If a discretely presented component unit consists of both one or more funds which use the modified accrual basis of accounting and one or more funds which use the full accrual basis of accounting, then the financial information related to that component unit may be presented on the operating statements in one of two ways. The component unit may appear in the operating statements based upon the accounting basis that is used for its principal activities, or the funds of the component unit may be disaggregated and reported on the appropriate operating statement depending upon each activity's accounting basis. Although budget to actual comparisons are not required by GASB Statement No. 14 to be presented for discretely presented component units, the LGC now requires that budget to actual statements be presented for those governmental entities which are presented as discretely presented component units of other legally separate entities and do not file separately issued financial statements with our office. Without these budget to actual statements, we are unable to determine that the component unit has fully complied with the Local Government Budget and Fiscal Control Act.

If more than one component unit is presented in a column on the exhibits, combining statements for these component unit columns must be presented in the supplemental schedules of the financial statements. In addition, certain summary information must be presented for each major component unit in the notes to the financial statements. Alternatively, these requirements may be met by including combining schedules of component unit columns in the general purpose financial statements.

B. Financial Reporting

The illustrative financial statements for Carolina County contain the general purpose financial statements (GPFS), or "liftables", a compliance section, a statistical section, and combining, individual fund and supplementary information required to be presented by our Contract to Audit Accounts (Form LGC-205). Other illustrative financial statements contain financial statements, supplemental schedules, and the required statistical schedules. The LGC requires the following statistical schedules be included in the reports of local governments when applicable: a schedule of ad valorem taxes receivable, an analysis of the current unit-wide tax levy, a schedule of transfers, and a breakdown of cash and investment balances.

C. Fund Accounting/Number of Funds

GASB Codification Section 1300.104 describes seven major fund types and two account groups which can be used by State and local governments. Also, the definition of the General Fund included in the Codification precludes the use of multiple general funds. In each set of illustrative financial statements, only the minimum number of funds which are necessary to meet each unit's legal and operational requirements is used. Using too many funds causes inflexibility and undue complexity in budgeting, accounting, and financial management. Finally, Debt Service Funds do not appear in the illustrative financial statements. A local government only needs to use a Debt Service Fund if the moneys are being accumulated to retire debt or if such a fund is required by a bond order.

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D. Notes to the Financial Statements

GASB Codification Section 2300.106 identifies those notes to the financial statements that are essential to present fairly the financial position and results of operations at the general purpose financial statement level. The notes essential to fair presentation in the reporting entity general purpose financial statements are not all-inclusive, and additional disclosures which should be made if applicable are included in Section 2300.107. In addition, Section 2300.901 includes a suggested disclosure sequence that is nonauthoritative. One of the key aspects of the reporting entity concept presented in GASB Statement No. 14 is that financial statement users should be able to distinguish between the primary government (and its blended component units) and its component units. It follows that users should also be able to distinguish between information that pertains to the primary government and that of its discretely presented component units. Determining which discretely presented component unit disclosures are essential to fair presentation at the reporting entity level is a matter of professional judgment and should be done on a component unit-by-component unit basis. A specific disclosure might be essential for one component unit but not for another, depending upon the component unit's significance relative to the total component units included in the component unit column(s) and the individual component unit's relationship to the primary government.

1. Summary of Significant Accounting Policies

The summary of significant accounting policies that is required to be included as an integral part of the financial statements includes significant changes resulting from the implementation of several GASB Statements or changes in the North Carolina General Statutes.

a. Reporting Entity

GASB Statement No. 14 required the revision of the reporting entity note. In the first sub-note of the summary of significant accounting policies, a brief description of the component units of the financial reporting entity and their relationship to the primary government should be disclosed. A discussion of the criteria for including those component units in the financial reporting entity and how the component units are reported should be included. In addition, information should be disclosed about how the separately issued financial statements for the individual component units may be obtained.

For those primary governments without any component units, GASB Statement No. 14 contains no specific disclosure requirements.

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b. Measurement Focus/Basis of Accounting

Revenue recognition criteria should be disclosed in the summary of significant accounting policies note. For governmental funds, revenues are generally recognized in the period they become susceptible to accrual. Governmental fund revenues are considered susceptible to accrual when they are both measurable and available. Available means collectible within the current period or soon enough thereafter to be available to pay the obligations of the current period. Each unit should adopt accounting policies that are appropriate taking into consideration the accrual criterion of measurability and availability and apply those policies on a consistent basis.

Also, the issuance of GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, affects the Basis of Accounting policy note. The Statement provides interim guidance pending further GASB research that is expected to ultimately result in the issuance of one or more pronouncements on the financial and reporting model for proprietary activities. Under the provisions of this statement, governmental activities that use proprietary fund accounting should apply all applicable GASB pronouncements as well as the following pronouncements issued on or before November 30, 1989 unless the pronouncements conflict with or contradict GASB guidance:

- FASB Statements and Interpretations,
- APB opinions, and
- Accounting Research Bulletins (ARBs).

For FASB Statements and Interpretations, APB Opinions, and ARBs issued subsequent to November 30, 1989, those units using proprietary fund accounting have two options. First, the entity may consistently apply all FASB guidance issued subsequent to November 30, 1989 except for those that conflict with or contradict GASB guidance. As an alternative, the entity may elect to apply none of the FASB pronouncements issued subsequent to the cutoff date. The Statement is effective for periods beginning after December 15, 1993.

In our illustrative financial statements, we assume that Carolina County, the City of Dogwood, Carolina County Board of Education, and the City of Dogwood Housing Authority have all chosen to not apply those FASB Statements and Interpretations, APB Opinions, and ARBs that were issued after November 30, 1989.

For fiscal periods ending on June 30, 2001 and thereafter, the staff of the LGC has implemented GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, in the illustrative financial statements. A detailed memorandum on the implementation of GASB Statement 33 will be following the publication of this Audit Manual. The 2001 version of the City of Dogwood contains a prior period adjustment for the accrual of the sales and use tax receivable, as a result of the implementation of GASB 33. Additionally, the statements have been revised to show that cash received from other governmental entities or developers for the purchase or construction of fixed assets is now recognized as "Capital contribution" revenue, rather than as additions to contributed capital.

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2. Deposits and Investments

The note disclosure should comply with the requirements of GASB Statement No. 3, *Deposits with Financial Institutions, Investments (Including Repurchase Agreements), and Reverse Repurchase Agreements*. At a minimum, the disclosure should indicate whether the unit's bank balances of deposits are entirely insured or collateralized with securities held by the entity or its agent in the entity's name. In addition, the notes to the financial statements should disclose any legal and contractual provisions for deposits and investments and significant violations of these provisions. Finally, the notes should disclose the reported amount and the fair value of investments, as of the balance sheet date in total and for each type of investment, with the reported amount categorized as to the various categories of credit risk as defined in GASB Statement No. 3.

GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and External Investment Pools* establishes accounting and financial reporting standards for all investments held by governmental external investment pools. For most other governmental entities, it establishes fair value standards for investments in (a) participating interest-earning investment contracts, (b) external investment pools, (c) open-end mutual funds, (d) debt securities, and (e) equity securities, option contracts, stock warrants, and stock rights that have readily determinable fair values. Governmental entities, including governmental external investment pools, should report investments at fair value in the balance sheet (or other statement of financial position). Fair value is the amount at which a financial instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Governmental entities other than external investment pools are permitted to report certain money market investments at amortized cost, provided that the investment has a remaining maturity of one year or less at time of purchase. External investment pools are permitted to report short-term debt investments at amortized cost, provided that the fair value of those investments is not significantly affected by the impairment of the credit standing of the issuer, or other factors. All investment income, including changes in the fair value of investments, should be reported as revenue in the operating statement (or other statement of activities). Governmental entities should disclose in the notes to the financial statements the methods and significant assumptions used to estimate the fair value of investments, if that fair value is based on other than quoted market prices; the policy for determining which investments, if any, are reported at amortized cost; for any investments in external investment pools that are not SEC-registered, a brief description of any regulatory oversight for the pool and whether the fair value of the position in the pool is the same as the value of the pool shares; any involuntary participation in an external investment pool and any income from investments associated with one fund that is assigned to another fund. The provisions of GASB Statement 31 are effective for financial statements for periods beginning after June 15, 1997, with earlier application encouraged. Accounting changes adopted to conform to the provisions of this Statement should be applied retroactively, if practical, by restating financial statements for all prior periods presented. If restatement of financial statements for prior periods presented is not practical, the cumulative effect of applying this Statement, if any, should be reported as a restatement of beginning fund balance or retained earnings, as appropriate, for the earliest period restated and the reason that it was not practical to restate prior periods presented should be explained. In the period this Statement is first applied, the financial statements should disclose the nature of any restatement and its effect.

Based upon the guidance in the GASB's Technical Bulletin 94-1, *Disclosures about Derivatives and Similar Debt and Investment Transactions*, "derivatives" are defined as contracts whose value depends on, or derives from the value of an underlying asset, reference rate, or index. An example of a derivative and the sample disclosure are presented in the City of Dogwood. For more information concerning derivatives, also refer to our LGC Bulletin No. 12, which was published in 1995.

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3. Ad Valorem Taxes Receivable

For both Carolina County and the City of Dogwood, the Ad Valorem Taxes Receivable accounting note disclosure reflects the unique legal circumstances surrounding the billing and collection of motor vehicle property taxes that was effective as of January 1, 1993. The 1995 General Assembly also amended the original law to make several technical changes to improve the administration of the law. Several memos and LGC Bulletin articles have been written on this issue over the years. The latest memorandums issued on the subject of motor vehicle tax property taxes are Memorandum #872, dated 8/10/1998, and Memorandum #872a, dated 12/1/1998.

4. Fixed Assets

The notes to the financial statements should include a disclosure of the balances of the major classes of fixed assets by nature and function, including construction in progress. For proprietary fund types, a general description should disclose the methods used to compute depreciation for the major classes of assets, depreciation expense for the current period and accumulated depreciation.

5. Liabilities

a. Compensated Absences

GASB Statement No. 16, *Accounting for Compensated Absences*, provides guidance on the accounting for and reporting on compensated absences for local governments. Statement No. 16 does not address presentation issues, that is, whether the liability for compensated absences should be reported in the General Long-Term Debt Account Group or within the governmental funds. Under the current treatment provided in NCGA Statement 4, the amount of compensated absences that would normally be liquidated during the year with expendable, available resources would be recorded as a governmental fund liability. The remaining amount of the liability would be recorded in the General Long-Term Debt Account Group (GLTDAG). Those liabilities that relate to proprietary funds would be reported within those funds as fund liabilities.

Compensated absences have characteristics similar to those of vacation leave if the paid-time off is not contingent upon a specific event outside the control of the employer and the employee. Vacation leave and compensated absences with similar characteristics should be accrued as a liability if both of the following conditions are met:

- a) The employees' rights to receive compensation are attributable to services already rendered; and
- b) It is probable that the employer will compensate the employees for the benefits through paid time-off or some other means, such as cash payments or retirement.

The accrual liability should include nonvested amounts that are expected to vest and should be calculated based on the current salary costs in effect at the balance sheet date. In addition, the statement requires that employers include salary-related payments in their accrual. The statement was effective for periods beginning after June 15, 1993.

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b. Pension Disclosures

In November of 1994, the Governmental Accounting Standards Board (GASB) issued Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, and Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*. The objective of these statements is to provide consistency in the measurement and disclosure of pension information reported by pension plans and their participating employers and to make pension information included in governmental financial reports more understandable and more useful to report users. Statement 25, effective for periods beginning after June 15, 1996, establishes standards for pension *plans*, whether their financial statements are included in the employer's financial report as a pension trust fund, or in a separate financial report issued by the plan or the public employee retirement system that administers the plan.

Statement 27, effective for periods beginning after June 15, 1997, establishes standards for state and local governmental *employers* to follow in reporting their expenditures/expense and their liabilities/assets related to pension contributions. Simultaneous adoption of these Statements is preferable; therefore, both Statements have been implemented in the 1997 revision of the illustrative financial statements.

The note disclosures for the Local Governmental Employees' Retirement System and the Teachers' and State Employees' Retirement System have been significantly reduced by the implementation of Statement No. 27. Disclosure of the actuarial information included in these notes in the past is no longer required. Note disclosures for the two defined contribution plans, the Register of Deeds' Supplemental Pension Fund and the Supplemental Retirement Income Plan for Law Enforcement Officers, also have been revised due to the implementation of GASB Statement No. 27. The pension note disclosure for Carolina County Hospital, a discretely presented component unit of Carolina County, also has been revised.

Included in the illustrative financial statements for the City of Dogwood is a new pension disclosure for the Firemen's and Rescue Squad Workers' Pension Fund (Fund). This disclosure is needed by those governmental units which report on-behalf payments for pension contributions made by the State to the Fund on behalf of the unit's eligible fire and rescue squad workers under GASB Statement No. 24, *Accounting and Financial Reporting for Certain Grants and Other Financial Assistance*. This is considered a special funding situation as defined in GASB Statement No. 27, and should be disclosed in the notes. A separate note disclosure is still required by GASB Statement No. 24, and is illustrated on page 35-C-47a of the Audit Manual.

Law Enforcement Officers' Special Separation Allowance - The provisions of both GASB Statement No. 25 and GASB Statement No. 27 apply to the Separation Allowance, regardless of whether or not the governmental unit funds the plan.

GASB Statement No. 25 Requirements: As discussed below, two financial statements are required by Statement 25 for plans such as the Separation Allowance that are reported as pension trust funds in an employer's report. Also required by Statement 25 are two supplementary schedules, notes to the financial statements and notes to the required schedules.

Financial Statements:

Statement of Plan Net Assets - This financial statement should be incorporated into the Combined Balance Sheet in the exhibits. The pension trust fund would be included in the Trust and Agency fund type column. This statement, which is prepared on the accrual basis, reports the plan's assets, liabilities, and net plan assets at fiscal year end. In accordance with footnote 9 of Statement 25, net plan assets should be captioned "fund balance reserved for employees' pension benefits" when a plan's financial statements are included in the report of

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the employer. This statement should report investments at their fair value at the reporting date.

Statement of Changes in Plan Net Assets - This financial statement should be presented as an additional exhibit. The statement is prepared on the accrual basis and includes information about the additions to, deductions from, and net increase (decrease) in plan net assets. Any adjustments needed as a result of implementing Statement 25 should be displayed as a restatement of the beginning balance of plan net assets for the earliest year presented.

Required Supplementary Information:

Schedule of Funding Progress - This schedule provides historical trend information about the actuarially determined funded status of the plan in accordance with the parameters, from a long-term, on-going plan perspective. It provides information on the progress being made in accumulating sufficient assets to pay benefits when due. In accordance with paragraph 37 of Statement 25, all actuarial information should be presented as of the actuarial valuation date.

Schedule of Employer Contributions - This schedule provides historical trend information about the annual required contributions (ARC) of the employer and the actual contributions made by the employer in relation to the ARC.

Information for the past six consecutive fiscal years should be presented for each of the required schedules; however, in the year of transition and the following five years, the schedules should include the current year and as many of the prior years as information calculated in accordance with the parameters is available. If the actuarial assumptions have not changed, the amounts reported as the unfunded actuarial accrued liability for past actuarial valuations should agree with amounts reported in the financial statements in prior years as the unfunded pension benefit obligation. Most of the information needed to compile the required supplemental schedules may be obtained from actuarial studies and audit reports from prior years. If you have any questions concerning the actuarial information needed for the schedules, contact the actuary.

Notes:

Notes to the Financial Statements - The notes should provide a description of the plan and the benefit provisions, a summary of significant accounting policies, the contribution requirements, and other information outlined in Statement 25.

Notes to the Required Schedules - Notes should accompany the required schedules that identify the actuarial methods and significant assumptions used for the most recent year reported in the schedules. The notes should also disclose factors that significantly affect the identification of trends in the amounts reported in the required schedules, for example, changes in benefit provisions or the actuarial methods and assumptions used.

GASB Statement No. 27 Requirements: Employers are required to disclose a description of the plan, its funding policy, the employer's annual pension cost (APC) for the current year and the dollar amount of contributions made. If the employer has a net pension obligation (NPO), then the components of APC, the increase or decrease in the NPO, and the NPO at the end of the year also must be disclosed. The notes should identify the date of the last actuarial valuation and the actuarial methods and assumptions used in determining the ARC for the current year. Three-year trend information concerning the APC and the NPO should be included in the notes.

Carolina County

Units that fund the Separation Allowance based on actuarial valuations should use the format presented for Carolina County. In this example, it is assumed that the employer did not have a net pension obligation at the beginning of the year and that the annual required contributions for

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the year are equal to the annual pension cost. Also, the Deposits and Investments note and the Cash and Cash Equivalents note for Carolina County have been revised to disclose the method of valuation for investments in the pension trust fund due to the requirement that investments be reported at fair value.

City of Dogwood

In this example the City has an actuarial study performed but has chosen to fund the Separation Allowance on a pay as you go basis. The note discloses the components of annual pension cost and the change in the NPO. The components of annual pension cost are the ARC, one year's interest on the NPO, and an adjustment to the ARC. The purpose of the adjustment to the ARC is to avoid an overstatement of annual pension cost and to maintain consistency between the actuarial and accounting measures. The result of the adjustment to the ARC should be that annual pension cost is approximately equal to the ARC that would have applied if the employer had no NPO (previous ARCs were paid in full), plus one year's interest on the NPO. The interest on the NPO should be calculated using the rate of return on plan investments that was assumed in determining the ARC for the current year. The amount of interest for the year should be equal to the return anticipated by the plan on the contributions that were not made. The positive year-end balance in the NPO is reported in the GLTDAG as the net pension obligation liability.

c. Risk Management

The effective date of GASB Statement No. 10, *Accounting and Financial Reporting For Risk Financing and Related Insurance Issues*, was amended for entities other than pools. Statement No. 10 is effective for entities other than pools for periods beginning after June 15, 1994. However, for the past several years, the Local Government Commission has recommended that local governments implement the disclosure requirements for GASB Statement No. 10 early. A sample risk management disclosure is included in each section of the illustrative financial statements. We assume in our sample that all risk is transferred to other entities through various pools and insurance. None of the entities in our illustrative statements are retaining risk.

d. Long-Term Debt

The long-term debt disclosures in the illustrative statements conform to those required by NCGA Statement 1 and Interpretation 6 and include the following:

- a. a description of issues,
- b. the changes in long-term debt,
- c. debt service requirements to maturity,
- d. details regarding the advance refunding of debt,
- e. bonds authorized but unissued, and
- f. revenue bond indenture information.

For each outstanding bond issue, a brief description should be included that details the purpose of the bonds, the original amount of the issue, the type of bonds (i.e., general obligation, revenue, or special obligation), the amount of installments, interest rates, and the maturity date range.

The adoption of GASB Statement No. 23, *Accounting and Financial Reporting for Refunding of Debt Reported by Proprietary Activities*, established new standards for reporting advance and current refundings which result in the defeasance of debt that is reported in proprietary activities. Under previous existing guidance, gains or losses from the defeasance of debt reported within a proprietary activity were required to be fully recognized in the period of the refunding as an extraordinary gain or loss. Numerous inquiries by financial statement preparers and users questioning whether this treatment accurately portrayed the substance of this transaction in a

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governmental environment led to the development and issuance of GASB Statement No. 23. The City of Dogwood illustrative statements include an assumed issuance of water and sewer refunding bonds to advance refund existing general obligation water and sewer bonds.

In August 1995, the GASB issued Interpretation No. 2, *Disclosure of Conduit Debt Obligations, an interpretation of NCGA Statement 1*. This interpretation, which was effective for periods beginning after December 15, 1995, defined conduit debt obligations as certain limited-obligation revenue bonds, certificates of participation, or similar debt instruments issued by a state or local governmental entity for the express purpose of providing capital financing for a specific third party that is not a part of the issuer's reporting entity. For conduit debt obligations, the issuing entity should disclose a general description of the transaction, the total amount of all conduit debt obligations outstanding at the balance sheet date (or the total original issue amount for those conduit debt obligations issued prior to the implementation of this interpretation if the amount outstanding is not determinable and cannot be reasonably estimated), and a clear indication that the issuer has no obligation for the debt beyond the resources provided by related leases or loans. The Carolina County illustrative financial statements include a sample disclosure for a conduit debt obligation assumed to be issued by a discretely presented component unit, the Carolina County Industrial Facility and Pollution Control Authority, on behalf of various private entities located within Carolina County.

Interpretation No. 2 excludes from its definition of conduit debt any debt issued for a specific third party which is part of the issuer's financial reporting entity. Therefore, revenue bonds and other limited obligations bonds issued by a primary government for a component unit do not meet the definition of conduit debt. Revenue bond debt issued for airports or other public authorities which are not included in the reporting entity financial statements may meet the definition of conduit debt. Some governmental entities have issued conduit debt which is carried on their own balance sheet along with the related assets. For debt such as that, this interpretation is not intended to alter that reporting or the reporting of similar debt issued in the future.

6. Fund Equity

The nature and purpose of all reserves or designations that are not described sufficiently on the combined balance sheet should be disclosed in the notes. The governmental fund balances are segregated for reporting purposes into two components: Reserved and Unreserved. The notes to the financial statements include disclosures about the classifications of governmental fund balance and about the summary of changes in contributed capital for proprietary funds. With the implementation of GASB Statement 33, *Accounting and Financial Reporting for Nonexchange Transactions*, no further additions are made to the contributed capital balance. Receipts that would have previously been additions to contributed capital are now recognized as revenue (GASB Statement 33, Footnote 18). For units that have been amortizing the contributed capital, that amortization should continue until the implementation of GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*.

7. Segment Information

Segment information is required if a government maintains enterprise funds in which material long-term liabilities are outstanding, the disclosures are essential to assure the general purpose financial statements are not misleading, or they are necessary to assure interperiod comparability. Segment information is needed to assure that the general purpose financial statements are not misleading if enterprise funds which provide different types of services, such as water and sewer and electrical services, are included in those financial statements. Examples of the types of information to be presented are included in the City of Dogwood, Carolina County, and the Carolina County Board of Education illustrative statements.

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E. Additional Reporting Requirements

1. Secondary Market Disclosure - For those units subject to the secondary market disclosure requirements of the SEC, the staff of the LGC recommends that the audited financial statements be used in the filing of the disclosures and should include the additional schedules and information (Point 11 of the Contract to Audit Accounts). The Carolina County illustrative financial statements include examples of the additional schedules: a listing of the ten largest taxpayers in the unit and additional information on the property tax base. (See pages 35-B-110a and -110b.) Because of the nature of the disclosure information, inclusion of such information during the preparation of the financial statements makes the secondary market disclosure filing in January as efficient as possible.
2. The Analysis of Current Tax Levy is a schedule which allows a unit to report on the effectiveness of its tax collection efforts. Additionally, the tax collection rate in the schedule is published annually in the Cash and Taxes Management report. This allows users to evaluate the tax collection efforts of their town or county compared to similar units. To maintain comparability, only those taxes levied on a unit-wide basis should be included on the schedule. Special service districts, animal taxes or other licensing fees should not be included.

II. **Carolina County Illustrative Statements**

A. Reporting Entity

1. Component Units

To illustrate the implementation of GASB Statement No. 14, The Financial Reporting Entity, the Carolina County illustrative statements include the Carolina County ABC Board and the Carolina County Hospital as discretely presented component units. In addition, although it has no account balances or transactions, the Carolina County Industrial Facility and Pollution Control Financing Authority meets the criteria for a discretely presented component unit. Therefore, it is disclosed as such in the illustrative statements. Finally, Carolina County Water District was to address a reporting problem noted by the staff of Department of State Treasurer which required the revision of the financial statements of several local governments before they went to the bond market. The decision to include all of these units was made by applying the criteria of GASB Statement No. 14 to the assumed organization of the potential component units as follows:

Carolina County Hospital - In the illustrative statements, we assumed that the Hospital is a legally separate organization whose board was appointed by Carolina County. The County is not able to impose its will on the potential component unit because the County cannot remove members of the Hospital's governing board at will, does not modify the budget of the Hospital, approve its fees, or overrule the decisions made by the Hospital's board. In addition, the Hospital's board, not the County, makes the decisions about the day-to-day operations of the organization. However, a financial burden relationship exists because the County has issued general obligation bonds to improve the Hospital's facilities and appropriates moneys periodically to defray the costs of indigent care provided by the Hospital. These payments are reflected as transfers from the primary government to a component unit. Because the Hospital has a September 30 fiscal year-end, which is different from the County's fiscal year-end, transfers between the primary government and the component unit are different on each unit's financial statements. This difference is reconciled in the notes to the financial statements for the County.

Carolina County ABC Board - In the illustrative statements, the ABC Board is a legally separate organization whose board members are appointed by the County. Using the same criteria applied for the Hospital, the County is not able to impose its will on the ABC Board; however, the County does receive a financial benefit from the ABC Board because the ABC Board is required

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by State statute to distribute its surpluses to the General Fund of the County. The ABC Board is included in the financial statements of the County as a discretely presented component unit.

In North Carolina, the price for alcoholic beverages is established by G.S. 18B-804(b). The price includes State excise taxes and mixed beverage taxes that are payable to the State. Also included in the price are bottle charges payable in the county in which the ABC Board is located. These charges are restricted for the treatment of alcoholism and substance abuse or research or education on alcohol or substance abuse. This portion of the price represents taxes on sales and is not reflected in the amount of sales revenues reported on the income statement. The bottle taxes remitted to the County are reflected as revenue in the County's General Fund. In addition, any sales taxes paid on fortified wine sales should be reflected as a tax and not included in sales on the income statement. These taxes are received from customers as a result of the operations of the ABC Board, so that the receipt and payment of these taxes are reflected in the Statement of Cash Flows in the operating section. The portion of the taxes payable to the State are included in the Intergovernmental Payable account. The amount due to Carolina County is included in the amount which is payable to the primary government presented on Exhibit 1, the Combined Balance Sheet.

The ABC Board is also required to spend a portion of the profits from sales on alcoholism and substance abuse treatment or education. These funds are most often paid to mental health centers. These payments are reflected as a non-operating expense on the operating statement and are included in the noncapital financing section of the cash flow statement. Any additional distributions of profits made to entities other than the primary government would be reflected in the same manner.

In addition, the ABC Board is required to spend a portion of the profits on law enforcement. These payments are based upon the profits of the ABC Board and not on the services rendered. For this reason, these payments are not viewed as a cost of operating the ABC Board. In the case of Carolina County ABC Board, the payments are presumed to be made to the County. Therefore, the payments are included in the amount of operating transfers from the component unit to the primary government that is presented on the operating statement and are included in the noncapital financing section of the Cash Flow Statement. Any profit distributions paid to the primary government would be reflected in the same manner. Law enforcement payments and profit distributions payable at year-end are included in the amount that is payable to the primary government which is presented on the Combined Balance Sheet.

Carolina County Industrial Facility and Pollution Control Financing Authority - In the illustrative statements, the Authority is disclosed as a component unit of the County. In the example, the County appoints all of the members to the Authority's board and can remove any of those members with or without cause. The Authority is disclosed as a component unit in the County's combined financial statements. However, the Authority has no financial transactions or account balances. In addition, the Authority does not issue its own financial statements. Therefore, the Authority does not appear in the combined financial statements.

Carolina County Water & Sewer District - In our example, the District is assumed to have been created by the County under G.S. 162A-86 through 93. Under State law, counties are authorized to create water and sewer districts which have the authority to issue general obligation debt and levy property taxes to finance the operations and maintenance or the debt service on the bonds. These county districts should be included in the audited financial statements as blended component units because they are legally separate entities whose governing board is the same as that of the county which created the district [G.S. 162A-89]. As a result, the District is presented as an enterprise fund within the County's proprietary fund types. The District also has the authority to issue general obligation bonds that pledge the taxing power of the District, not the County in which the District is located. This distinction is important because the general obligation debt of the District should be differentiated from that of the County in the notes to the financial statements. The District does not issue its own financial statements.

Principles Used in the Preparation of the Illustrative Financial Statements

2. Related Organization

In the illustrative statements, the Carolina County Recreation Corporation is disclosed as a related organization. The County appoints the Corporation's board, but its accountability does not extend beyond the appointments. The County is not able to impose its will on the Corporation because none of those criteria apply. No financial benefit/burden relationship exists between the County and Corporation. Therefore, a related organization note disclosure is appropriate under GASB Statement No. 14 guidance.

3. Joint Ventures

In the illustrative statements, the County participates with several other local governments in a regional library and a regional airport. Neither the County nor any of the participating governments appoint a majority of the governing boards. Both the library and the airport are fiscally independent because they meet the criteria for fiscal independence which are included in Statement No. 14. Unless it would be misleading to exclude the potential component unit (PCU) because of the nature and significance of its relationship with the primary government, the PCU is not a component unit. We assumed that it was not misleading to exclude the regional airport and library; therefore, both are disclosed as joint ventures without equity interest.

4. Jointly Governed Organization

In the illustrative statements, the County and numerous other local governments are members of the Red Bird Council of Governments. Each participating government appoints one member to the governing board. The Council is not fiscally dependent upon the County. In addition, it would not be misleading to exclude the Council from the County's financial statements. The Council is not a component unit of the County. The Council does meet the definition of a jointly governed organization as provided in GASB Statement No. 14, and a disclosure of the Council's relationship with the County is appropriate.

B. Highlights of Funds Utilized by Carolina County

General Fund - The County's General Fund is the general operating fund of the County, which accounts for all financial resources of the County except for those that are required to be accounted for in another fund.

Special Revenue Funds - Carolina County maintains four Special Revenue Funds: the Capital Reserve Fund, the Fire District Fund, the Revaluation Fund, and the Emergency Telephone System Fund. The Capital Reserve Fund is a fund which North Carolina local governments are allowed to establish under G.S. 159-18. According to G.S. 159-18, local governments or public authorities can establish a Capital Reserve Fund for any purpose for which they would issue bonds. Capital Reserve Funds are used to accumulate funds for ongoing or future capital projects. The Fire District and Emergency Telephone System Funds are reported as Special Revenue Funds because they are special service districts established under North Carolina State law. G.S. 159-26(b)(2) requires that such special tax districts be reported as Special Revenue Funds. Finally, the County has a Revaluation Fund which accounts for the accumulation of funds necessary to cover the cost of the real property revaluation. State law requires the County to have a property revaluation completed every eight years and to reserve funds for this revaluation so that all the associated costs will not be incurred in one year.

Principles Used in the Preparation of the Illustrative Financial Statements

Capital Projects Fund - The County has two Capital Projects Fund, the Northwest Park Capital Projects Fund, which accounts for the financial resources and the acquisition and construction of the park and the School Capital Projects Fund, which accounts for the County's construction and acquisition for the local board of education.

Enterprise Funds - The County has two enterprise funds: the Landfill Fund and Carolina County Water District. Carolina County Water District is consolidated with the Water District Capital Projects Fund for financial reporting purposes. (Note: For illustrative journal entries of the consolidation process and a more complete discussion, see Section 35-A of this manual.) The Landfill Fund is combined with the Landfill Closure and Postclosure Reserve Fund for reporting purposes. The Landfill Reserve Closure and Postclosure Reserve Fund is a reserve established by the County to accumulate the funds that will be necessary to cover the closure and postclosure care costs that will be incurred by the landfill at the time of closure and subsequent to closure during the monitoring period of thirty years.

Agency Funds - Among its other Agency Funds, Carolina County has a Motor Vehicle Tax Fund which accounts for the registered motor vehicle property taxes that are billed and collected by the County for various municipalities and special districts within the County.

C. Accounting for the Wingate Drive Landfill Facility

In the illustration of GASB Statement No. 18, *Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Costs*, the LGC assumed that the County had met the requirements of the local government financial test that is included in the regulations of the State as one method of providing financial assurance for closure, postclosure care, and corrective action. The example in the illustrative statements also assumes that the County is making voluntary contributions to a Landfill Closure and Postclosure Care Fund in order to accumulate resources to cover those closure and postclosure care costs which it will inevitably incur. Based upon these assumptions and those included below, we made the following calculations to determine the amount of current year closure and postclosure care costs that should be recognized in the County's Landfill Fund:

We assumed that the Wingate Drive facility had seven cells with an individual capacity of 136,364 units per cell, resulting in a total capacity for the entire landfill of 954,548 units.

<u>Usage</u>	<u>Current Year</u>		<u>Cumulative</u>	
	<u>Units</u>	<u>%</u>	<u>Units</u>	<u>%</u>
19X1	31,000	3.25	161,000	16.87
19X0	30,000	3.14	130,000	13.62
Prior to 19X0	100,000	10.48	100,000	10.48

Principles Used in the Preparation of the Illustrative Financial Statements

Expenses and Liabilities Recognized in Prior Years:

19X1	\$ 43,544
Prior to 19X1	<u>136,240</u>
Total expenses related to prior years	<u>\$179,784</u>

Computation of 19X1 Expense and Liability:

Total cost estimate of closure and postclosure care costs at June 30, 19X1 (after annual re-evaluation):	\$1,340,000
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Multiplied by:

Percentage of cumulative capacity used through the current period	16.87%
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Divided by:

Total estimated capacity	100.00%
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Total liability at June 30, 19X1	226,058
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Less: Amounts previously recognized	(179,784)
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Current period expense	<u>\$ 46,274</u>
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The illustrative financial statements also contain a sample of the disclosure required by GASB Statement No. 18. The disclosure should include:

- a. The nature and source of landfill closure and postclosure care requirements (federal, State, or local laws or regulations).
- b. That recognition of a liability for closure and postclosure care is based on landfill capacity used to date.
- c. The reported liability for closure and postclosure care at the balance sheet date (if not apparent from the financial statements) and the estimated total current cost of closure and postclosure care remaining to be recognized.
- d. The percentage of landfill capacity used to date and the estimated remaining landfill life in years.
- e. How closure and postclosure care financial assurance requirements are being met. Also, any assets restricted for payment of closure and postclosure care costs (if not apparent from the financial statements).
- f. The nature of the estimates and the potential for changes due to inflation or deflation, technology, or applicable laws or regulations.

Principles Used in the Preparation of the Illustrative Financial Statements

For a detailed discussion of the regulations and their impact on local governmental units in North Carolina, the 1994 Local Government Bulletin published by the IOG presents an article on this subject, co-authored by Craig Barfield of the Department of State Treasurer, and K. Lee Carter of the IOG.

D. Conduit Debt Obligations

In illustrating the disclosures required by Interpretation No. 2, *Disclosures of Conduit Debt Obligations*; the LGC assumed that the County has industrial revenue bonds outstanding which were issued by the Industrial Facility and Pollution Control Authority on behalf of private third parties that are not part of the Control Authority's reporting entity. Under the guidance provided in the interpretation, conduit debt obligations are certain limited-obligation revenue bonds, certificates of participation, or similar debt instruments issued by a local governmental entity to provide capital financing for a specific third party that is not part of the issuer's financial reporting entity. For debt that meets this definition, the notes to the financial statements of the issuing entity should include a general description of the conduit debt transactions, the total amount of all conduit debt obligations outstanding at the balance sheet date and a clear indication that the issuer has no obligation for the debt beyond the resources provided by related leases or loans. If the total amount of the outstanding conduit debt cannot be reasonably determined or estimated, issuers may disclose the original issue amounts for that conduit debt which was issued prior to the implementation of this interpretation.

E. Public School Construction Financed under North Carolina General Statute 160A-20

The 1995 General Assembly amended G.S. 153A-158.1 to enable counties to acquire property for use by local boards of education. After the most recent legislation was passed, a total of 76 counties in North Carolina now have the legal authority to enter into installment purchases to finance school construction. When counties enter into these arrangements to finance school construction, these obligations are typically issued pursuant to a deed of trust. Under the provisions within the deed of trust, the assets remain in the county's name while the debt remains outstanding. However, the county transfers the rights and responsibilities of ownership to the board of education through a lease between the two parties. The lease may contain annual payments and a bargain purchase option involving nominal amounts which do not reflect the true value of the assets. Also, the length of the lease is often tied to the term of the installment purchase contract.

Because the county has a legal responsibility to provide for the capital needs of the local board of education, the agreement between the county and the board is not an "arm's length transaction." Instead, the agreement is a result of the county using an alternative method to finance school capital outlay. As a result, the transaction involved will be handled in the same manner as construction financed from county revenues and reserves, the State School Building Capital Fund, or general obligation bond proceeds. When the debt is sold, the county will report the proceeds of the long-term financing in its School Capital Projects Fund as an other financing source which is offset by an expenditure. In addition, the total face amount of the debt will be reported in the county's general long-term debt account group since the obligation for repaying the debt rests with the county. Specific information about the transaction, the purpose for the debt issued, debt service requirements to maturity, interest rates should be disclosed in the notes to the county's financial statements as required by generally accepted accounting principles.

For a discussion of the local board of education and how this transaction should be handled in that entity's financial statements, refer to the Carolina County Board of Education section of this part of the manual.

F. Miscellaneous

The illustrative statements have been updated to recognize a new revenue source in the Carolina County General Fund, the Wireless 911 Tax. This is in addition to the funds received to support the Emergency System Telephone Fund. The Wireless 911 Tax is enacted under G.S. 62B and does not contain the

Principles Used in the Preparation of the Illustrative Financial Statements

requirement that the moneys be accounted for in a special revenue fund. Recipients of 911 Charges account for those moneys in a Special Revenue Fund per G.S. 62A-7. However, information provided to the staff of the Fiscal Management Section indicates that some units have chosen to report the Wireless 911 revenues and expenditures as separate departments within their Special Revenue Fund. See the revisions to the City of Dogwood for an illustration of this alternative accounting.

Qualified Zone Academy Bonds (QZABs) - QZABs are a new mechanism of debt, established by the US Congress, authorizing units of local government to issue debt for the purposes of repairing or rehabilitating certain qualified public school buildings. No interest is paid by the issuing government; the holders receive federal tax credits as incentives to purchase the bonds. The staff of the Fiscal Management Section has received inquiries about the accounting QZABs. At this time QZABs are not included in the Carolina County illustrative financial statements because only two counties in North Carolina have issued such debt. The debt should be recognized on the county's books and disclosed either as an installment purchase or general obligation debt, as appropriate. Because the issuing government is liable for the entire amount and may not alter that amount by prepayment, no interest should be imputed.

Reserved for Register of Deeds: Effective January 1, 2002, a portion of the fees collected and maintained by the register of deed's office are to be maintained in the Automation and Enhancement Fund [G.S. 161-11.3]. These funds are to be used to provide computer equipment and imaging technology for the register of deed's office. The enabling legislation does not require that this fund be maintained as a separate revenue fund. In keeping with the minimum number of funds principle, the amount designated for future expenditures for this purpose is shown as "Reserved for register of deeds" on the Carolina County illustrative financial statements. Some counties may prefer to use the designation "Reserved for Automation and Enhancement Fund." Whichever description is used, there should be a note disclosure discussing the funding of the reservation and the future use of the reserve. See Memorandums #963 and #972 for more discussion of this issue.

III. **City of Dogwood Illustrative Statements**

A. Reporting Entity

1. **Discretely-Presented Component Unit** To illustrate the implementation of GASB Statement No. 14, *The Financial Reporting Entity*, the City of Dogwood illustrative statements include the City of Dogwood ABC Board as a discretely presented component unit. The decision to include the ABC Board as a component unit was made by applying the criteria of GASB Statement No. 14 to the assumed organization of the potential component unit as follows:

City of Dogwood ABC Board - In the illustrative statements, the ABC Board is a legally separate organization whose board members are appointed by the City. The City is not able to impose its will on the potential component unit because the City cannot remove the members of the ABC Board's governing body at will, cannot modify the budget of the ABC Board, approve its fees or overrule the decisions made by the ABC Board's governing body. In addition, the ABC Board, not the County, makes the decisions about the day-to-day operations of the organization. While the City is not able to impose its will on the ABC Board, the City does receive a financial benefit from the ABC Board because the ABC Board is required by State statute to distribute its surpluses to the General Fund of the City. The City of Dogwood ABC Board is included in the financial statements of the City as a discretely presented component unit.

In North Carolina, the price for alcoholic beverages is established by G.S. 18B-804(b). The price includes State excise taxes and mixed beverage taxes that are payable to the State. Also included in the price are bottle charges payable to the county in which the ABC Board is located. These charges are restricted for the treatment of alcoholism and substance abuse or research or education on alcohol or substance abuse. This portion of the price represents taxes on sales and

Principles Used in the Preparation of the Illustrative Financial Statements

is not reflected in the amount of sales revenues reported on the income statement. In addition, any sales taxes paid on fortified wine sales should be reflected as a tax and not included in sales on the income statement. These taxes are received from customers as a result of the operations of the ABC Board, so that the receipt and payment of these taxes are reflected in the Statement of Cash Flows in the operating section. The taxes payable to the State and the County are included in the intergovernmental payable amount shown on Exhibit 1. The ABC Board is also required to spend a portion of the profits from sales on alcoholism and substance abuse treatment or education. These funds are most often paid to mental health centers. These payments are reflected as a non-operating expense on the operating statement and are included in the noncapital financing section of the Statement of Cash Flows. Any additional distributions of profits made to entities other than the primary government, such as mixed beverage profits shared, would be reflected in the same manner.

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Principles Used in the Preparation of the Illustrative Financial Statements

The ABC Board is also required to spend a portion of the profits on law enforcement. These payments are based upon the profits of the ABC Board and not on the services rendered. For this reason, these payments are not viewed as a cost of operating the ABC Board. In the case of the City of Dogwood ABC Board, the payments are presumed to be made to the County. Therefore, the payments are included in the operating transfers from the component unit to the primary government on the operating statement and are in the noncapital financing section of the Cash Flow Statement. Any profit distributions paid to the primary government would be reflected in the same manner. Law enforcement payments and profit distributions payable at year-end are included in the amounts payable to the primary government that is included on the Combined Balance Sheet.

2. Joint Ventures

In the illustrative statements, the City participates with several other local governments in a regional library and a regional airport. Neither the City nor any of the participating governments appoint a majority of the governing boards. Both the library and the airport are fiscally independent because they meet the criteria for fiscal independence which are included in Statement No. 14. Unless it would be misleading to exclude the potential component unit (PCU) because of the nature and significance of its relationship with the primary government, then the PCU is not a component unit. We assumed that it was not misleading to exclude the regional airport and library; therefore, both are disclosed as joint ventures without equity interest.

We also included a note disclosure concerning the local board of trustees for the Firemen's Relief Fund, which is addressed in G.S. 58-84-40. Under State law, the State Insurance Commissioner appoints one member to the five-member local board of trustees. The City and the member's of the fire department each appoint two additional members. The fund is supported by a portion of the fire and lightning insurance premiums which the State remits to the local board. At their discretion, the local board may use these funds to assist firefighters in various ways. The City obtains an ongoing financial benefit from the fund because of the on-behalf of payments for the \$1,540 of salaries and fringe benefits made to the members of its fire department by the local board.

3. Jointly Governed Organization

In the illustrative statements, the City of Dogwood and numerous other local governments are members of the Red Bird Council of Governments. Each participating government appoints one member to the governing board. The Council is not fiscally dependent upon the City. In addition, it would not be misleading to exclude the Council from the City's financial statements. The Council is not a component unit of the City. The Council meets the definition of a jointly governed organization as provided in GASB Statement No. 14, and a disclosure of the Council's relationship with the City is appropriate.

The City of Dogwood is also a member of the North Carolina City Electric Agency Number 12, an organization that enables municipalities that own electric distribution system to finance, construct, own, operate, and maintain the facilities. No one member appoints a majority to the governing board of the Agency. The Agency is a special-purpose government that is fiscally independent. Since it would not cause the City's financial statements to be misleading by not including the Agency, the Agency is not a component unit of the City. Based upon the criteria provided in Statement No. 14, the Agency is disclosed as a jointly governed organization.

Principles Used in the Preparation of the Illustrative Financial Statements

4. Related Organization

The City of Dogwood Housing Authority is governed by a five-member board that is appointed by the mayor of the City of Dogwood. The City is not able to impose its will on the Housing Authority nor does any financial benefit/burden relationship exist. The Housing Authority is a related organization to the City of Dogwood and is disclosed as such in the notes to the financial statements.

B. Water and Sewer Debt

1. Advance Refunding of Water and Sewer Debt

GASB Statement No. 23, *Accounting and Financial Reporting for Refundings of Debt Reported by Proprietary Activities*, establishes new standards of accounting and financial reporting for current refundings and advance refundings that result in the defeasance of debt that is reported by proprietary activities. Under previously existing guidance, gains or losses from the defeasance of debt reported in a proprietary fund were required to be recognized immediately in the current operations results reported in the period the debt was extinguished.

For those current and advance refundings that result in the defeasance of proprietary fund debt, GASB Statement No. 23 requires that the difference between the reacquisition price and the net carrying amount of the old debt be deferred and amortized as a component of interest expense over the remaining life of the old debt or over the life of the new debt, whichever is shorter. The statement defines the reacquisition price as the amount required to repay previously issued debt in a refunding transaction, usually the principal of the old debt plus any call premium. The premium or discount and the issuance costs pertaining to the new debt are not considered part of the reacquisition price but are separate items related to and amortized over the life of the new debt. The net carrying amount is the amount due at maturity, adjusted for any unamortized premium or discount and the issuance costs related to the old debt. On the balance sheet, the deferred amount should be reported as a deduction from or an addition to the new debt liability. The provisions of this statement are effective for periods beginning after June 15, 1994. Early application is encouraged.

In our illustrative statements, the difference between the reacquisition price and the net carrying amount of the old debt is \$200,000. We assumed that the bond issuance costs on the new debt were expensed because they were immaterial. The \$200,000 difference, net of the current year's amortization of \$42,386, is reported on the balance sheet as a deduction of bonds payable. Amortization is charged to operations using the effective interest method over the eight-year life of the new bonds, which is shorter than the remaining life of nine years on the old bonds. A sample disclosure as required by GASB Statement No. 23 is included in the notes to the financial statements.

2. Water and Sewer Revenue Bond

The debt outstanding in the Water and Sewer Fund has been reclassified in order to illustrate special reporting requirements common to revenue bonds. Often the bond documents for a revenue bond will contain covenants requiring the unit to maintain a specified ratio of income available for debt service, as compared to debt service. The staff of the LGC has observed that this debt service coverage ratio is often omitted from the audit when the bond document specifically requires the auditor to recalculate the coverage ratio and issue an opinion on such. We have included such a recalculation of the coverage ratio in the notes to the financial statements, page 35-C-45. Because the calculation of the debt service coverage ratio may vary, we urge the preparers of the financial statements to read the actual bond documents closely to determine what should be included in the calculation and what should be disclosed in the notes to the financial statements or in supplementary information.

Principles Used in the Preparation of the Illustrative Financial Statements

C. City of Dogwood Electric Fund

1. Electric Fund Policy Adoption by the City of Dogwood

Based upon the recent developments in the electric power industry, the City of Dogwood illustrative statements have been revised to assume that the City has addressed the issues concerning reimbursements and payments in lieu of taxes which we noted in LGC Memorandum #814, "Issues of Concern For Fiscal Year 1995-96 and Future Years" dated May 1, 1995. We also assumed that the City had implemented the policy of transferring a specific percentage of gross electric sales to a Rate Stabilization Fund. For financial reporting purposes, this fund has been consolidated with the electric operating fund.

2. Electric Deregulation

In 1997, the General Assembly of North Carolina appointed the Study Commission on the Future of Electric Service in North Carolina (Study Commission). The Study Commission was charged with examining many issues related to the electric power industry, including recommendations as to the electrical system debt of the members of the two municipal power agencies in the state. In January 2001, the Study Commission decided not to present legislation to the General Assembly in 2001. The Study Commission is continuing to study the issue of electric deregulation.

The note disclosure on page 35-C-49(b) is factually based and is designed to alert users of the financial statements that certain cities in the State may be facing fundamental changes in the operation of their electric systems. The note should be adjusted should actual events warrant.

D. Emergency Telephone System Fund

The Emergency Telephone System Fund demonstrates presenting both the wire line and the wireless 911 revenues as different cost centers of a single special revenue fund. This should enable the Wireless 911 Board to monitor the use of the fees and should reduce the inquiries to the Public Service Answering Points concerning the use of the funds. It would also meet the requirements of NCGS Chapter 62A, which requires the wire line funds to be accounted for in a special revenue fund. To further demonstrate spending compliance, the fund balance portion of the supplemental statements have been revised to show the opening and ending fund balances for both funding sources. See Memorandum #927, *Wireless 911 Funds, Court Costs, and Changes in Billing for Medicaid Services*, for further information.

E. SAS No. 93, Omnibus Statement on Auditing Standards - 2000

The Independent Auditor's Report has been updated to indicate the country of origin for (a) the generally accepted auditing standards and (b) the generally accepted accounting principles.

F. GASB Statements 33, Accounting and Financial Reporting for Nonexchange Transactions, and 36, Recipient Reporting for Certain Shared Nonexchange Revenues

Current year additions to contributed capital have been reclassified as revenue items labeled *Capital Contributions*. Additionally, a cumulative effect of change in accounting for nonexchange transactions has been demonstrated in the general fund. Based on the individual unit's nonexchange transactions, other funds may need to be restated; but the preparer should always consider materiality when determining whether restatement is necessary. For illustrative purposes, the local option sales tax revenue amount was adjusted assuming that an accrual for the last quarter of the current year had not been made and that the payment for the last quarter of the previous year was included in revenue. If the unit has been properly accruing the local option sales tax, an adjustment should not be necessary.

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Principles Used in the Preparation of the Illustrative Financial Statements

D. On-behalf of Payments for Employee Firemen or Volunteers

GASB Statement No. 24, *Accounting for Certain Grants and Other Financial Assistance*, defines on-behalf of payments as direct payments made by one entity to a third-party recipient for the employees of another, legally separate entity. For on-behalf of payments, the employer government is required by the statement to recognize a revenue and an offsetting expenditure for payments made for their employees or for their volunteers by another entity. In the City of Dogwood illustrative statements, we recognized as a revenue and an expenditure in the General Fund an amount equal to the per member contribution made by the State to the Firemen and Rescue Squad Worker's Pension Plan. In addition, we also recognized as a revenue and an expenditure in the General Fund an amount equal to the moneys paid out as salary supplements or stipends to eligible employee or volunteer firemen from the Firemen's Relief Fund. Paragraph 55 of Statement No. 24 indicates that on-behalf of payments made to members of a fire department with which a unit contracts for fire protection services would not fit the criteria for disclosure under the Statement. Therefore, this Statement only applies to instances in which recipients are the employees or volunteers of a fire department which is not a legally separate entity.

E. Revocation of Restrictions on Sales and Use Tax Revenue

Session Law 1998-98 deleted G.S. 105-487(b) of Article 40 and G.S. 105-504 of Article 42, which restricted portions of the revenue derived from those taxes to water and sewer capital outlay or the retirement of capital outlay debt. The financial statements for the City of Dogwood have been updated to reflect the full amount of Local Option Sales Tax as revenue in the General Fund. Because a portion of the revenues in the past were unrestricted, resulted from a local decision to levy the tax, and were available to all funds of the City, the unrestricted portion was accounted for in the General Fund. Recognizing all the unrestricted proceeds from sales and use taxes levied under Articles 40 and 42 is consistent with prior accounting treatment.

Because the Local Option Sales Tax revenue is now all unrestricted revenue, amounts may be transferred from the General Fund to other funds as the governing board and management deem appropriate. The City of Dogwood illustrative financial statements show a residual equity transfer from the General Fund directly to a Water and Sewer Capital Project Fund. Because this is a one time transfer that is a contribution of equity to a new fund, a residual equity transfer is the proper method of accounting for this transaction. Transfers to support daily operations of a fund, or to make debt service payments, or are recurring in nature should be accounted for as operating transfers. For more details on this issue, see Memorandum # 880, dated April 22, 1999.

IV. **Carolina County Board of Education – Summary Revised May 1999**

A. Fund Classification

The required funds of the local administrative unit such as the Local Current Expense Fund, the Capital Outlay Fund, the State Public School Fund, and Federal Grants Fund are classified into the appropriate fund type as required by generally accepted accounting principles.

1. General Fund

NCGA Statement 1 defines a General Fund as accounting for all financial resources except those required to be accounted for in another fund. Therefore, the Local Current Expense Fund is shown as the General Fund. For local boards of education, this fund includes the majority of revenues for regular operations for which the board has some discretion over how the moneys are expended.

Principles Used in the Preparation of the Illustrative Financial Statements

2. Special Revenue Funds

Special Revenue Funds are used to account for the proceeds of specific revenue sources (other than special assessments, expendable trusts, or major capital projects) that are legally restricted to expenditures for specified purposes. NCGA Statement 2 states that grants or entitlements received for purposes normally financed through the General Fund may be accounted for within that fund provided the applicable legal requirements can be appropriately satisfied. The use of special revenue funds is not required unless they are legally mandated. G.S. 115C-426 and 115C-440 mandate the State Public School Fund for budget and accounting purposes; therefore, that fund would be appropriately classified as a special revenue fund. The Federal Grants Fund is also considered to be a special revenue fund.

3. Trust and Agency Funds

The individual school funds are presented as expendable trust funds in the illustrative statements. A Combining Statement of Revenues, Expenditures, and Changes in Fund Balance by administrative unit and by totals for all individual schools is presented in the supplementary information section.

4. Enterprise Funds

The illustrative financial statements for Carolina County Board of Education were revised to include an additional enterprise fund, the Child Care Fund. This fund was created to account for the Board's before and after school programs at the various elementary schools within the school system. Since the Board now has two enterprise funds reported within the enterprise fund type, the addition of this new fund required the addition of combining statements as well as a budget to actual comparison within the supplementary information for the new fund. The notes to the financial statements were also revised to include required disclosures related to the new fund. If a school board budgets and accounts for before and after school care within the General Fund, the auditor should reclassify the budget and operations to an enterprise fund.

B. Additional Details Provided in Board of Education Statements and Other Issues

1. In the illustrative statements, a greater level of detail is required to be presented in Exhibits A-1 and C-1 than in prior years. To adequately answer questions about public school capital funding and facilitate the preparation of the various reports required for the General Assembly, our staff requires more information than had previously been presented by auditors in these schedules. As in the prior year, this level of detail has not been carried forward into Exhibits 2 and 3.

In order to provide more thorough guidance to all school boards, the illustrative statements for Carolina County Board of Education were prepared under the assumption that a special taxing district exists which levies a voted school supplemental tax within the district. This assumption is not mirrored in the illustrative statements for Carolina County. We also assumed that the county within which the board of education is located distributes sales taxes on an ad valorem basis. Because the county distributes sales tax in this manner, the board of education in our illustration received a proportionate share of sales and use taxes, inventories tax reimbursements, and sales tax reimbursements for food stamps and special supplemental food purchases. Exhibits A-1 and C-1 in the Board of Education's illustrative statements reflect these revenue sources. For more information concerning these revenue sources and their applicability to a local board of education, refer to the Revenue Sources section of the North Carolina Department of State Treasurer Policies Manual.

2. The revenues, expenditures, receivables and deferred revenues of many of the funds of the Carolina County Board of Education have been adjusted to reflect legislation enabling boards of education to apply for refunds of sales tax paid. For sales tax refunds from all sources, expenditures have been reduced and a corresponding receivable has been accrued. Some funds carry eligibility requirements, such as funding from the State of North Carolina or the U.S. Government. In order to

Principles Used in the Preparation of the Illustrative Financial Statements

properly account for the revenue from these sources, the amount originally recorded as revenue and used to pay sales tax is deducted from revenue and recognized as deferred revenue. When the refund of sales tax paid is received, the receivable and deferred revenues would be reduced, and cash and revenue would be recognized.

The Department of State Treasurer has consulted with officials from the Department of Public Instruction and the Attorney General's Office. Refunds of sales tax paid are to be considered unrestricted revenue when received, except for refunds of sales tax paid with grants from the State Public School Building Bond Fund. Refunds for sales tax paid with State Public School Building Bond money are restricted to the capital project funded by State Public School Building Bond money. The accruals in Carolina County Board of Education were made assuming that none of the refunds were received within 60 days of year end and therefore were not available resources.

C. Installment Purchase by County for School Construction

In the illustrative financial statements, we assumed that Carolina County was one of the counties in North Carolina authorized under G.S. 160A-20 to issue installment purchase obligations to finance school construction and improvements. The assets constructed and financed by the county from the debt proceeds should be accounted for on the board of education's records. This treatment reflects the true economic substance of the transaction as evidenced by the nominal lease and the bargain purchase option amounts, the insurance on the assets secured by the board of education, and the provisions of 153A-158.1(b) which states that the board of education will be involved in the construction of the asset to the same extent the it would be involved if it owned the property. The assets are, in substance, the assets of the board of education and should be included in the board of education's financial statements at cost.

During construction, the board of education will report the various expenditures to construct the assets within the Capital Outlay Fund. These expenditures should be offset by a revenue such as "County-issued installment purchase." These revenues should be reported as part of the county's appropriation to the school board. The debt transactions associated with the asset construction are entered into by the county, not the board of education. Therefore, these revenues do not constitute an "other financing source" as they would in the county's financial statements.

For an discussion of a county's treatment of this transaction, refer to the Carolina County discussion within this section of the manual.

D. Guaranteed Energy Savings Contracts

In 1994, the North Carolina General Assembly passed legislation authorizing local governments, including local boards of education, to enter into contracts for energy savings improvements to existing buildings in which the contractor guarantees that the savings will, over a period of time, pay for the costs of the improvements. According to G.S. 143-64.17 through 143-64.17E, a "guaranteed energy savings contract (GESc)" is a contract for the evaluation, recommendation, or implementation of energy conservation measures, including the design and installation of equipment or the repair or replacement of existing equipment, in which all payments are to be made over time, and in which the energy savings are guaranteed to exceed the costs. These measures may include insulation, storm windows or doors, caulking, weather-stripping, heating and air conditioning modifications or replacements, replacement or modification of lighting fixtures, energy recovery systems, or other long-term energy reducing or cost saving measures on existing buildings. The GESc must not be for a period longer than eight years from the date that the energy savings measures are installed and accepted by the governmental entity. The "guarantee" must be secured by a bond equal to 100% of the total cost of the contract. The statute authorizes local boards of education and other governmental entities to finance these contracts under installment purchase contracts under G.S. 160A-19 and 20.

Principles Used in the Preparation of the Illustrative Financial Statements

In our illustration, the Carolina County Board of Education has entered into an installment purchase contract to finance various energy saving measures. The transaction is recorded within the Board's Capital Projects Fund as an "other financing source" of \$200,000. As is appropriate for a lease transaction, the other financing source is offset in the initial year by an expenditure of \$200,000 within the Capital Projects Fund. The addition of the fixed asset is appropriately carried in the Board's General Fixed Asset Account Group. As the Board makes the debt service payments on the GESC, the payments would be expended in the General Fund, or the Local Current Expense Fund. Under existing guidance, the payments could be broken out from other functional areas and reported separately as debt service principal and interest, or included within the functional area where the utility payments which are offset by the GESC contract would have been reported. The intent of the law is for the debt service payments on the GESC to be offset by a reduction in utility payments. In addition, local boards of education should not have other debt service payments in the General Fund. Therefore, we have chosen to present the debt service payments for GESCs within the functional area within our illustrative statements. Those reports which break debt service out as a separate functional area will be accepted.

E. Donated Commodities

The illustrative financial statements for the Carolina County Board of Education have been adjusted to reflect the changes necessary for the new treatment of food commodities donated by the federal government. In prior years, the amount of donated commodities consumed and donated commodities recognized as nonoperating revenue were equal on the financial statements because the title to the commodities did not pass to the board of education until they were used. Unused commodities on hand were accounted for as deferred revenue. During the 2000-01 fiscal year, North Carolina boards of education began receiving federally donated commodities with labels identical to commercial available food items. The new labeling and new handling procedures are expected to ultimately reduce Food Service Fund expenses. However, because donated commodities are no longer distinctively labeled and school warehouses are no longer required to segregate the commodities, the year end inventory will not include a separate amount for donated commodities. The staff of the LGC has been in contact with DPI officials, school board officials, and school board auditors. Because the opening balance of donated commodities is known from the prior year's audit and the amount of donated commodities is known, analytical procedures will need to be used to determine the amount of donated commodities consumed. The Statement of Revenues, Expenses and Changes in Retained Earnings and the Statement of Cash Flows are both impacted by the amount recognized as "Donated Commodities Consumed."

V. **City of Dogwood Housing Authority – Summary Revised May 1999**

Reporting Entity

In the illustrative financial statements, the activities of the City of Dogwood Housing Authority are accounted for in an enterprise fund type and financial statements are prepared using the full accrual basis of accounting. An enterprise fund type was chosen because it is beneficial to the entity's management and to the general public to determine the extent to which the housing authority is supported by grant moneys. Additionally, use of the enterprise fund type is recommended, but not required, by the U.S. Department of Housing and Urban Development (HUD).

The City of Dogwood Housing Authority is governed by a five-member board that is appointed by the mayor of the City of Dogwood. The City is not able to impose its will on the Housing Authority nor does any financial benefit/burden relationship exist. The Housing Authority is a related organization to the City of Dogwood and is disclosed as such in the notes to the financial statements of both units.

Principles Used to Prepare Illustrative Financial Statements

Conversion from “HUD Accounting” to GAAP

For Public Housing Authorities with fiscal years ending September 30, 1999 and later, HUD is requiring that the financial statements be in accordance with generally accepted accounting principles. The staff of the LGC has worked with officials from the Real Estate Assessment Center (REAC) of HUD to coordinate the revisions and format of the illustrative financial statements. Detailed information from HUD and REAC is available at www.hud.gov/library/index.cfm. From that site, select the Resources option. The Real Estate Assessment Center Customer Service Center is available at telephone number 1-888-245-4860.

Financial Data Schedule (FDS)

The illustrative financial statements for the City of Dogwood Public Housing Authority contain an example of the completed Financial Data Schedule. This is a new form, effective for Public Housing Authorities with years ending September 30, 1999 and later, that is to be completed and submitted electronically. The form is to be submitted to HUD using unaudited information within 60 days of year-end. The FDS is due to HUD again, with audited information, within 9 months of year-end. Note that the *Contract to Audit Accounts* anticipates that the audit will be delivered to the LGC within 4 months of year-end. Because the FDS is required supplementary information required by HUD, **the FDS should be included with the audited financial statements and opined on by the auditor**. See the above Internet site and toll-free telephone number for the most recent information from the Department of Housing and Urban Development and the Real Estate Assessment Center.

VI. **Soil and Water Conservation District – Deleted May 2000**

These statements have been deleted as no longer being a statewide need. The staff of the LGC has observed that only a small percentage of the soil and water conservation districts across the state opt to have an independent audit done. Preparers seeking presentation guidance for Soil and Water Conservation District issues should follow the reporting illustrated in the statements of Carolina County or the City of Dogwood.

VII. **Cardinal Charter School - Summary Revised May 2000**

Reporting Entity The Cardinal Charter School is a public school operated by a local non-profit corporation and is chartered under General Statute 115C-238.29B. From G.S. 115C-238.29F(f) charter schools are required to follow the audit requirements as found in G.S. 155C-447. Charter schools are also required by this section to use the Uniform Education Reporting System established by the State Board of Education, and to report annually to the chartering entity and the State Board of Education, certain required information. The staff of the Local Government Commission has consulted with representatives from the Department of Public Instruction and the Attorney General’s Office. The charter schools in North Carolina must comply with the requirement to have an annual audit. The other provisions and requirements of The School Budget and Fiscal Control Act are not applicable. The charter schools may still be subject to specific requirements based on the restricted intergovernmental funding they receive.

Budgeting The illustrative financial statements for the Cardinal Charter School assume that the governing board has adopted a budget similar to a local education agency. While there is no statutory requirement that a charter school adopt a budget annually, they are expected to use “sound business practices.” The Department of Public Instruction will receive a copy of each charter school audit for their own evaluation of the charter schools and their business practices. If a school fails to adopt a budget, this should be noted in the report on internal controls or the management letter of the school.

Funds Maintained and Fund Activities The Cardinal Charter School is set up with a general fund to account for those resources that are not legally required to be accounted for in other funds and the contributions from the funding Boards of Education. The General Fund accounts for fund received from a local education agency. In these statements, the staff of the Local Government Commission has assumed that the Cardinal Charter School is drawing students from three local education agencies:

Principles Used to Prepare Illustrative Financial Statements

Carolina County Board of Education, Dogwood County Board of Education, and Old Pine County Board of Education.

Because the Charter School receives funding from both State and federal sources, the State Public School Fund and the Federal Grants Fund are established and maintained, as they would be in a Board of Education. One transaction assumed to have happened is that the charter school has purchased land with money from the State Public School Fund. While this is not illegal for a charter school to purchase land, it is not an allowable use of this State money. The charter school is assumed to keep the land and will be repaying the State Public School Fund from the General Fund. By having the repayment originate in the General Fund and pass through the State Public School Fund three accounting goals are met: the capital outlay for the land is recorded in the General Fund, the revenue and expenditures for the State Public School Fund are adjusted to reflect the allowable expenditures, and a due to the State of North Carolina is recorded for the amount of State money improperly used. As this example illustrates, the uses of the State Public School Fund monies are strictly prescribed. The illustrative use of the due to/due from amounts should not be taken as an indication that the State Public School Fund monies are available to support the Local Current Expense Fund throughout the year.

No Capital Outlay Fund is shown because charter schools are not bound by that specific requirement as boards of education are. Thus, in keeping with the minimum number of funds concept, no capital outlay fund is established for the capital outlay illustrated in the General Fund. Should a charter school need to establish a capital project fund, either annually or project ordinance budgeted, that fund should be included in the general purpose financial statements.

Financial Reporting As noted above, charter schools have much less reporting requirements than traditional local education agencies. For example, there is not statutory basis for the fund balance available for appropriation calculation being applied to charter schools, therefore, the Reserved by State Statute amount does not appear in the Cardinal Charter School. As noted in the paragraph above, restrictions may still be attached to the funds received from State and federal sources. Also, note that the auditor should consider those restrictions which the governing board of the charter school might have imposed. The notes to the financial statements disclose the overexpenditures because the board imposed the requirement of budgetary compliance.

The auditor should consider all these factors when reporting on the activities of a charter school. Something that might not be a statutory violation, such as budgetary overexpenditures or failure to adopt a budget, could still be an item that is a reportable condition or material weakness in the internal controls of the charter school. If the item does not rise to the level of a reportable condition, it could still be a management letter comment.

Teachers' Retirement Based upon audit reports received by the Department of State Treasurer, the majority of charter schools have opted to provide some form of tax sheltered retirement plan, either a 401(k) plan or a 403(b) plan. The pension note disclosures now illustrate that the Cardinal Charter School is providing a 403(b) retirement plan to eligible employees. Charter schools that have joined the Teachers' and State Employees Retirement System should use the guidance provided in the Notes to the General Purpose Financial Statements for Carolina County Board of Education.

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