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Accounting and financial reporting by state and local governments : an experiment

American Institute of Certified Public Accountants. State and Local Government Accounting Committee

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An Experiment

AICPA American Institute of Certified Public Accountants

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by the
State and Local Government Accounting Committee
American Institute of Certified Public Accountants

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Preface

The AICPA State and Local Government Accounting Committee is publishing this report to help evaluate the accounting principles described in the *AICPA Industry Audit Guide, Audits of State and Local Governmental Units,* as amended.[1] Some people contend that financial statements prepared in conformity with those principles do not provide information on cost of services for all activities and an adequate overview of the financial affairs of a government unit.

The accounting principles described in this report differ from the audit guide principles in two major respects. First, operating performance, including cost of services, is reported for governmental funds, and noncurrent assets and liabilities are included in their balance sheets. Second, each type of financial statement consolidates all funds of a government unit.

Government units volunteered to apply the accounting principles described in this report and to submit opinions on their usefulness and practicality. Their opinions are summarized in the report, whose publication does not modify or supplant the audit guide principles.

A broad group of interested persons was asked to participate in the study. In response, officials of twenty-seven government units, listed in chapter 3, prepared the requested financial statements and completed a questionnaire. Officials of twenty-nine other state and local government units and thirteen other persons completed applicable parts of the questionnaire. Because the respondents were not randomly selected and the statistical properties of the sampled population are not known, inferences that might be drawn from the responses summarized in this report have unknown statistical properties and may not be statistically valid.

State and Local Government Accounting Committee

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1. The amendments incorporate the principles set forth in National Council on Governmental Accounting Statement 1, *Governmental Accounting and Financial Reporting Principles.*

AICPA Staff

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Four members of the committee served on the task force for this report: Earl C. Keller, who served as chairman; Bert T. Edwards; Anthony J. Mottola; and Terry N. Sapp.

The committee acknowledges the contribution made to this experiment by the former chairman of the committee, Frank S. Belluomini; former members of the committee, Joseph Antonello, Jr., Leroy Bergstrom, William D. Callahan, Herman O. Coleman, James R. Fountain, Jr., Bruce M. Heider, Clark D. Hollingsworth, George L. Patterson, Sr., Robert J. Ryan, Max R. Sanchez, James Lee Savage, Harold I. Steinberg, Robert H. White, and Keith E. Wiggins; and a former staff aide, Gabriel V. Carifi. The Municipal Finance Officers Association assisted in promoting the experiment and obtaining participants.

1

Accounting Experiments

Experiments are most commonly conducted in the physical sciences, but they have also been conducted in the social sciences and in accounting. For example, experiments dealing with the application of accounting principles have involved adjustment or restatement of traditional financial statements for changes in prices or in the general level of prices.[1] Also, the federal government is experimenting with the application of accounting principles. Since 1975 it has issued prototype financial statements for the U.S. government. Those prototype statements have a three-way reporting focus: (1) to report operating performance (including cost of services), (2) to report financing performance (the sources and uses of financing resources), and (3) to report financial position, with financial position defined to include both current and non-current assets and liabilities. The prototype report consolidates U.S. government financial activities in one set of financial statements.

The principles applied in this experiment are similar to those used to prepare the prototype U.S. government financial statements. Those principles likewise call for reporting operating performance, financing performance, and financial position, similarly defined, and the presentation of a consolidated set of financial statements. The principles of this experiment are described in chapter 2.

Why Experiment?

Accounting principles should result in information that is useful to readers of financial statements, and the principles should be practical and unambiguous. Experiments in accounting can provide information that will help authoritative bodies to decide whether principles applied in the experiments meet those criteria.

1. For example, see Ralph C. Jones, *Price Level Changes and Financial Statements: Case Studies of Four Companies* (Chicago: American Accounting Association, 1955); Paul Rosenfield, "Accounting for Inflation: A Field Test," *Journal of Accountancy* (June 1969); Financial Accounting Standards Board, *Field Tests of Financial Reporting in Units of General Purchasing Power* (Stamford, Conn.: FASB, 1977); and American Institute of CPAs, *The Accounting Responses to Changing Prices: Experimentation With Four Models* (New York: AICPA, 1979).

Usefulness

The usefulness of information in financial statements resulting from the application of particular accounting principles would be determined ideally by the extent to which the information helps users in making economic decisions. Since the manner in which users employ information in making their decisions is not completely understood, accounting experiments of this type are helpful because they provide informed opinions about the usefulness of the information.

Practicality

Adoption of new accounting principles makes no practical difference unless the data they produce differ materially from data produced from the application of the principles they would supplant. Unimportant differences do not justify the costs of change.

Accounting experiments of this type help determine whether the data produced by the application of the proposed accounting principles are significantly different from the data presently available. For example, a common argument against constant dollar accounting during the 1950s and early 1960s was that the low rate of inflation during the period meant that its adoption would not produce material differences. However, experiments in constant dollar accounting covering that period demonstrated that material differences were common.

Adoption of new accounting principles is also not practical unless the time and effort needed to apply the principles can be kept within reasonable limits. Accounting experiments of the type discussed in this report can reveal problems and costs of application that otherwise may not be apparent.

Unambiguity

Written descriptions of accounting principles are sometimes interpreted in diverse ways, often because the writers of the descriptions do not anticipate all of the ramifications or implementation problems of the accounting principles. Unforeseen difficulties can be minimized if the principles are applied experimentally.

This Experiment

In this experiment the committee requested state and local government units to prepare financial statements for a recently ended accounting period in conformity with the principles described in chapter 2 and to answer a questionnaire. The committee also encouraged nonparticipants in the experiment to complete the portion of the questionnaire that solicited opinions on the usefulness of those principles for the financial statements of state and local governments.

The principles applied in the experiment, the questionnaire, and other pertinent information were contained in a booklet, *Experimentation Booklet: An Experiment in Government Accounting and Reporting by the AICPA State and Local Government Accounting Committee,* which was issued in September 1979.

The participants are listed in chapter 3. The questionnaire is reproduced at the back of this book, and the responses to the questionnaire are summarized in chapters 3 and 4. The contents of financial statements prepared under the principles applied in the experiment are discussed in chapter 5, and examples are presented.

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Description of the Principles Applied in the Experiment

Information for External Users

In recent years, government has become more complex, and its economic effects have grown significantly. Along with growth have come greater visibility and greater demand for accountability. Because the public, elected representatives, holders of debt obligations, and creditor-related parties (such as bond-rating agencies and bond counsels) are becoming more interested in the financial activities of government units, it may be argued that more understandable and usable financial statements will be needed—financial statements that (*a*) are concise and easy to read, (*b*) are presented in a usable and meaningful format, (*c*) apply similar accounting principles to all parts of a government entity, and (*d*) most importantly, provide information that serves users' needs.

The principles discussed in this chapter were designed for the external general-purpose financial statements of government units. The reporting formats discussed in this chapter were not designed to displace the comprehensive fund-by-fund or fund-type accounting and reporting systems that many government units provide for various purposes. They were also not designed to replace any type of internal reporting deemed desirable by a government unit.

The committee considered the fundamental principles presently underlying government accounting and the principles being applied in other areas. Each principle discussed in this chapter was considered on its own merits and evaluated according to whether its application had the potential of serving certain needs of users of nonbusiness general-purpose financial statements. Those needs have been described by Robert N. Anthony in *Financial Accounting in Nonbusiness Organizations* (Stamford, Conn.: Financial Accounting Standards Board, 1978) as follows: (1) to assess the organization's ability to continue to provide the services for which it exists, (2) to determine whether the organization has complied with spending and other fiscal mandates, (3) to assess the effectiveness of management performance, and (4) to obtain information about the cost of services provided.

Reporting on a Single Entity

Defining the Reporting Entity

In reporting on government operations, it is necessary to determine what constitutes the reporting entity. That is particularly difficult in the government area because of the multitude of funds, activities, and agencies having overlapping responsibilities. For purposes of the experiment, the reporting entity for general-purpose financial statements consisted of all functions, programs, and activities that were controlled by or were dependent on a government unit's legislative or executive body. If one government unit is dependent on another, the dependent unit was to be reported as part of the other. A controlling or dependent relationship exists under one or more of the following circumstances: (1) budget adoption, (2) taxing authority, (3) debt issuance secured by general obligations, and (4) financing of deficits. Control or dependence does not result from federal or state aid or grants, statutory powers given one government unit or official to formally approve another unit's actions, or constitutional or statutory authority limiting a government unit to specific authority.

The foregoing definition does not imply that the financial statements of all political subdivisions within a given state were to be consolidated in the financial statements of the state; however, guarantees of the debts of those subdivisions by a state were to be disclosed.

Fund Accounting

Fund accounting was originally developed to account for the stewardship responsibilities of organizations. Because government units originally provided a limited variety of services, fund accounting and reporting was suitable as a control technique to account for those units. Reasons often given for reporting on each fund or fund type as a separate entity are that each fund is based on legal requirements, all funds have distinct purposes that should not be combined, and the stewardship responsibility of a government unit requires each function to be accounted for separately.

Although those reasons are understandable, some critics contend that government operations are too complex to permit reporting on only separate interests in the general-purpose financial statements; an overall view of operations is needed. The growth of government activities has caused the development of numerous and complex funds within government units. The view has been expressed that reporting separately on each fund or group of funds of the same type has become cumbersome and that the resulting fragmentation of the entity has made it difficult for the user of a government report to understand the activities of the unit as a whole.

For purposes of the experiment, the fund types were to be consolidated for general reporting purposes.

Need for Consolidating Funds

It has been argued that a single overall report that provides a composite picture of the government unit as a single economic entity provides the reader with the information needed to assess the unit's solvency, to evaluate management's effectiveness in financial matters, to assess the cost of programs, and to review the source and use of resources. Program activities of an organization would be reported in a concise manner rather than spread over several funds or fund types. In the process of consolidating the individual fund statements, the reporting of interfund balances, revenue, and expenses would be eliminated. Consolidation of funds would be facilitated by having all funds use the same accounting principles for external general-purpose financial statements. Also, a single consolidated set of financial statements with operating information presented for separate functions would make the overall comparison of financial activities and trends of government units, particularly government units that have similar activities and programs, more relevant and practical than it now is.

The proposal for a single consolidated set of financial statements is not new. Many nongovernment organizations and a few government units that use fund accounting have been restructuring their reports to present consolidated information.

Trust and Agency Funds

Accountability for trust and agency funds is often part of the responsibilities of a government unit. If the unit has stewardship responsibility for those funds because they meet the criteria for control described above, the funds were to be included as part of the government unit for the purposes of the experiment. Pension and similar funds that are not separately controlled by a fiduciary (for example, taxes withheld from employees, taxes collected for other government units, and performance bond deposits) were to be included in the consolidated financial statements. However, pension and other deferred compensation plans under which contributions are irrevocable and under the complete power of a separate trustee are examples of trust and agency funds that do not meet the control criteria, and those funds were not to be part of the general-purpose financial statements.

Cooperative Ventures

Under the principles set forth in this chapter, the equity method of accounting was to be used for intergovernmental cooperative ventures—for example, the Dallas-Fort Worth Regional Airport Board and the Port Authority of New York and New Jersey. Under that method, the government unit initially records its cost as the carrying amount of the venture. The carrying amount is adjusted by the government unit's share of an excess or deficit of current revenues compared with the cost of current operations for a period.

Basic Financial Statements

For purposes of the experiment, the basic financial statements of a government unit were to consist of a balance sheet, a statement of financial activity, a flow-of-financing-resources statement, and related notes.

The major components of the balance sheet were to be unrestricted assets; restricted assets; property, plant, and equipment; bonded debt; other liabilities; and government capital. Restricted assets were to be assets restricted by outsiders, such as lenders and grantors, or revenue from special taxes. The government capital section was to show separate unrestricted and restricted balances, and the unrestricted balance was to be classified into appropriated and unappropriated balances. The sources of restrictions and the amounts involved, as well as other information that describes the nature of the restrictions, were to be disclosed in the notes.

The statement of activity was to show total costs by function, related revenues classified by user charges and intergovernmental revenue, and net function costs. General-use revenues, by source, were to follow net function costs. The difference was to be captioned "Excess (deficit) of current revenues over costs of current operations." The addition of the excess to, or deduction of deficit from, the beginning capital balance results in the ending capital balance.

For the purpose of preparing a flow-of-financing-resources statement, one alternative permitted was to define *financing resources* as cash and investments. Another alternative was to define financing resources as working capital reported on the balance sheets for enterprise funds or as those assets and liabilities reported on the balance sheets for governmental funds under National Council on Governmental Accounting (NCGA) Statement 1.

The flow-of-financing-resources statement was to present the balance of financing resources at the beginning and end of the period and the increases and decreases in financing resources during the period. Financing resources derived from operations could be calculated by (1) adding and subtracting receipts and disbursements of financing resources or (2) adding and subtracting adjustments to or from the difference between revenue and expenses in the statement of activity.

To provide adequate disclosure, notes to the financial statements were to be included, as well as segment information of the type described in FASB Statement no. 14.

Accrual Accounting

Need for Accrual Accounting

An accrual accounting system is needed to produce a statement of the cost of services provided by the government entity and the revenues that financed those services. Cash basis accounting permits the cost of services to be recorded only when payment is made for the services and permits revenues to be recorded only when money is collected from taxes and other sources. Because services are commonly provided before or after payment is made, and taxes are levied and become legally enforceable claims before the taxes are collected, a cash basis accounting system could produce a misleading statement of both the cost of services provided and the revenues that financed those services. An accrual accounting system permits costs and revenues to be recorded independently of payments and collections. Furthermore, accrual accounting reduces the ability to reflect a desired financial statement result by speeding up or deferring cash payments.

Accrual accounting is also needed to produce a complete statement of the resources, obligations, and capital of the government entity. For government accounting, resources include receivables pertaining to legally enforceable claims for taxes, licenses, and other revenue-raising devices. Obligations include payables pertaining to legally enforceable liabilities for services, such as wages and insurance. Receivables and payables of those types cannot be reported under a cash basis accounting system. Accrual accounting also permits reporting of nonmonetary assets and long-term debt.

Some critics have argued that accrual accounting would not be appropriate for government units because budgets are not usually prepared on an accrual basis and comparison of financial statements to budgets would be misleading. Although information with which budgets are compared should be prepared on the same basis as the budgets, that requirement need not prevent the use of accrual accounting. If budgets prepared on other than the accrual basis are included in external general-purpose financial statements, historical information prepared on the same basis should be included for comparison purposes, and that information should be clearly distinguished from that prepared under accrual accounting. For purposes of the experiment, inclusion of budget information in the external general-purpose financial statements was optional.

Applying Accrual Accounting

Expense Recognition. Under the principles applied in the experiment, expenses were to be recognized when goods and services for which costs were incurred are provided to beneficiaries or are used in operations. The same approach is taken in accounting for business enterprises, and costs in government accounting that are similar to those in business enterprise accounting were to be recognized as expenses in a similar manner.

Revenue Recognition. For the purposes of the experiment, revenue from operations of enterprise funds was to be recognized when goods or services are exchanged. Revenue derived from the imposition of taxes—which were interpreted to include licenses, fines, permits, and other similar items—does not result from sales and required a recognition approach different from that taken in accounting for business enterprises.

For experimental purposes, claims to taxes were to be recorded as receivables by a government unit when all of the following criteria are met:

- All substantive events have occurred to give rise to a legally enforceable claim except the passage of time.
- Collection of the claim is probable. (Probability may be determined by aggregating individual claims and estimating an allowance for uncollectible amounts on the basis of collectibility experience.)
- Revenue pertaining to a tax the amount of which is initially calculated by the taxpayer—for example, sales and income taxes—must be estimable by the government unit with reasonable accuracy.

Applying those criteria, claims to taxes calculated initially by the government unit were to be recorded as receivables when the tax is formally levied by the legislative body, which, for real estate taxes, is the assessment date. Claims to taxes calculated initially by the taxpayer were to be recorded as receivables when the events that give rise to the taxes occur. For sales taxes, that event is the collection by the taxpayer of taxes on sales made during the period. For income taxes, that event is the earning of taxable income, as defined by the government unit, during the period.

The selection of a method of estimation and determination of the accuracy of the estimate are matters of judgment for the accountants preparing the financial statements. If estimates could not be made with reasonable accuracy, no claim to taxes was to be recorded as a receivable. For the purpose of the experiment, however, most government units were thought to be able to make estimates of sales and income taxes that were accurate enough to justify immediate recording of receivables.

The receipt or accrual of taxes in accordance with the foregoing criteria was to be recognized as current-period revenue. However, a legislative body may have specified as part of a tax levy that the taxes have been assessed to apply to the cost of goods and services to be provided in the next succeeding period. If so, the receipt or accrual of taxes was to be recorded as deferred revenue (a balance sheet credit outside the government capital section) in the current period, and revenue was to be recognized in the next succeeding period.

Fixed Assets and Depreciation

As used in the experiment, the term *fixed assets* referred to exhaustible and nonexhaustible long-lived assets used in providing government services. Exhaustible fixed assets included movables, buildings, roads, bridges, water and sewer lines, viaducts, and tunnels. Nonexhaustible fixed assets included land, works of art, and monuments. Under the experiment, exhaustible fixed assets were to be recorded as assets and depreciated over their estimated useful lives. Nonexhaustible fixed assets were to be recorded as assets but not depreciated.

The services of one government unit may be compared with those of another, in part, by cost determinations. Depreciation of fixed assets used in providing services is an element of the cost of services. Depreciable fixed assets are both valuable and exhaustible: thus, there is a cost associated with using an asset, whether it is owned or rented and whether it is used by a profit or nonprofit organization.

The capitalization of fixed assets can provide additional benefits to a government unit. Fixed-asset records can be periodically reviewed to determine whether assets are properly controlled; the responsibility for the custody of assets, as well as their effective use, can be established, and information on sources of supply, prices, and useful lives would be available. The amount of capital grants used to purchase fixed assets can be determined, and information for insurance needs that is helpful in substantiating recoverable losses would be available.

For purposes of the experiment, fixed assets were to be capitalized at cost or, if donated, at fair value at the date of the gift. Government units that had not capitalized fixed assets in the past were to do so retroactively. Historical cost or fair value at the date of the gift could be estimated if necessary.

If depreciation is not recorded by government units for general operations, the cost of using resources can be overstated in the years an asset is acquired and understated in the years the asset is used but not depreciated. Depreciation is not an exact measurement of the cost to use an asset but provides an allocation of that cost over the benefited periods.

Some accountants believe that by recording depreciation, the cost of assets will be charged to expense twice—once when they are purchased and again when they are depreciated. If depreciation were recorded under the present flow-of-funds system of government accounting, that would occur; but under the cost basis of reporting it would not occur. Also, depreciation does not fund the purchase of assets, as some people believe. Depreciation is an allocation process that spreads the cost of an asset over its useful life in an attempt to reflect the expiration of the usefulness of the assets and is not a financing process.

Finally, payments on debt incurred to purchase assets, which have a legitimate place in a statement of flow-of-financing resources, should not be considered as amounts comparable to depreciation. Such payments rarely correspond to the expiration of the usefulness of the assets.

Encumbrances

NCGA Statement 1 defines *encumbrances* as "commitments related to unperformed (executory) contracts for goods and services" and states that they can be recorded for budgetary control purposes. Because encumbrances represent only commitments (that is, the goods or services have not been received), they were not to be recorded as liabilities or as part of the cost of goods or services for purposes of the experiment.

Pensions

Pensions represent a substantial and growing expense to government units, and the obligation for pensions is important information to readers of government financial statements. For the purposes of the experiment, pension costs were to be accrued on the basis of one of the acceptable actuarial methods specified in Opinion 8 of the AICPA Accounting Principles Board, *Accounting for the Cost of Pension Plans* (1966), and the disclosure requirements of the opinion were to be followed. Pension costs accrued but not paid or irrevocably funded were to be recorded as a liability.

Comparison of the Principles Applied in the Experiment With the Audit Guide Principles

Level of Aggregation

The AICPA Industry Audit Guide, *Audits of State and Local Governmental Units,* as amended, specifies that the financial statements for a state or local government unit should be as follows:[1]

1. Combined balance sheet for all fund types and account groups.
2. Combined statement of revenues, expenditures, and changes in fund balances for all governmental fund types.
3. Combined statement of revenues, expenditures, and changes in fund balances—budget and actual for general and special revenue fund types (and similar governmental fund types for which annual budgets have been legally adopted).
4. Combined statement of revenues, expenses, and changes in retained earnings (or equity) for all proprietary fund types.
5. Combined statement of changes in financial position for all proprietary fund types.
6. Notes to the financial statements.

Trust fund operations may be reported in statements 2, 4, and 5, as appropriate, or separately.

Those financial statements are referred to collectively as general-purpose financial statements. The combined financial statements are prepared in columnar format with a separate column for each of the five governmental fund types, two proprietary fund types, one trust or agency fund type, and two account groups for general fixed assets and general long-term debt. Each of the eight fund-type columns represents the aggregation of individual funds that account for activities of the same type. In the aggregating of individual funds to arrive at the totals for each fund-type column in the combined statements, the elimination of interfund transactions and balances is optional.

The focus of the audit guide is on the eight separate fund types and two account groups. State and local government units have the option of presenting a total column in the combined financial statements; but if such a column is presented, it must be marked "Memorandum Only." Further, a note to the combined financial statements

1. The amendments refer to the principles set forth in NCGA Statement 1, *Governmental Accounting and Financial Reporting Principles.*

should indicate that the data in the total column do not present financial position, results of operations, or changes in financial position in conformity with generally accepted accounting principles and that such data are not comparable to a consolidation. In the aggregating across fund types and account groups to arrive at the "Memorandum Only" totals, the elimination of interfund transactions and balances is also optional.

In contrast, under the principles applied in the experiment, the financial statements for a government unit were as follows:

1. Consolidated balance sheet for the government unit as a whole.
2. Consolidated statement of financial activity for the government unit as a whole. This statement contains operating data such as cost of services.
3. Consolidated flow-of-financing-resources statement for the government unit as a whole.
4. Notes to the financial statements.

In preparing the financial statements called for in the experiment, all interfund transactions and balances were eliminated, with the result that the consolidated statements reflected only transactions with parties outside the government unit. The focus of the experiment was on the consolidated government unit and not on the eight separate fund types and two account groups.

Content of the Statements

The audit guide separates government activities into two major types for purposes of determining what should be presented in financial statements:

- Proprietary fund types, used to account for activities that operate in a manner similar to business enterprises.
- Governmental fund types, used to account for other government activities.

Under the audit guide, the objectives of the financial information on proprietary fund types are as follows:

- To report operating performance (for example, cost of services and net income) during the accounting period. That information is presented in the combined statement of revenues, expenses, and changes in retained earnings (or equity) for all proprietary fund types.
- To report the inflows and outflows of financing resources (usually defined to equal the difference between all current assets and all current liabilities—working capital) during the accounting period. That information is presented in the combined statement of changes in financial position for all proprietary fund types.
- To report financial position (defined to include all current and noncurrent assets and liabilities) as of a specified date. That information is presented in the combined balance sheet for all fund types and account groups.

The objectives of the financial information on governmental fund types under the audit guide are as follows:

- To report inflows and outflows of financing resources (defined to equal the difference between expendable financial resources and related current liabilities—spendable fund balance) during the accounting period. That information is presented in the combined statement of revenues, expenditures, and changes in fund balances for all governmental fund types.
- To report financial position (defined to include only expendable financial resources and related current liabilities) as of a specified date. That information is presented in the combined balance sheet for all fund types and account groups. General fixed assets and general long-term debt are accounted for in two separate account groups and are not included in the balance sheets of the governmental fund types. Instead, general fixed assets and general long-term debt are presented in two separate columns of the combined balance sheet for all fund types and account groups.

In contrast, the type of information presented under the experiment was the same for all government activities. It was the type of information presented under the audit guide for proprietary fund types.

The experiment modified the information presented under the audit guide for governmental fund types as follows:

- The experiment added noncurrent assets and liabilities to the balance sheets of governmental fund types.
- The experiment required that statements of operating performance be prepared for governmental fund types as well as proprietary fund types. Under the audit guide, those statements are prepared only for proprietary fund types.

The most significant difference between financial statements prepared in conformity with the audit guide and those called for in the experiment is the addition of the operating performance statements for governmental fund types. Among the changes required by the experiment to prepare the operating performance statements were the following:

- Depreciation expense was recognized on general fixed assets.
- Pension costs were accrued as an expense, regardless of when they were paid.
- Accrued vacation and sick leave were recognized as incurred, regardless of when they were paid.
- Interest on long-term debt was accrued as an expense as it was incurred, regardless of when it was paid.

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Implementation of the Experiment

Characteristics of the Experimenters

The twenty-seven experimenters consisted of two states; sixteen cities, towns, and villages; four counties; four public school districts; and one metropolitan sewage and transportation system. Specific information about the experimenters is contained in the two tables.

Cities, Towns, and Villages

Municipality	*Population*	*Operating budget (in millions)*
Kenilworth, Illinois	3,000	$ 1
Cartersville, Georgia	12,000	18
Novi, Michigan	22,000	6
Oshkosh, Wisconsin	49,000	14
Greenwich, Connecticut	64,000	60
Daly City, California	75,000	17
Beaumont, Texas	133,000	50
Greensboro, North Carolina	157,000	70
Shreveport, Louisiana	220,000	78
Sacramento, California	274,000	124
Charlotte, North Carolina	350,000	125
Portland, Oregon	367,000	447
Washington, D.C.	650,000	1,285
Phoenix, Arizona	753,000	276
Dallas, Texas	898,000	411
Philadelphia, Pennsylvania	1,760,000	1,467

Other Experimenters

Government unit	*Operating budget (in millions)*
Counties	
Anne Arundel, Maryland	$ 167
Mecklenburg, North Carolina	140
Outagamie, Wisconsin	36
Hennepin, Minnesota	362
Public school districts	
Milwaukee, Wisconsin	272
Charlotte—Mecklenburg, North Carolina	148
Conroe, Texas	25
New Orleans, Louisiana	168
States	
Colorado	2,654
Tennessee	3,100
Municipality of Metropolitan Seattle, Washington (sewage and transportation)	77

In preparing the financial statements they regularly publish for external users, seventeen experimenters substantially follow the audit guide principles, but ten make minor departures from them, principally in accounting for encumbrances. All except two experimenters have their financial statements audited annually by independent auditors.

Depreciation Difficulty

The principal difficulty in preparing the experimental financial statements was in estimating depreciation expense on property, plant, and equipment used in the operations of governmental funds. Although the cost of many of the individual assets or groups of assets of the same type must be kept separately in property records to prepare financial statements under the audit guide principles, most of the government units that participated in the experiment had not previously used those records to calculate depreciation expense on each asset or group of assets.

Since the time that would have been needed to make the calculations solely for the purpose of the experiment would have been excessive, the participants commonly resorted to estimating the accumulated depreciation at the beginning and end of the year and computing depreciation expense as the difference. Under one procedure, the accumulated depreciation was assumed to bear the same percentage relationship to gross property, plant, and equipment as the accumulated depreciation on property, plant, and equipment of proprietary funds (on which the audit guide calls for depreciation) bears to the gross assets of those funds. Under a more complex procedure, property, plant, and equipment was divided into several broad categories, and all property in that category was assumed, on the average, to have been used for a certain number of years and to have a remaining life of a certain number of years. Although satisfactory for the experiment, the shortcut methods for estimating depreciation would not be acceptable for published annual financial statements.

Conclusions

Fourteen participants thought that preparation of published annual financial statements under the principles applied in the experiment would cost more than under the audit guide principles; ten participants believed that preparation would cost the same; two believed it would cost less, and one did not give an opinion.

Conceptual Problems

The experimenters encountered two types of conceptual problems in interpreting the principles. The first problem was that certain principles apparently were stated vaguely or inconsistently in the experimentation booklet. The second problem was that accounting for certain types of transactions was not discussed.

Vague and Inconsistent Principles

The experimentation booklet called for classification of assets in the balance sheet as restricted assets, unrestricted assets, or property, plant, and equipment. Restricted assets were defined as assets restricted by outsiders, such as lenders, grantors, or revenue from special taxes.

Some experimenters said that the definition of restricted assets was vague and that classification of certain assets described in the experimentation booklet as restricted and unrestricted appeared inconsistent with the definition. The vagueness of the definition involved the meaning of outsiders, particularly the question of whether legislative bodies were to be treated as insiders (management) or as outsiders.

Others said that the definition of restricted and unrestricted government capital and the method of adding and subtracting adjustments to or from the difference between revenues and expenses to obtain financing resources provided by operations in the statement of the flow of financing resources were not clear.

No Discussion of Accounting for Certain Transactions

Accounting for grants or special assessments as capital or revenue was mentioned by a number of participants as an issue that should have been discussed in the experimentation booklet but was not. Another issue cited was accounting for the issuance of debt by one government unit to pay for assets that are then turned over to another unit. One participant who has issued debt of that type reported both an asset and a liability in the experimental balance sheet, but another reported only the liability and charged government capital in the amount of the asset turned over to the external government unit. Another participant who had received assets of that type reported both the asset and the liability in the experimental balance sheet.

Departures From Principles

Twenty-one participants applied all the principles in preparing the experimental financial statements, and six participants departed from the principles. One participant accounted for pension costs on a cash basis and did not use the equity method to account for the investment in an intergovernmental cooperative venture. Another accounted for encumbrances as expenses and liabilities. Those departures were made to simplify the experimental effort and not because the participants disagreed with the principles.

Four participants did not present depreciation expense on fixed assets used by governmental funds in the statement of activity. Instead, they presented the payments to discharge long-term debt in the statement of activity. Those four participants strongly disapprove of depreciation accounting for those assets.

4

Opinions on the Usefulness of the Principles and the Experiment

Opinions on the usefulness of the principles applied in the experiment and on the experiment itself were given in answers to the questionnaire by the twenty-seven officials of state and local governments who prepared experimental financial statements (group 1), twenty-nine officials of state and local governments who did not prepare experimental financial statements (group 2), and thirteen people who were not officials of state and local governments (group 3). Their opinions are summarized in this chapter. Because the respondents were not selected randomly and because the experiment was not conducted in a controlled setting, no generalized conclusions should be drawn from the summary of opinions.

The committee recognizes that participants in the three groups who were interested enough to participate may be biased in favor of the principles applied in the experiment. However, even statistically significant results would not be conclusive, since the opinions of the respondents are not necessarily what they would have been had they participated in the due-process procedures required of standard setters. The summary of responses to the questionnaire may nevertheless be helpful in evaluating the principles.

Consolidation Policy

Balance Sheet

The respondents gave their preferences for the level of aggregation that should be followed in presenting general-purpose balance sheets for state and local government units.

	Group 1	Group 2	Group 3	Total
Combine all funds and account groups into one consolidated balance sheet	13	10	3	26
Present all fund types and account groups in one combined balance sheet with one column for each fund type and each account group	14	15	6	35
Both of the above approaches	0	2	1	3
Combine all funds and account groups into separate balance sheets, one each for proprietary, governmental, and fiduciary funds and account groups	0	0	1	1
Present separate combining balance sheets, one for each fund type, with separate columns for each fund	0	2	1	3
Present individual balance sheets for each fund and account group	0	0	1	1
Total	27	29	13	69

The experiment called for the inclusion of all funds and account groups into one consolidated balance sheet, whereas the audit guide calls for presenting separate columns for each fund type and account group in one combined balance sheet. Five of the twenty-six respondents who prefer the balance sheet called for in the experiment and thirteen of the thirty-five respondents who prefer the audit guide balance sheet also prefer one or more additional balance sheets containing a lower level of aggregation.

Although virtually all the respondents preferred a balance sheet for government units in which all funds and account groups are presented, they differed about the type of balance sheet that should be presented. Those who preferred the audit guide balance sheet did so because they contended that it presents more completely the restrictions on the assets of the government unit. They pointed out that, although the balance sheet called for in the experiment discloses the assets restricted by outsiders, it does not classify unrestricted assets by fund type, and they held that it thereby gives financial statement users the mistaken impression that unrestricted assets are available for any activity of the government unit. The audit guide balance sheet, in contrast, was said to show clearly that unrestricted assets are assigned to particular activities and are not available for other activities. The audit guide balance sheet is also superior in presenting restricted assets, according to its advocates, because it enables them to be classified by the nature of the restriction (the fund to which they are assigned), whereas that information has to be disclosed in a note to the balance sheet called for in the experiment.

Those who preferred the balance sheet called for in the experiment did so because they contended that it is easier to understand, more similar to balance sheets of business enterprises, and more consistent with the need of financial statement users to evaluate the financial affairs of the government unit as a whole rather than as a collection of separate funds. Advocates of that balance sheet argued that the financial information that pertains to the activities of separate funds, for example, interfund loans and transfers and compliance with legal restrictions, is best disclosed in notes.

Statement of Activity

The respondents gave their preferences for the level of aggregation that should be used in presenting a statement of activity (statement of revenue and expenses or revenue and expenditures).

	Group			
	1	*2*	*3*	*Total*
Combine all funds into one consolidated statement of activity	16	11	5	32
Combine all fund types into two combined statements of activity, one each for governmental and proprietary fund types, with one column for each fund type	11	15	6	32
Present separate combining statements of activity, one for each fund type, with separate columns for each fund	0	3	1	4
Present individual statements of activity for each fund	0	0	1	1
Total	27	29	13	69

The experiment called for combining all funds into one consolidated statement of activity, whereas the audit guide calls for two combined statements of activity.

One of the respondents who preferred the statement of activity called for in the experiment believed that interfund transactions should not be eliminated. Fifteen of the thirty-two respondents who preferred the two combined statements of activity and eight of the thirty-one respondents who preferred the statement of activity called for in the experiment preferred one or more additional statements of activity containing a lower level of aggregation.

The audit guide statement of activity for governmental funds reports information that is different from the information reported by the audit guide statement of activity for proprietary funds. The governmental fund statement of activity reports financing performance (the sources and uses of spendable financing resources), whereas the proprietary fund statement of activity reports operating performance (including costs of services). In contrast, the statement of activity called for in the experiment reports operating performance for both governmental and proprietary fund types.

The respondents who preferred the statement of activity called for in the experiment also tended to prefer its single reporting focus. Those who preferred the two audit guide statements of activity for governmental and proprietary funds also tended to prefer their two different reporting focuses. This group of respondents supported the two statements of activity because they believe that the different reporting focuses prevent aggregation into a single statement from being meaningful.

Statement of the Flow of Financing Resources

The respondents gave their preferences for the type of funds that should be included in a statement of the flow of financing resources.

	Group			
	1	*2*	*3*	*Total*
All funds	13	14	5	32
Proprietary funds only	14	13	5	32
No statement of the flow of financing resources should be presented	0	1	2	3
Not answered	0	1	1	2
Total	27	29	13	69

The respondents who preferred that all funds be included in the statement gave their preferences for the level of aggregation that should be used in presentation.

	Group			
	1	*2*	*3*	*Total*
Consolidation of all funds	13	12	4	29
Consolidation into three groups, one each for governmental, proprietary, and fiduciary fund types	0	1	1	2
Individual statements for each fund	0	1	0	1
Total	13	14	5	32

The respondents who preferred only proprietary funds to be included in the statement gave their preference for the level of aggregation that should be used in presentation.

	Group			
	1	*2*	*3*	*Total*
Combined statement for proprietary fund types, with a separate column for enterprise, internal service, and fiduciary fund types	13	9	4	26
Combining statements, one for each different proprietary fund type, with a separate column for each fund	1	3	0	4
Individual statement for each fund	0	1	1	2
Total	14	13	5	32

The statement of the flow of financing resources reports the inflows and outflows of financing resources. The audit guide calls for reporting inflows and outflows of financing resources for both governmental and fiduciary funds, but the definition of financing resources can differ for the two fund types. Financing resources for governmental funds are defined as the difference between expendable financial resources and related current liabilities. Financing resources for proprietary funds usually are defined as working capital—the difference between total current assets and total current liabilities. Changes in financing resources are reported under the audit guide in two separate statements. The changes are reported for governmental funds in the combined statement of revenues, expenditures, and changes in fund balances for all governmental fund types. The changes are reported for proprietary funds in the combined statement of changes in financial position for all proprietary fund types.

The experiment called for one consolidated statement that includes both governmental and proprietary fund types. This statement was intended to report the inflows and outflows of financing resources for the government unit as a whole. Under the experiment, financing resources could be defined in different ways. Among the definitions were (1) cash and investments and (2) the difference between current monetary assets and current monetary liabilities.

The respondents generally agreed that a statement of the flow of financing resources should be presented for proprietary funds, but they disagreed on whether it should also include governmental fund types. Those who supported the consolidated statement of the flow of financing resources tended to support the three-way reporting focus called for by the experiment, in which (1) the operating statement includes information on cost of services for all funds, (2) the statement of the flow of financing resources reports the inflows and outflows of financing resources for all funds, and (3) the statement of financial position reports both current and noncurrent assets and liabilities for all funds.

Accounting Policies for the Operating Statement

Depreciation

The respondents gave their opinions on whether depreciation expense should be accrued on exhaustible fixed assets of proprietary and governmental funds.

	Group			
	1	*2*	*3*	*Total*
Proprietary funds				
Depreciation on all items	24	28	11	63
No depreciation on any items	3	1	2	6
Total	27	29	13	69
Governmental funds				
Depreciation on all items	13	11	5	29
Depreciation on all items except highways and bridges	0	2	0	2
Depreciation only on items with short lives—for example, automobiles	1	0	0	1
No depreciation on any items	13	16	8	37
Total	27	29	13	69

The substantial agreement on the need for depreciation expense for proprietary funds probably results from the fact that both the principles in the audit guide and the principles applied in the experiment require such depreciation.

Several respondents did not approve of depreciation on either proprietary or governmental funds. One reason given was that government units have no owners, and depreciation should be accrued only for organizations with owners.

The respondents in favor of depreciation for governmental funds argued that depreciation is necessary to report the total cost of services provided by governmental funds, which includes the cost of using exhaustible fixed assets. They also considered depreciation necessary to make accounting consistent for governmental funds and proprietary funds.

Those respondents who opposed depreciation expense for governmental funds argued that the method of raising revenue for governmental funds, through taxation, makes depreciation unnecessary for those funds, since taxes are set at amounts needed to pay for exhaustible fixed assets or to redeem bonds connected with previous purchases rather than at amounts equal to depreciation expense. They held that, if taxes were set at amounts needed to recover depreciation expense, legislative bodies might improperly consider those taxes to be ample for the replacement of exhaustible fixed assets, and, thus, they might refuse to issue the bonds needed for replacement or might refuse to appropriate amounts sufficient for future replacement.

Pensions

The respondents substantially favored accrual rather than cash basis accounting for pension costs.

	Group			
	1	*2*	*3*	*Total*
Accrual basis	24	22	11	57
Cash basis	3	5	2	10
Not answered	0	2	0	2
Total	27	29	13	69

The respondents noted that accrual is required of business enterprises, and they argued that the similarity between government and private pension systems indicates that government units should also accrue pension costs. Furthermore, they pointed out that accrual prevents manipulation of expense by varying the timing of payments to the pension fund.

Those respondents who favored cash basis accounting argued that the information needed for accrual of pension costs commonly cannot be obtained or can be obtained from pension plan administrators only after long delay. They also felt that the uncertainty of future pension payments makes calculation of the accrual too subjective for reporting in published financial statements.

Other Accrual Subjects

The respondents substantially favored the principles applied in the experiment over the principles in the audit guide in the area of accounting for revenue from taxes and for expenses other than depreciation and pensions.

	Group 1	Group 2	Group 3	Total
Revenue from taxes				
Principles applied in the experiment	26	24	9	59
Audit guide principles	0	4	3	7
No accrual	1	0	0	1
Not answered	0	1	1	2
Total	27	29	13	69
Expenses other than depreciation and pensions				
Principles applied in the experiment	22	22	10	54
Audit guide principles	5	2	3	10
Not answered	0	5	0	5
Total	27	29	13	69

Classification

Assets and Liabilities

The respondents stated whether they preferred changes in the experiment's approach to the classification of assets and liabilities in the consolidated balance sheet.

	Group 1	Group 2	Group 3	Total
No changes	15	16	7	38
Changes specified	12	11	6	29
Not answered	0	2	0	2
Total	27	29	13	69

Several types of changes were suggested. Some respondents suggested more than one type of change.

	Group 1	Group 2	Group 3	Total
Introduce the current/noncurrent classification	4	5	3	12
Classify liabilities as restricted or unrestricted	5	2	2	9
Eliminate the restricted/unrestricted classification of assets	5	5	1	11
Use consolidation instead of the equity method for intergovernmental cooperative ventures	1	3	1	5
Total	15	15	7	37

Government Capital

The respondents gave their preferences for changes in the experiment's approach to the classification of government capital in the consolidated balance sheet.

	Group			
	1	*2*	*3*	*Total*
No changes	16	21	9	46
Use the audit guide classification	7	4	2	13
Classify restricted capital by source of restrictions	2	3	1	6
Classify into two categories, contributed capital and earnings	1	0	0	1
Eliminate classification of unrestricted capital into appropriated/unappropriated categories	1	0	0	1
Show investment in fixed assets separately	0	0	1	1
Not answered	0	1	0	1
Total	27	29	13	69

Revenues and Expenses

Seven respondents suggested changes in the experiment's approach to the classification of revenues and expenses in the statement of activity. Five would use consolidation instead of the equity method for intergovernmental cooperative ventures. One would include with the statement of activity a schedule in which total expenses are classified by categories—depreciation, wages, insurance, and so forth. Another would classify the excess of revenues over expenses into restricted and unrestricted categories.

Encumbrances

The respondents gave their preferences for the treatment of encumbrances.

	Group			
	1	*2*	*3*	*Total*
As a reservation of government capital or disclosed in a note	20	15	10	45
Not reported in the financial statements	5	9	1	15
As expenses and liabilities	2	5	2	9
Total	27	29	13	69

According to some respondents, encumbrances should not be reported as liabilities and expenses because they are wholly executory contracts and no resources have yet been given up. Other respondents believed that, if encumbrances are included in budgeted expenses, they should be reported as liabilities and expenses to aid the comparison of expenses in the statement of activity with budgeted expenses.

Statement of Financing Resource Flows

Definition of Financing Resources

The respondents gave their preferences for the definition of financing resources that should be used in presenting a statement of the flow of financing resources (statement of changes in financial position).

	Group 1	Group 2	Group 3	Total
Proprietary funds				
Cash	2	2	0	4
Cash and investments	13	12	3	28
Working capital	9	10	4	23
No statement should be presented for proprietary funds	0	1	2	3
Not answered	3	4	4	11
Total	27	29	13	69
Governmental funds				
Cash	1	1	0	2
Cash and investments	5	8	2	15
Cash, investments, and receivables	0	0	1	1
All current assets and liabilities	2	4	2	8
No statement should be presented for governmental funds	14	14	7	35
Not answered	5	2	1	8
Total	27	29	13	69

The respondents who believed that no statement should be provided for governmental funds tended to favor the audit guide type of operating statement for governmental funds. Since that statement is a financing resources statement, with financing resources defined as the difference between expendable financial resources and related and current liabilities, many of these responses imply that definition.

Financing Resources From Operations

The respondents gave their preferences for how financing resources provided by operations should be presented in the statement of the flow of financing resources.

	Group 1	Group 2	Group 3	Total
Listing receipts and payments of financing resources	3	12	5	20
Adding or subtracting adjustments to or from the difference between revenues and expenses	22	12	4	38
No statement of the flow of financing resources should be presented	0	1	2	3
Not answered	2	4	2	8
Total	27	29	13	69

Respondents who rejected the adding or subtracting of adjustments in favor of the listing of receipts and payments contended that nonaccountants cannot understand the adding or subtracting of adjustments and that it has the undesirable result of including in the statement items that are not flows of financing resources. Respondents who preferred the adding or subtracting of adjustments to the listing of receipts and payments contended that the listing of receipts and payments leads to the presentation in the statement of amounts that differ from the amounts for items of the same nature in the statement of activity. Another reason given for the adding or subtracting of adjustments is that it is more commonly used by business enterprises in statements of changes in financial position than is the listing of receipts and payments.

Budgets

The respondents gave their opinions on whether government units should use the same basis to prepare their budgets and their general-purpose financial statements.

	Group			
	1	*2*	*3*	*Total*
Same basis should be used	17	21	8	46
Same basis is not necessary	9	6	3	18
Not answered	1	2	2	5
Total	27	29	13	69

The forty-six respondents who believed that the same basis should be used gave their preferences for whether the basis should be designed to serve the purposes of budgets or of general-purpose financial statements.

	Group			
	1	*2*	*3*	*Total*
Budgets	4	6	2	12
Financial statements	10	10	3	23
Both	3	5	3	11
Total	17	21	8	46

The respondents gave their opinions on whether budgets should be included with general-purpose financial statements.

	Group			
	1	*2*	*3*	*Total*
Should be included	14	18	8	40
Inclusion not necessary	13	8	4	25
Not answered	0	3	1	4
Total	27	29	13	69

Evaluation of the Principles

Four Types of Information

The respondents evaluated the principles applied in the experiment as superior or inferior to the audit guide principles in providing the four types of information needed by users of financial statements of nonbusiness organizations.[1] They used a rating score from −3 (very inferior) to +3 (very superior), with a zero rating indicating that both sets of principles are equally satisfactory.

Evaluation of the Information Provided by the Principles

	Group			
	1	*2*	*3*	*Total*
Financial viability				
+3 (very superior)	4	6	5	15
+2	7	2	0	9
+1	3	3	1	7
0	4	3	0	7
−1	2	4	0	6
−2	2	3	4	9
−3 (very inferior)	3	2	2	7
Not rated	2	6	1	9
Total	27	29	13	69
Fiscal compliance				
+3 (very superior)	2	1	1	4
+2	1	2	1	4
+1	2	0	0	2
0	6	6	3	15
−1	3	4	1	8
−2	4	4	1	9
−3 (very inferior)	7	6	4	17
Not rated	2	6	2	10
Total	27	29	13	69
Management performance				
+3 (very superior)	2	5	4	11
+2	7	1	0	8
+1	2	1	0	3
0	6	6	3	15
−1	3	2	1	6
−2	2	2	1	5
−3 (very inferior)	3	6	2	11
Not rated	2	6	2	10
Total	27	29	13	69

1. The four types of information are identified by Robert N. Anthony in *Financial Accounting in Nonbusiness Organizations* (Stamford, Conn.: FASB, 1978).

Evaluation of the Information Provided by the Principles (Continued)

	Group			
	1	*2*	*3*	*Total*
Cost of services				
+3 (very superior)	7	5	6	18
+2	7	5	0	12
+1	8	5	2	15
0	3	2	0	5
−1	0	4	0	4
−2	0	1	1	2
−3 (very inferior)	0	1	2	3
Not rated	2	6	2	10
Total	27	29	13	69

Condensed Results of the Evaluation

	Group			
	1	*2*	*3*	*Total*
Financial viability				
Principles applied in the experiment superior	14	11	6	31
Audit guide principles superior	7	9	6	22
Neither superior	4	3	0	7
Not rated	2	6	1	9
Total	27	29	13	69
Fiscal compliance				
Principles applied in the experiment superior	5	3	2	10
Audit guide principles superior	14	14	6	34
Neither superior	6	6	3	15
Not rated	2	6	2	10
Total	27	29	13	69
Management performance				
Principles applied in the experiment superior	11	7	4	22
Audit guide principles superior	8	10	4	22
Neither superior	6	6	3	15
Not rated	2	6	2	10
Total	27	29	13	69
Cost of services				
Principles applied in the experiment superior	22	15	8	45
Audit guide principles superior	0	6	3	9
Neither superior	3	2	0	5
Not rated	2	6	2	10
Total	27	29	13	69

The respondents indicated the features of the principles applied in the experiment that caused them to evaluate the principles as superior or inferior to the audit guide principles. Some features were cited by different respondents as support for antithetical conclusions.

One controversial feature is the recording of depreciation for long-lived assets of governmental funds. The feature caused respondents to rate the principles as superior in providing information on management performance. But, while the feature caused some respondents to rate the principles superior in providing information on financial viability, it caused others to rate the principles as inferior in providing that type of information. The feature caused some respondents to rate the principles as superior in providing information on cost of services, but it caused others to rate the principles as inferior in providing that information.

Another frequently cited feature is the consolidation of governmental and proprietary funds in the statement of activity. This caused respondents to rate the principles applied in the experiment as superior in providing information on financial viability and as inferior in providing information on fiscal compliance.

Respondents cited the omission of columns in the consolidated balance sheet for each fund type as a reason for rating the principles as inferior in providing information on financial viability and fiscal compliance.

Omission of budget comparisons caused respondents to rate the principles as inferior in providing information on fiscal compliance and management performance.

The recognition of long-term receivables from tax assessments caused respondents to rate the principles as superior in providing information on financial viability.

Overall Usefulness

The respondents also rated the overall usefulness of the information derived from the principles as superior or inferior to the audit guide principles.

Evaluation of the overall usefulness of the principles

	Group			
	1	*2*	*3*	*Total*
+3 (very superior)	4	7	6	17
+2	6	5	1	12
+1	4	1	0	5
0	1	2	0	3
−1	6	6	0	12
−2	3	1	1	5
−3 (very inferior)	2	5	4	11
Not rated	1	2	1	4
Total	27	29	13	69

No respondent who gave the principles applied in the experiment a superior rating gave a reason for his rating. Several respondents who gave them inferior ratings gave reasons; one of them stated

> I do not believe this type of experiment serves to acknowledge the significance of the budget to external users. The key financial report read by the public is the budget. The

public is concerned about management performance and taxation (financing). Municipalities produce budgets on a financing basis and a key tax (property tax) is derived from the budgeting equation. The accounting principles of the NCGA retain the financing basis and those principles are well accepted by the bond market and investment community.

Condensed Results of the Evaluation

	Group			
	1	*2*	*3*	*Total*
Experimental principles superior	14	13	7	34
Audit guide principles superior	11	12	5	28
Neither superior	1	2	0	3
Not rated	1	2	1	4
Total	27	29	13	69

Usefulness of the Experiment

Seventeen officials of state and local governments who prepared the financial statements called for in the experiment said they thought the experiment was meaningful and beneficial; three said they thought it was not, and seven gave no opinion. Similarly, thirteen officials of state and local governments who did not prepare financial statements for the experiment but answered part of the questionnaire thought the experiment was helpful; four thought it was not, and twelve gave no opinion. Seven people who are not state and local government officials but answered part of the questionnaire thought the experiment was helpful; two thought it was not, and four gave no opinion.

The following are some of the favorable comments:

> Experimentation such as this is most useful. We are in a dynamic society, hence must continue to change. While some charged into this issue with little actual preparation, the AICPA has chosen to deliberate. For this they should be commended.

> The experiment is meaningful even if the conclusion reached is that none of the concepts should be applied. Examining actual statements is more meaningful than theorizing.

> Participating in this experiment serves to direct governments to be more responsive and vocal in their contributions to the body of generally accepted accounting principles. It is not appropriate for academicians or others outside government to be the sole developers of changes in principles.

The following comment from one respondent summarizes the position of those who did not like the experiment:

> This experiment demonstrates the inappropriateness of starting with conclusions, i.e., alleged inadequacy of present generally accepted accounting principles for governments and principles used by business organizations are suitable for all organizations, and attempting to develop an approach that conforms to those conclusions. This makes the experimentors committed to overall change and a change in the specific principles,

whether such change makes sense conceptually. A better way to conduct an accounting and reporting experiment in this area would be along the lines of the Financial Accounting Standards Board project on financial accounting in nonbusiness organizations. This would have the experimentors defining the users and the user needs first and then specifying reporting objectives to meet those needs. Second, any experiment in financial reporting should involve the users as well as the preparers of the financial statements. Also, an experiment in financial reporting should be coordinated closely with an industry association or standard-setting body, should one exist. This results in the experiment proposals being more responsive and responsible. It also would stimulate greater participation from those who can contribute the most to the experiment.

5

The Experimenters' Financial Statements

This chapter describes the general characteristics of the financial statements prepared by twenty-seven government units as part of the experiment. Three sets of financial statements are presented as examples.

Characteristics

Twenty-three government units that participated in the experiment submitted sets of financial statements consisting of balance sheets, statements of activity, and statements of the flow of financing resources; four units submitted sets consisting of balance sheets and statements of activity. Two units submitted an additional statement of changes in government capital. Twenty-four of the participants included notes with their financial statements.

The date of the latest balance sheet ranged from December 31, 1978, to December 31, 1979, but the latest balance sheet date for most experimenters was June 30, 1979.

Fourteen sets of statements contained balance sheets and statements of activity for two years; three contained balance sheets for two years and a statement of activity for one year, and ten contained a balance sheet and statement of activity for one year. The statements of the flow of financing resources covered the same periods as the statements of activity, except that one experimenter submitted a statement of activity for two years and a statement of the flow of financing resources for one year.

Balance Sheet and Statement of Financing Resources

Fifteen participants classified assets and liabilities in the manner called for under the experiment, and twelve modified the prescribed classification. Some participants made more than one modification.

Assets and Liabilities

Modification	*No. of participants*
Current and noncurrent assets classified separately	6
Current and noncurrent liabilities classified separately	8
Restricted and unrestricted liabilities classified separately	4
Restricted/unrestricted classification of assets eliminated	3
Deferred charges shown separately	2
Total	23

Twenty participants classified government capital in the manner called for under the experiment, and seven modified the prescribed manner.

Government Capital

Modification	*No. of participants*
Audit guide classification method used	4
Investment in fixed assets shown separately	2
Government capital reported as one amount (a deficit)	1
Total	7

The twenty-three participants who submitted statements of the flow of financing resources used the following definitions of financing resources.

Definition	*No. of participants*
Cash	1
Cash and investments	19
All short-term assets and liabilities	3
Total	23

In all the statements submitted, financing resources derived from operations were computed by adding and subtracting adjustments to or from the difference between revenue and expenses in the statement of activity.

Statement of Activity

Twenty-three participants presented the statement of activity in the form described in chapter 2, and four participants modified that form. Of those, two did not subtract revenue from the expenses of particular government functions but simply subtracted total expenses from total revenues. One presented additional columns that enabled the total expenses for each government function to be classified into expenses of personnel, materials and services, depreciation, and interest. The fourth presented additional columns that enabled the total expenses for each government function to be classified into expenses of the various types of funds.

Fifteen participants allocated all expenses to particular government functions, but twelve did not allocate some expenses. Interest was the most common type of unallocated expense; other types were depreciation, employee benefits, plant maintenance and operations, computer processing, business services, office services, supplies, and insurance.

Notes

The notes to the experimental financial statements submitted by the participants covered the following topics:

Accounting policies.
Ad valorem taxes.
Asset restrictions.
Bonded debt.
Cash management.
Commitments (principally leases and contracts).
Compliance with legal budget restrictions.
Compliance with restrictions on the use of receipts.
Contingent liabilities (principally lawsuits).
Deferred revenue.
Description of organization, including fund types.
Employee accrued leave.
Encumbrances.
Expenditure financing.
Expenses classified by nature.
Government capital classification.
Interfund transactions.
Inventories.
Investments.
Pension plans.
Prior-period adjustments and restatements.
Property, plant, and equipment.
Receivables.
Reconciliation of government capital from principles applied in the experiment to principles in the audit guide.
Related government units.
Segment revenues and expenses.
Subsequent events.

Examples of Statements

The financial statements submitted in the experiment by Anne Arundel County, Maryland, and the cities of Novi, Michigan, and Phoenix, Arizona, are presented as examples. The notes to the statements are included, except for those that do not clarify application of the principles and are of a type that would appear in financial statements prepared under the principles in the audit guide.

Anne Arundel County, Maryland
Consolidated Balance Sheet
June 30, 1979 and 1978
(in thousands of dollars)

	1979	*1978*
Assets		
Unrestricted assets		
Cash and temporary investments	$ 10,821	$ 18,588
Receivables (net of uncollectibles)	16,259	12,355
Accrued income taxes	11,927	7,951
Inventories at cost	1,578	1,263
Long-term investments at cost	784	505
Total unrestricted assets	41,369	40,662
Restricted assets (primarily for debt service requirements)		
Cash and temporary investments	1,579	1,441
Cash with fiscal agents for matured bonds and interest	1,812	2,303
Receivables (net of estimated uncollectibles)	2,035	1,538
Assessments receivable—non-current	73,171	68,082
Total restricted assets	78,597	73,364
Property, plant and equipment, at cost		
Land and buildings	53,241	35,189
Roads, bridges and other plant	177,550	149,330
Machinery and equipment	16,176	14,151
Construction work in progress	168,946	163,834
	415,913	362,504
Less accumulated depreciation	27,222	23,373
Net property, plant and equipment	388,691	339,131
Total assets	$508,657	$453,157
Liabilities and Municipal Capital		
Liabilities		
Accounts payable	$ 18,578	$ 9,031
Accrued interest payable	1,855	1,668
Other accrued expenses	2,188	1,608
Matured bonds and interest payable	1,812	2,303
Other liabilities	2,758	2,481
Deferred assessments revenues—non-current	73,171	68,082
	100,362	85,173
General obligation bonds payable	293,164	281,313
State loans payable	8,769	9,851
Total liabilities	402,295	376,337
Municipal capital		
Restricted	98,117	66,255
Unrestricted		
Appropriated	5,945	6,784
Unappropriated	2,300	3,781
Total unrestricted	8,245	10,565
Total municipal capital	106,362	76,820
Total liabilities and municipal capital	$508,657	$453,157

Anne Arundel County, Maryland
Consolidated Statement of Financial Activity
Years Ended June 30, 1979 and 1978
(in thousands of dollars)

	1979				
		Related Revenues			
	Total Costs	*Inter-governmental*	*Customer Charges and Other*	*Net Costs*	*1978 Net Costs*
General government					
County executive	$ 2,117	—	—	$ 2,117	$ 1,568
County council	606	—	—	606	543
Support activities	23,322	$ 6,972	$ 1,832	14,518	12,608
Public safety					
Police	13,679	6,901	—	6,778	8,200
Fire	10,883	3,806	—	7,077	6,422
Other	2,377	863	—	1,514	1,531
Public works					
Public works	13,002	—	—	13,002	11,794
Waste collection	4,188	—	4,453	(265)	(258)
Human resources					
Public health	10,081	3,224	—	6,857	2,700
Education	75,545	—	—	75,545	73,500
Other	656	—	—	656	957
Culture and recreation					
Recreation and parks	2,931	—	—	2,931	2,062
Library	2,467	—	—	2,467	1,944
Planning and zoning	1,740	419	—	1,321	1,149
Public utilities					
Operations	9,984	11,258	8,533	(9,807)	(6,329)
Debt service	6,524	—	10,428	(3,904)	(2,583)
Total	$180,102	$33,443	$25,246	121,413	115,808
Financed by					
Taxes					
Property				59,134	61,769
Income				42,517	35,616
Recordation and transfer				10,006	9,489
State shared				9,336	8,904
Sales				7,355	6,861
Total taxes				128,348	122,639
Licenses and permits				2,780	2,975
Intergovernmental revenues (unallocated)				5,775	6,305
Fines and forfeits				135	162
Interest				1,502	1,571
Other				6,671	6,084
Total financing				145,211	139,736
Excess of current revenues over costs of current operations				23,798	23,928
Contributions from contractors				5,744	2,115
Municipal capital (beginning of year)				76,820	50,777
Municipal capital (end of year)				$106,362	$ 76,820

Anne Arundel County, Maryland
Consolidated Statement of Changes in Cash and Investments
Years Ended June 30, 1979 and 1978
(in thousands of dollars)

	1979		1978	
Resources Provided by Current Operations				
Excess of current revenues over costs of current operations		$23,798		$23,928
Add operating costs not requiring current resources—depreciation		4,048		3,857
		27,846		27,785
Other Sources				
Contributions in aid of construction	$ 5,744		$ 2,115	
Bond proceeds	25,000		25,000	
Increase in liabilities	15,189		739	
		45,933		27,854
Total resources available		73,779		55,639
Uses of Resources				
Acquisition of property, plant and equipment	53,609		44,872	
Bond principal paid	14,230		13,217	
Increase in other assets	13,569		3,077	
		81,408		61,166
Decrease in cash and investments		7,629		5,527
Cash and investments (beginning of year)		20,029		25,556
Cash and investments (end of year)		$12,400		$20,029

Anne Arundel County, Maryland
Notes to Consolidated Financial Statements
Years Ended June 30, 1979 and 1978

1. Significant accounting policies

The accompanying financial statements have been designed to facilitate an understanding of the financial position and results of operations of Anne Arundel County, Maryland (the "County"). Accordingly, consolidated financial statements have been prepared because, in the judgement of the County, they represent the most reasonable presentation of its overall financial condition and results of operations.

Basis of accounting. The financial statements are prepared on the accrual basis of accounting. Assets are recorded at the time there is a right, now or in the future, to their receipt, and liabilities are recorded when they are incurred. Costs are recorded in the period in which they are incurred, and revenues are generally recognized in the period in which the goods and services financed by the revenues are provided.

Purpose of funds and account groups. The County records its transactions in individual funds and groups of accounts to comply with the limitations and restrictions placed on both the resources made available to the County and the services provided. The following individual funds and groups of accounts are aggregated in the accompanying financial statements:

General Fund	Enterprise Funds
Special Revenue and Assessment Funds	Intragovernmental Service Funds
Capital Project Funds	General Fixed Assets Account Group
Trust and Agency Funds	General Long-Term Debt Account Group

A comprehensive annual financial report has been prepared and may be obtained from the County Controller's Office.

The following pension trust funds are controlled by independent boards:

Anne Arundel County Police and Firemen Pension Plan
Anne Arundel County Merit System Plan
Anne Arundel County. Appointed and Elected Official's Plan
Maryland State Retirement System

Their assets, held in trust for plan participants are not available for any municipal purpose. They are therefore not included in the consolidated financial statements.

Balance sheet classifications. Assets restricted for debt service payment by county charter provisions are so classified in the consolidated financial statements.

Receivables. Receivables, including grant and federal revenue sharing receivables and uncollected taxes are accrued when legally enforceable claims arise.

Inventories. Inventories of materials and supplies are stated at cost as determined by the first-in, first-out method.

Fixed assets and depreciation. Roads, bridges and storm drains acquired prior to January 1, 1965, for which detailed cost records are not available, are carried at an aggregate amount approximating $2,750,000. For other general fixed assets, conservative estimates have been used in compiling details for pre-1965 acquisitions.

All other fixed assets are stated at cost, or in the case of gifts or contributions, at fair value at the time received. Fixed assets are depreciated generally on the straight line method over their estimated useful lives, except for the water and sewer facilities which are depreciated at less than the straight line rates during the first ten years of the life of such assets. The purpose of this policy is to compensate for the gradual connections of the users into the water and sewer system.

Capital accounts. A portion of municipal capital has been classified as restricted to reflect certain limitations and restrictions placed on the capital of various activities by county charter provisions.

The unrestricted portion is further classified into appropriated and unappropriated. The appropriated amount represents capital that has been set aside by the County Council for specific purposes. The unappropriated amount is the residual municipal capital available for appropriation for general government activities in future periods.

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8. Board of education

The assets, liabilities, and fund balance of the Board of Education are not included in these financial statements. The County's expenditures for the Board of Education consist of $71,098,000 and $66,450,000 transferred to the Board of Education for operating purposes and $4,447,000 and $4,443,000 for debt service costs in 1979 and 1978 respectively.

Included in long-term debt at June 30, 1979 is $52,320,000 applicable to school bonds and State of Maryland loans issued for school construction. Assets purchased with the proceeds of this debt are held by the Board of Education of Anne Arundel County and, accordingly, are reflected in the Board of Education's financial statements as required by the laws of the State of Maryland.

City of Novi, Michigan
Consolidated Balance Sheet

	June 30	
	1979	*1978*
Assets		
Unrestricted assets		
Cash and certificates of deposit	$ 245,995	$ 206,913
Receivables	415,163	359,356
Total unrestricted assets	661,158	566,269
Restricted assets		
Cash and certificates of deposit	12,654,892	11,511,630
Receivables	5,333,669	5,020,766
Inventories—At cost	104,739	35,000
Assets held by county	1,553,549	1,546,934
Total restricted assets	19,646,849	18,114,330
Property, plant and equipment—At cost		
Land and building	2,501,518	1,210,149
Roads	27,890,000	21,890,000
Water and sewer system	15,165,876	14,380,445
Vehicles and equipment	953,908	827,661
	46,511,302	38,308,255
Less accumulated depreciation	4,320,082	3,551,557
Net property, plant and equipment	42,191,220	34,756,698
Total assets	$62,499,227	$53,437,297

Liabilities and Municipal Capital		
Liabilities		
Accounts payable	$ 539,504	$ 195,892
Contracts payable	625,475	205,527
Accrued interest payable	87,868	59,213
Vested employee benefits	418,000	365,000
Deposits	751,939	446,145
Other	252,485	265,962
	2,675,271	1,537,739
Long-term debt	17,957,685	16,458,965
Total liabilities	20,632,956	17,996,704
Municipal capital		
Restricted	41,686,688	35,216,889
Unrestricted:		
Appropriated	179,583	—
Unappropriated	—	223,704
Total unrestricted	179,583	223,704
Total municipal capital	41,866,271	35,440,593
Total liabilities and municipal capital	$62,499,227	$53,437,297

City of Novi, Michigan
Consolidated Statement of Changes in Cash and Investments
Year Ended June 30, 1979

Resources Provided		
From current operations:		
Excess of current revenues over costs of current operations		$ 480,015
Add operating costs not requiring current resources—depreciation		657,361
Resources from operations		1,137,376
Other sources:		
Contributions	$5,945,663	
Proceeds from long-term indebtedness	2,530,342	
Increase in liabilities other than long-term debt	1,137,532	9,613,537
Total resources provided		10,750,913
Uses of Resources		
Acquisition of property, plant and equipment	8,091,883	
Principal payments on long-term indebtedness	1,031,622	
Increase in other assets	445,064	9,568,569
Increase in cash and investments		1,182,344
Cash and investments—Beginning of year		11,718,543
Cash and investments—End of year		$12,900,887

City of Novi, Michigan
Consolidated Statement of Financial Activity
Years Ended June 30, 1979 and 1978

	1979				
		Related Revenues			
	Total Costs	*Inter-govern-mental*	*Customer Charges and Other*	*Net Costs*	*1978 Net Costs*
General government					
Mayor and council	$ 11,874	—	—	$ 11,874	$ 11,254
City manager	88,608	—	—	88,608	68,202
Assessor	99,971	—	—	99,971	81,517
Treasurer	54,351	—	—	54,351	800
Clerk	99,668	—	—	99,668	61,712
Finance	126,422	—	—	126,422	128,387
General Administration	383,584	$230,550	—	153,034	120,644
City Hall and other	106,187	—	—	106,187	102,051
Public safety					
Police	1,310,303	145,952	—	1,164,351	886,616
Fire	186,667	—	—	186,667	132,390

Public works					
Department of Public Works	345,891	—	—	345,891	227,493
Streets	959,958	245,139	—	714,819	185,317
Culture and recreation					
Parks and recreation	160,955	30,803	$ 43,140	87,012	33,633
Library	206,080	25,397	—	180,683	173,926
Urban development					
Building	349,769	—	218,850	130,919	93,549
Planning	35,200	—	—	35,200	37,174
Utilities—Water and sewer	1,820,245	—	1,066,904	753,341	(451,544)
Total	$6,345,733	$677,841	$1,328,894	4,338,998	1,893,121
Financed by					
Property taxes				2,668,614	2,005,167
State-shared revenue				553,693	546,089
Interest				1,337,274	618,642
Licenses, permits and other (unallocated)				259,432	194,000
Total financing				4,819,013	3,363,898
Excess of current revenues over costs of current operations				480,015	1,470,777
Contributions from contractors and customers				5,945,663	3,915,403
Municipal capital—Beginning of year				35,440,593	30,054,413
Municipal capital—End of year				$41,866,271	$35,440,593

City of Novi, Michigan
Notes to Consolidated Financial Statements
June 30, 1979 and 1978

1. Significant accounting policies

The accompanying financial statements have been prepared in accordance with an experimental project undertaken by the American Institute of Certified Public Accountants State and Local Government Accounting Committee to report the balance sheet, statement of financial activity and the statement of changes in cash and investments and related notes to financial statements on a consolidated basis.

Basis of accounting. The financial statements are prepared on the accrual basis of accounting. Assets are recorded at the time there is a right, now or in the future, to their receipt, and liabilities are recorded when they are incurred. Costs are recorded in the period in which they are incurred, and revenues are generally recognized in the period in which the goods and services financed by the revenues are provided.

Purpose of funds and account groups. The City records its transactions in individual funds and groups of accounts to comply with the limitations and restrictions placed on both the resources made available to the City and the services provided. The following individual funds and groups of accounts are aggregated in the accompanying consolidated financial statements:

- General Fund
- Major and Local Street Funds
- Municipal Street Fund
- Fire Fund
- Park and Recreation Fund
- Federal Revenue-Sharing Fund
- Antirecession Fiscal Assistance Fund
- Library Fund
- Debt Service Funds
- Capital Projects Funds
- Water and Sewer Fund
- Trust and Agency Fund
- Special Assessment Funds
- General Fixed Asset Group of Accounts
- Long-Term Debt Group of Accounts

A comprehensive annual financial report has been prepared for the individual funds and account groups and may be obtained from the Finance Director's office.

The City has a retirement plan covering all permanent full-time employees through participation in the Michigan Municipal Employees' Retirement System, an independent State entity (see Note 2).

Balance sheet classifications. Assets that can be designated by the City Council for any use are classified as unrestricted assets. Assets that are restricted for specific uses by bonded debt requirements, grant provisions, city charter provisions, or other requirements are classified as restricted assets. Assets are restricted principally for debt service payment, operation of the city water and sewer system, construction or purchase of general fixed assets and trust and agency commitments.

Receivables. Receivables, including Federal grant and Federal revenue-sharing receivables and uncollected property taxes, are accrued when legally enforceable claims arise.

Inventories. Inventories of materials and supplies are stated at the lower of cost or market. Cost is determined by the average method.

Property, plant and equipment. Property, plant and equipment are stated at cost, estimated cost when original cost is not available, or appraised value at the time received, in the case of gifts. Maintenance and repairs are expensed as incurred. Replacements that improve or extend the lives of property are capitalized. Depreciation is computed on the straight-line method on a composite basis. Costs of assets retired are removed from the asset accounts and charged to the accumulated depreciation accounts.

Capital accounts. A portion of municipal capital has been classified as restricted to reflect certain limitations and restrictions placed on the capital of various activities by bond covenants, grants and other contractual agreements.

The unrestricted portion is further classified as either appropriated or unappropriated. The appropriated amount represents capital that has been set aside by the city council for specific purposes. The unappropriated amount is the residual municipal capital available for appropriation for general governmental activities in future periods.

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5. Municipal capital appropriations

An appropriation of unrestricted municipal capital as of June 30, 1979 was established for working capital purposes. The amount of the appropriation was equal to monies earned but not received as of June 30, 1979 from the State of Michigan under its local government revenue-sharing formulas. This amounted to $237,000. However, since the amount of unrestricted municipal capital is less than this amount, only the balance is shown as appropriated in the balance sheet.

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8. Municipal activities

The City of Novi, Michigan principally operates as a provider of general governmental services. It also has an enterprise activity in the water and sewer utility system. This enterprise activity is wholly owned by, and responsible to, the City Council. Revenue bonds have been issued that restrict the use of net revenues to purposes associated with the water and sewer system.

The following schedule shows the financial results of operations for the water and sewer enterprise, identifiable assets, and its portion of municipal capital for the year ended June 30, 1979.

	Water and Sewer Enterprise	*General Governmental Activities*	*Total*
Sales and charges	$ 1,066,904	$ 261,990	$ 1,328,894
Tax revenues	—	2,668,614	2,668,614
Grants and state-shared revenue	—	1,281,534	1,281,534
Other	489,551	1,057,155	1,546,706
Total revenue	$ 1,556,455	$ 5,269,293	$ 6,825,748
Excess of revenue over (under) expenses	$ (245,751)	$ 725,766	$ 480,015
Identifiable assets at June 30, 1979	$23,482,697	$39,016,530	$62,499,227
Municipal capital at June 30, 1979	$15,859,544	$26,006,727	$41,866,271

City of Phoenix
Consolidated Balance Sheet
June 30, 1979 and 1978
(in thousands of dollars)

	1979	*1978*
Assets		
Unrestricted assets		
Cash	$ 1,560	$ 2,854
Investments	33,151	23,529
Receivables	9,858	6,600
Inventories	3,103	2,741
Prepaid expenses	7	—
Other	—	547
Total unrestricted assets	47,679	36,271
Restricted assets		
Cash	19,148	14,768
Investments	102,406	98,607
Receivables	25,847	15,901
Inventories	2,127	2,005
Prepaid expenses	580	547
Other	17,887	22,244
Total restricted assets	167,995	154,072
Property, plant and equipment		
Land	118,241	109,226
Buildings, equipment and improvements	663,306	631,330
Accumulated depreciation	(233,436)	(221,602)
Net plant in service	548,111	518,954
Construction in progress	177,818	114,916
Total property, plant and equipment	725,929	633,870
Intangibles, net of amortization	845	1,097
Total assets	$942,448	$825,310
Liabilities and Municipal Capital		
Liabilities		
Warrants payable	$ 12,811	$ 10,876
Accounts/contracts payable	63,764	65,256
Notes payable	10,063	7,106
Accrued interest expense	9,216	6,158
Accrued liabilities		
Salaries	5,250	4,883
Vacation leave	8,609	7,501
Other	80	74
Other liabilities	17,124	6,509
	126,917	108,363
Revenue bonds payable	174,220	148,485
General obligation bonds payable	228,315	201,080
Water repayment agreements	6,372	7,926
Contracts payable	53,267	51,817
Total liabilities	589,091	517,671
Municipal capital		
Restricted—Other	94,211	77,151
—Contributed	102,398	83,634
Unrestricted	156,748	146,854
Total municipal capital	353,357	307,639
Total liabilities and municipal capital	$942,448	$825,310

City of Phoenix
Consolidated Statement of Financial Activity
Years Ended June 30, 1979 and 1978
(in thousands of dollars)

	1979				
	Total Costs	*Inter-govern-mental Revenue*	*Customer Charges and Other Revenue*	*Net Costs*	*1978 Net Costs*
General government					
Mayor and council	$ 491	—	—	$ 491	$ 334
City manager	452	—	—	452	369
Support activities	13,949	$ 2	$ 1,664	12,283	13,144
Criminal justice					
Police	51,935	6,497	—	45,438	40,048
City courts	5,157	—	—	5,157	4,342
Public safety					
Fire	21,128	1,800	—	19,328	16,235
Other	3,039	22	3,228	(211)	142
Transportation					
Streets	12,550	15,870	—	(3,320)	531
Aviation	18,195	—	21,964	(3,769)	(3,155)
Transit	6,388	4,021	—	2,367	1,779
Other	4,209	1,012	178	3,019	3,299
Sanitation					
Sewers	12,761	864	1,877	10,020	11,814
Refuse	19,012	2	258	18,752	14,194
Community enrichment					
Parks and recreation	13,049	1,374	1,569	10,106	9,541
Library	5,202	303	14	4,885	4,588
Civic plaza	4,322	—	778	3,544	3,271
Other	1,523	—	—	1,523	1,299
Public utilities					
Water	31,844	—	35,995	(4,151)	(2,961)
Housing and urban redevelopment					
Public housing	7,850	4,394	1,530	1,926	1,276
Other	2,520	5,067	—	(2,547)	653
Human resources	40,525	40,596	—	(71)	9,288
Total	$276,101	$81,824	$69,055	$125,222	$130,031

Consolidated Statement of Financial Activity (continued)

	1979 Net Costs	*1978 Net Costs*
Financed by		
Taxes		
General property	$ 30,500	$ 30,588
City sales and franchise	58,003	48,598
Other	5,896	5,063
Total taxes	94,399	84,249
Licenses and permits	1,269	1,390
Intergovernmental revenues (unallocated)	54,383	44,168
Fines and forfeitures	4,665	3,894
Interest	11,280	9,170
Other	5,165	5,773
Total financing	171,161	148,644
Excess of current revenue over costs of current operations	45,939	18,613
Increase in employee contributions over refunds in deferred compensation fund	1,118	1,113
Increase in reserves for		
Inventories	361	336
Insurance claims	393	665
Cumulative effect on prior years (to June 30, 1978) of changing accounting method for capitalized interest	(2,093)	—
Municipal capital (beginning of year)	307,639	286,912
Municipal capital (end of year)	$353,357	$307,639

City of Phoenix
Consolidated Statement of Changes in Cash and Investments
Years Ended June 30, 1979 and 1978
(in thousands of dollars)

	1979		1978	
Resources Provided by Current Operations				
Excess of current revenues over costs of current operations		$ 45,939		$ 18,613
Add operating costs not requiring current resources				
Depreciation and amortization		21,772		24,354
Resources from operations		67,711		42,967
Other Sources				
Bond proceeds	$ 57,700		$159,670	
Increase in liabilities	25,536		11,160	
Other	2,213	85,449	—	170,830
Total resources available		153,160		213,797
Uses of Resources				
Acquisition of property, plant and equipment	113,864		92,237	
Bond principal paid	4,355		12,818	
Other long-term debt paid	2,629		2,417	
Increase in other assets	15,806	136,654	40,512	147,984
Increase in cash and investments		16,506		65,813
Cash and investments (beginning of year)		139,759		73,946
Cash and investments (end of year)		$156,265		$139,759

City of Phoenix
Notes to Financial Statements
June 30, 1979

1. Significant accounting policies

The accompanying financial statements have been designed to facilitate an understanding of the financial position and results of operations of the City of Phoenix. Accordingly, consolidated financial statements have been prepared to present the City's overall financial condition and results of operations.

Fund accounting. The accounts of the City are organized on the basis of funds or groups of accounts, each of which is considered to be a separate accounting entity. The operations of each fund are accounted for by providing a separate set of self-balancing accounts which comprise its assets, liabilities, reserves, fund balance, revenues and expenditures.

Basis of accounting. The financial statements are prepared on the accrual basis of accounting. Assets are recorded at the time there is a right, now or in the future, to their receipt, and liabilities are recorded when they are incurred. Costs are recorded in the period in which they are incurred, and revenues are generally recognized in the period in which the goods and services financed by the revenues are provided.

Departures from generally accepted accounting principles. The combined basis utilized in preparation of these financial statements differs significantly from the fund basis required by generally accepted accounting principles, although it provides financial information of the City in a summarized manner which is not provided by financial statements prepared on the fund basis.

In summary, the significant modifications made to the City's previously published financial statements prepared under generally accepted accounting principles are as follows:

The presentation of separate fund financial statements and the related footnotes are eliminated.

The General Fund and Special Revenue Funds which are included in the combined financial statements have been converted from the modified accrual to the full accrual basis of accounting. As a result of such conversion, revenues relating to these funds are recorded as earned; vacation and compensation time pay is recorded as the liability is incurred and disbursements for capital outlay are not included as expenditures. The unearned portion of encumbrances would also be eliminated; however, for these statements no analysis was made as to earned and unearned encumbrances and all encumbrances are shown as accounts payable and expensed.

All significant interfund transactions are eliminated.

Budget information and comparisons of budgeted and actual expenditures and revenues are not provided.

Depreciation is reported for all fixed assets in the General Fixed Assets Account Group.

The following funds are not included in the combined statements:

General Employees' Retirement Plan Fund
Special Assessments Fund

The Annual Financial Report of the City for the fiscal year ended June 30, 1979 prepared under generally accepted accounting principles should be used by those requiring conventional fund statements and audited figures.

Inventories. Inventories are stated at average cost and consist of expendable supplies held for consumption.

Property, plant and equipment. Property, plant and equipment owned by the City of Phoenix is stated at cost or estimated historical cost if original cost is not available. Gifts or contributions are stated at fair market value at the date received. Depreciation has been provided over the estimated useful lives using the straight-line method and the following estimated useful lives:

Buildings and improvements	5 to 50 years
Motor vehicles and motorized equipment	5 to 15 years
Furniture, machinery and equipment	5 to 25 years

Gain or loss is recognized when assets are retired from service or are otherwise disposed.

Effective July 1, 1978, the City changed its method of accounting for capitalized interest costs of certain funds engaged in construction activity. In prior years, the Aviation Department Fund interest on bonded indebtedness used to finance the construction of the airport expansion was capitalized, whereas the investment income from idle monies during the construction period was recorded as income. Effective July 1, 1978, the interest, net of related investment income, is capitalized as a cost of the project. The new method is preferable since it more accurately reflects the actual interest cost required to bring the respective asset to the condition necessary for its intended use. Aviation Department Fund net income for the year ended June 30, 1979 was decreased by $534,817 as a result of the change. The cumulative effect of the change on fiscal years prior to June 30, 1979 is $2,092,956 for the Aviation Department Fund. Public Housing Fund net income was decreased by $274,002 as a result of the change. There was no prior year effect for Public Housing.

Investments. Investments are stated at cost, net of amortized premium or discount. Premiums and discounts are amortized over the life of the investment. It is the City's policy, except for the General Employees' Retirement Plan and Deferred Compensation Plan investments, to invest only in certificates of deposit and securities guaranteed by the Federal government or its agencies.

The General Employees' Retirement Plan has investments in U.S. Government bonds, corporate bonds and common stocks. The City Charter allows up to a 60% investment in common stocks. The Pension Board's present policy has resulted in approximately 20% invested in common stocks and the remainder in bonds.

The Deferred Compensation Plan is currently invested in U.S. Government bonds and corporate bonds, although the ordinance allows for the investment in common stock.

AICPA State and Local Government Accounting Committee Experiment Questionnaire

This questionnaire should be completed by all participants in the experiment conducted by the AICPA State and Local Government Accounting Committee. Nonparticipants are encouraged to complete the first thirty-one questions. The questionnaire is essential to accomplish one of the major purposes of the experiment, which is to assess the usefulness and practicality of the experimental accounting and reporting principles set forth in the experimentation booklet.

Each question should be answered in the space provided or on a separate sheet if more space is needed. If separate sheets are used, the number of the question being answered should be inserted at the top of each sheet. If the answer to a particular question can be found in other material submitted to the committee by a participant or nonparticipant—for example, in a note to the financial statements or in a letter—the question may be answered by cross-reference to that material.

Identification of Respondent

Name of person responsible for completing this questionnaire:

Address:

Telephone:

Position:

If you are an official of a state or local government unit, please provide the following information about the unit.

Name of unit:

Type of unit:

Population of political jurisdiction of the unit:

Amount of unit's operating budget:

Amount of unit's capital budget:

Frequency with which an audit is performed by independent accountants. If no audit is performed, please so state:

Departures from the accounting and reporting recommendations in Statement 1 of the National Council on Governmental Accounting (NCGA) made by the unit in preparing financial statements for external users. If no departures are made, please so state:

Evaluation Questions (Participants and Nonparticipants)

1. Which level of combination should be followed in presenting a balance sheet or sheets for a government unit intended for external users?
   - ☐ A completely consolidated balance sheet for all fund types and account groups should be presented, as described in this experimentation booklet.
   - ☐ A "combined" balance sheet for all fund types and account groups should be presented, as described in Statement 1 of the NCGA.
   - ☐ "Combining" balance sheets for all funds of each type should be presented, as described in Statement 1.
   - ☐ Individual balance sheets for each fund and account group should be presented.
   - ☐ Other (please describe).

2. Why do you favor the level of combination you selected in question 1?

3. Which level of combination should be followed in presenting a statement or statements of financial activity?
   - ☐ A completely consolidated statement for all fund types should be presented, as described in this experimentation booklet.

- ☐ "Combined" statements for all the different fund types should be presented, as described in NCGA Statement 1.
- ☐ "Combining" statements for all funds of each type should be presented, as described in NCGA Statement 1.
- ☐ Individual statements for each fund should be presented.
- ☐ Other (please describe).

4. Why do you favor the level of combination you selected in question 3?

5. Which level of combination should be followed in presenting a statement or statements of the flow of financing resources?
   - ☐ A completely consolidated statement for all fund types should be presented, as described in this experimentation booklet.
   - ☐ A "combined" statement for all proprietary fund types should be presented, as described in NCGA Statement 1.
   - ☐ "Combining" statements for all proprietary funds of each type should be presented, as described in NCGA Statement 1.
   - ☐ Individual statements should be presented for each of the funds controlled by the government unit.
   - ☐ Individual statements should be presented for each proprietary fund only.
   - ☐ Other (please describe).

6. Why do you favor the level of combination you selected in question 5?

7. Which of the following approaches do you favor for reporting pension costs in the statement of activity?
   - ☐ Accrual, as described in this experimentation booklet.
   - ☐ Cash basis (if separate pension funds are used to pay pensions).
   - ☐ Pay-as-you-go (if pensions are paid directly by the government unit).
   - ☐ Other (please describe).

8. Why do you favor that approach?

9. Should depreciation expense on all exhaustible fixed assets be reported in the statement of activity, as described in this experimentation booklet?
   - ☐ Yes
   - ☐ No

10. If you answered No to question 9, for what exhaustible fixed assets *would* you report depreciation expense and why would you report it for only those assets?

11. Which of the following approaches to accounting for encumbrances do you favor?
    - ☐ Encumbrances should be reported in the financial statements as expenditures and liabilities.
    - ☐ Encumbrances should be reported as reservations of fund balances or disclosed in notes to the financial statements, depending on the circumstances, as recommended in NCGA Statement 1.

☐ Encumbrances should not be reported in the financial statements but may be used for budgetary control purposes.
☐ Other (please describe).

12. Why did you choose that approach to accounting for encumbrances?

13. What changes would you make in the approach to accruing receivables in the balance sheet and recognizing revenue in the statement of activity described in this experimentation booklet, and why would you make those changes? If you would make no changes, please so state.

14. What changes would you make in the approach to recognizing expenses (other than depreciation and pension expense) in the statement of activity described in this experimentation booklet, and why would you make those changes? If you would make no changes, please so state.

15. What changes would you make in the classification of assets and liabilities in the balance sheet described in this experimentation booklet, and why would you make those changes? If you would make no changes, please so state.

16. What changes would you make in the classification of government capital in the balance sheet described in this experimentation booklet, and why would you make those changes? If you would make no changes, please so state.

17. How would you define financing resources for the purpose of preparing the flow-of-financing-resources statement described in this experimentation booklet?

☐ As cash.
☐ As cash and investments.
☐ As working capital, in the case of balance sheets for proprietary funds.
☐ As those assets and liabilities recorded under NCGA Statement 1, in the case of balance sheets for government funds.
☐ Other (please describe).

18. Why did you select that definition?

19. How would you present financing resources provided by operations in a flow-of-financing-resources statement?

☐ By listing receipts and disbursements of financing resources.
☐ By adding or subtracting adjustments to or from the difference between revenue and expenses in the statement of activity.

20. What is the reason for your choice in question 19?

21. In *Financial Accounting in Nonbusiness Organizations* (FASB, 1978, pages 48 through 52), Robert N. Anthony discusses four types of information needed by users of

financial statements of nonbusiness organizations: (1) financial viability, (2) fiscal compliance, (3) management performance, and (4) cost of services provided. Do you believe financial statements prepared in conformity with the experimental accounting and reporting principles described in this experimentation booklet are superior or inferior to financial statements prepared in conformity with the accounting and reporting principles presently used by government units in providing these four types of information? In answering, please use a rating scale from −3 (very inferior) to +3 (very superior). A zero rating denotes equality of usefulness.

	Financial Viability	*Fiscal Compliance*	*Management Performance*	*Cost of Services*
+3 (very superior)	☐	☐	☐	☐
+2	☐	☐	☐	☐
+1	☐	☐	☐	☐
0	☐	☐	☐	☐
−1	☐	☐	☐	☐
−2	☐	☐	☐	☐
−3 (very inferior)	☐	☐	☐	☐

22. Please explain why you ranked the experimental information as you did in question 21, including why the rankings differ, if they do.

    a. Financial viability

    b. Fiscal compliance

    c. Management performance

    d. Cost of services

23. From the perspective of users of financial statements, are financial statements prepared in conformity with the experimental accounting and reporting principles described in this experimentation booklet more or less useful *in overall terms* than financial statements prepared in conformity with the accounting and reporting principles presently used by government units? In answering, please use a rating scale from −3 (much less useful) to +3 (much more useful). A zero rating denotes equality of usefulness.

    ☐ +3 (much more useful)
    ☐ +2
    ☐ +1
    ☐ 0
    ☐ −1
    ☐ −2
    ☐ −3 (much less useful)

24. Why did you rate overall usefulness at the level you did in question 23?

25. The relationship between financial statements and budgets is subject to differences of opinion. Do you believe a government unit should use the same basis to prepare (1) its budget and (2) its general-purpose financial statements issued to external users?

☐ Yes
☐ No

26. If you answered yes to question 25, do you believe the basis used for budgetary and financial statement purposes should be designed to serve the purposes and objectives of (1) budgets or (2) external general-purpose financial statements?

☐ Budgets
☐ External general-purpose financial statements

27. Please explain why you answered as you did in question 26.

28. Do you believe that inclusion of budgets with external general-purpose financial statements should be mandatory?

☐ Yes
☐ No

29. If you answered yes to question 28, please explain why you answered as you did.

30. If participation in this experiment or reading this booklet and answering this questionnaire changed any of your views on the accounting and reporting principles that government units should follow in preparing financial statements for external users, please explain the change. If your views did not change, please so state.

31. Please give general comments on the meaningfulness and benefits of the experiment, including whether, and what type of, experimentation should be undertaken in the future.

Other Questions (Participants Only)

32. If you refrained from applying any of the experimental accounting or reporting principles described in this experimentation booklet in carrying out the experiment, which principles did you omit and why? If you applied all the principles, please so state.

33. Please describe any procedures that you used or estimates that you made to save time in carrying out the experiment (see the discussion of shortcuts in this experimentation booklet) but that are not customarily used in preparing financial statements for external users.

34. If the experimental accounting and reporting principles described in this experimentation booklet became mandatory for government units and no shortcut pro-

cedures were allowed, do you believe the cost of preparing general-purpose financial statements for external users would be higher than, lower than, or the same as the cost presently incurred by your government unit?

☐ Higher (If this line is checked, please go to question 35.)
☐ Lower (If this line is checked, please go to question 36.)
☐ Same (If this line is checked, please go to question 37.)

35. Please rate numerically the significance of the additional cost you estimate you would have to incur to prepare financial statements for external users. Use a rating scale from 1 (very significant) to 4 (very insignificant). After completion, please go to question 37.

☐ 1 (very significant)
☐ 2
☐ 3
☐ 4 (very insignificant)

36. Please rate numerically the significance of the reduction in cost you estimate you would incur to prepare financial statements for external users. Use a rating scale from 1 (very significant) to 4 (very insignificant).

☐ 1 (very significant)
☐ 2
☐ 3
☐ 4 (very insignificant)

37. Please disclose any experimental accounting or reporting principles described in this experimentation booklet that you found to be vague or ambiguous and that required interpretation to apply, and describe the interpretation you made. If no interpretations were required, please so state.

38. Please describe any other difficulties you had in applying the experiment.

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