



PRACTICE AID SERIES

Applying Special Purpose Frameworks in State and Local Governmental Financial Statements



P R A C T I C E A I D S E R I E S

Applying Special Purpose Frameworks in State and Local Governmental Financial Statements

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Preface

A significant number of state and local governments maintain their accounting records and prepare their annual financial statements using an alternative accounting and financial reporting framework other than accounting principles generally accepted in the United States of America (GAAP). Most of these governments have elected or are required to use a special purpose framework, such as the cash or regulatory basis of accounting.

In contrast to the amount of guidance available for preparing governmental financial statements in accordance with GAAP, there is little direct authoritative guidance for preparing special purpose financial statements of state and local governments, with the possible exception of guidance from regulatory agencies with respect to defining their unique regulatory financial reporting requirements and certain international guidance from the International Public Sector Accounting Standards Board (IPSASB). The Auditing Standards Board of the AICPA recognizes certain bodies, including the Governmental Accounting Standards Board (GASB), the Financial Accounting Standards Board (FASB), the Federal Accounting Standards Advisory Board, and the International Accounting Standards Board (IASB), as the designated accounting standard setters for establishing GAAP. However, with the exception of the IPSASB's standard, *Financial Reporting Under the Cash Basis of Accounting*, these designated accounting standard setters have not established accounting and financial reporting standards for special purpose financial statements.

With the relative complexity of the state and local government financial reporting model, questions are often faced by financial statement preparers and auditors regarding the applicability of GASB accounting principles and financial reporting requirements to special purpose financial statements. Also, there are differing professional opinions about the proper application of certain GAAP requirements to special purpose financial statements, such as the manner of financial statement presentation and the extent of appropriate disclosures.

This practice aid is intended to provide accounting and auditing professionals with guidelines and best practices to promote consistency and for resolving the difficult questions of special purpose framework application, specifically for the financial statements of state and local governments. Although this practice aid is the best source for such guidance, it is nonauthoritative and should not be used as a substitute for the preparer's professional judgment. This publication is not intended for use by governments that are required by law, regulation, contract, or policy to prepare financial statements in accordance with GAAP. This practice aid is an *other auditing publication*, as defined in AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards* (AICPA, *Professional Standards*). *Other auditing publications* are defined as publications, other than interpretive publications, that may be used to assist the auditor in the conduct of an engagement in accordance with

professional standards. Although other auditing publications have no authoritative status, they may help the auditor understand and apply applicable professional standards. Practitioners should use professional judgment and assess the relevance and appropriateness of guidance in other auditing publications to the circumstances of the engagement when applying such guidance. The term *should* is used in this practice aid in the context of recommended best practice and is not intended to necessarily indicate a requirement. When guidance is derived from an audit standard, then “should” would be a presumptively mandatory requirement.

Although this practice aid is focused primarily on providing accounting and financial reporting guidance for the preparation of financial statements for state and local governments, in accordance with a special purpose framework, it also contains guidance for auditor reporting on such financial statements. This practice aid does not provide any other guidance with respect to procedures for auditing, reviewing, or compiling special purpose financial statements. Practitioners engaged to audit such special purpose financial statements should refer to Statements on Auditing Standards, including AU-C section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks* (AICPA, *Professional Standards*), and chapter 16, “Financial Statements Prepared in Accordance With a Special-Purpose Framework,” of the AICPA Audit and Accounting Guide *State and Local Governments*. Practitioners engaged to review or perform a compilation engagement for such financial statements should refer to Statements on Standards for Accounting and Review Services.

This practice aid was originally published in 2003 and was titled, *Applying OCBOA in State and Local Governmental Financial Statements*. In 2012, this practice aid was updated to reflect the clarified auditing standards and was enhanced to include additional practice points and guidance. This edition, retitled to *Applying Special Purpose Frameworks in State and Local Governmental Financial Statements*, uses the 2012 edition as its basis. However, it has been enhanced for developments since the 2012 edition and includes the following:

- ▶ Clarified and additional guidance and practice points related to the treatment of defined benefit pension plan and OPEB benefit costs
- ▶ Additional practice points on accounting and reporting issues related to the timing or payroll payments and the impact of the use of special purpose frameworks on single audit low risk auditee status
- ▶ Refinements to illustrative auditor reports and an added illustrative auditor report dealing with financial statements presented using both GAAP and special purpose frameworks

This publication presents the views of the author and others who helped in its development. The publication has not been approved, disapproved, or otherwise acted upon by any technical committee of the AICPA.

Recognition

This practice aid was written by Michael A. (Mike) Crawford and edited by the AICPA Accounting and Auditing Publications Team. The original practice aid and significant updates since then were reviewed by members of the AICPA State and Local Government Expert Panel and the Private Companies Section Technical Issues Committee. Thanks to Mike Crawford for his dedication to this publication and to those committee members who were involved in the review of this practice aid. In addition to this practice aid, the AICPA has also published the separate practice aid *Accounting and Financial Reporting Guidelines for Cash- and Tax-Basis Financial Statements*, authored by Mike Glynn. Mike Crawford also served as an invaluable resource in the preparation of that practice aid.

Special thanks to Mike Glynn for his work in the development of this practice aid and his efforts to review and offer technical expertise to Mike Crawford. Finally, thanks also go to Chuck Landes for his invaluable reviews and guidance on both of these practice aids.

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Chapter 1

Background and Overview

Introduction

In measuring the complete financial health of a state or local governmental entity in the United States, there is no replacement for accounting principles generally accepted in the United States of America (GAAP) as established by GASB. However, for a variety of reasons, a significant number of state and local governments maintain their internal accounting records and prepare their annual financial statements using an alternative financial reporting framework other than GAAP. Most of these governments have elected or may be required to use a financial reporting framework, such as a cash basis or regulatory basis framework, as an alternative to applying GAAP.

Of the approximately 90,000 units of state and local government in the United States (according to the 2010 United States Census of Governments), the large majority represent small governments. In fact, a 2008 GASB research report, *State and Local Government Use of Generally Accepted Accounting Principles for General Purpose External Financial Reporting*, estimates that the largest one-third of these governments account for 98 percent of all state and local government revenue in the United States. For a variety of reasons, as discussed later in this chapter, many of the other smaller units of government that report the remaining 2 percent of all state and local government revenue, use special purpose frameworks in the preparation of their internal and external financial statements.

Despite the use of special purpose frameworks by a significant number of government entities, little authoritative guidance and reference materials are available for preparing and reporting on special purpose financial statements, particularly in a state and local government environment.

Because the use of special purpose financial statements is prevalent in smaller state and local governments, the AICPA developed this practice aid to close the gap between the use of special purpose frameworks and the unavailability of reference materials and guidance and to provide some consistency over the preparation of special purpose financial statements for state and local governments. This publication begins with a general discussion of special purpose frameworks, and the remainder of the practice aid addresses the specific application of special purpose frameworks most commonly used by state and local governments.

Overview of Special Purpose Frameworks

All financial statements are prepared in accordance with a *financial reporting framework*. A financial reporting framework is defined as a set of criteria used to determine measurement, recognition, presentation, and disclosure of all material items appearing in the financial statements; for example, U.S. GAAP, International Financial Reporting Standards (IFRS) promulgated by the International Accounting Standards Board, or a special purpose framework.

Financial reporting frameworks determine both the form and content of financial statements and are generally classified in professional standards as either general purpose frameworks or special purpose frameworks.

Simply stated, financial statements prepared in accordance with GAAP and IFRSs are considered financial statements prepared in accordance with a general purpose framework and are referred to as general purpose financial statements. Financial statements prepared in accordance with a special purpose framework are referred to as *special purpose financial statements*.

For purposes of this practice aid, reference to OCBOA frameworks is limited to the cash basis (including modifications) and regulatory basis of accounting.

Paragraph .07 of AU-C section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, identifies *special purpose framework* as a financial reporting framework other than GAAP that an entity uses for the following bases of accounting:

- a. **Cash basis.** Used to record cash receipts and disbursements and modifications of the cash basis having substantial support (for example, recording depreciation on fixed assets).
- b. **Tax basis.** Used to file a tax return for the period covered by the financial statements.
- c. **Regulatory basis.** Used to comply with the requirements or financial reporting provisions of a regulatory agency to whose jurisdiction the entity is subject (for example, a basis of accounting that insurance companies use pursuant to the accounting practices prescribed or permitted by a state insurance commission).
- d. **Contractual basis.** Used to comply with an agreement between the entity and one or more third parties other than the auditor.

- e. **Other basis.** Uses a definite set of logical, reasonable criteria that is applies to all material items appearing in financial statements.

For purposes of this practice aid, discussion of special purpose frameworks is limited to the cash (including modifications of the cash basis) and regulatory bases of accounting.



Practice Pointer: Defining Financial Statements and Applicable Financial Reporting Frameworks. For the purposes of this practice aid, the term financial statements means a complete set of *financial statements*, including the related notes. A complete set of financial statements is intended to present both financial position and changes in financial position and should be distinguished from a presentation of a single financial statement or financial statement element. The form and content of special purpose financial statements and what constitutes a complete set of financial statements is determined by the applicable financial reporting framework. For special purpose financial statements of state or local governments, the most commonly used financial reporting framework is either the cash basis (including modifications as chosen and applied by management or those charged with governance that are acceptable in view of the nature of the entity and the objective of the financial statements) or a regulatory basis financial reporting framework an entity is required or permitted to use to comply with the requirements or financial reporting provisions of a regulatory agency to whose jurisdiction the entity is subject.



Practice Pointer: General Use of Special Purpose Financial Statements. Financial statements prepared in accordance with a special purpose framework, such as the cash basis or regulatory basis of accounting, may be the only financial statements the entity prepares and may be available for general use by users other than those for whom the special purpose framework is primarily intended. Despite this broad or general distribution and use, in an effort to ensure that users fully understand that the financial statements are not prepared in accordance with GAAP, these financial statements are still considered special purpose financial statements for purposes of applying generally accepted auditing standards.

Chapter 2, “Recognition and Measurement Issues in Special Purpose Financial Statements of State and Local Governments” and chapter 3, “Presentation and Disclosure Issues in Special Purpose Financial Statements of State and Local Governments,” of this practice aid provide guidance for determining the accounting and financial reporting requirements of special purpose frameworks with respect to the following:

- ▶ *Basis of recognition and measurement.* Criteria for what information should be reported in financial statements, when transactions or events are recognized, and how transactions or events are recorded and at what amounts.
- ▶ *Basis of presentation and disclosure.* Criteria for the form and content of the financial statements or, in other words, which financial statements should be presented and what the financial statements should include and disclose.

Comparing Special Purpose Frameworks and GAAP

Special purpose frameworks are alternative financial reporting frameworks other than GAAP. Although there are obvious differences between special purpose frameworks and GAAP, there are also similarities between them. The discussion of these differences and similarities gives rise to disagreements of professional opinion about the proper application of special purpose frameworks. The recognized accounting standard setters (that is, GASB, FASB, the FASAB, and the IASB) establish GAAP and do not establish special purpose frameworks. However, certain aspects of GAAP may be applicable to special purpose financial statements. As a result, interpreting the general authoritative guidance available requires the application of a good deal of professional judgment.



Practice Pointer: Disclosures in Special Purpose Financial Statements.

Although special purpose financial statements may provide a less complex and more understandable alternative to GAAP financial statements for certain financial statement users, it is important for preparers to be knowledgeable of GAAP disclosure requirements. When special purpose financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP, the special purpose financial statements should include informative disclosures similar to those required by GAAP. For example, in any state and local government special purpose framework presentation that includes cash, the financial reporting and disclosure requirements of GAAP applicable to cash, such as those contained in section C20, *Cash Deposits with Financial Institutions*, of the GASB *Codification of Governmental Accounting and Financial Reporting Standards*, are appropriate for consideration. In addition, certain GAAP standards, such as GASB Statement No. 77, *Tax Abatement Disclosures*, are essentially disclosure-only type standards and could have applicability to special purpose financial statements. The special purpose financial statements may also require additional disclosures, beyond those required by the framework, related to matters that are not specifically identified on the face of the financial statements or disclosures for the financial statements to achieve fair presentation.

Chapters 2 and 3 of this practice aid provide a more in-depth discussion of the application of certain GAAP requirements to special purpose framework financial presentations, including similarities and differences between the different frameworks.

Reasons for Application of Special Purpose Frameworks in the Financial Statements of State and Local Governments

Why is the use of special purpose frameworks so prevalent in small state and local governmental entities? Special purpose framework accounting and financial statement alternatives, if properly applied, may offer some benefits to certain government financial statement preparers and users, including the following:

- ▶ Special purpose framework accounting records may be easier to understand and maintain. In many small governments, the accounting and finance personnel responsible for maintaining the accounting records lack the necessary skills, knowledge, and experience to maintain the records on a GAAP basis. Cash basis or regulatory basis accounting records may be easier for them to understand and maintain.
- ▶ Special purpose financial statements may be easier to prepare. As with the maintenance of accounting records, special purpose financial statements are often easier to prepare than GAAP basis financial statements. The relatively complex reconciliation in state and local government GAAP-basis statements between the government-wide and fund financial statements may not apply as frequently to special purpose financial statements.
- ▶ Special purpose framework accounting and financial reporting may be less costly than GAAP. Most small governments have significant limitations on resources and experience dramatic competition for the allocation of such resources. Therefore, resources allocated to accounting, financial reporting, and auditing may not be sufficient to maintain GAAP basis accounting records and to prepare and audit GAAP basis financial statements.
- ▶ Special purpose financial statements may be more understandable and usable by some government officials. Many governments prepare their annual budgets using special purpose frameworks (such as a cash basis modified to report outstanding encumbrances). As a result, for these governments, the internal accounting records and interim reports focus more on the basis of accounting used for budgetary accounting, reporting, and monitoring than on measuring the complete economic financial condition and results of operations. In addition, most elected officials and

government managers and administrators might not be sufficiently trained to understand and effectively use GAAP basis financial statements.

- Regulatory basis financial statements may better meet the specific needs of certain regulatory or oversight agencies. In meeting their oversight responsibilities or providing guidance for complying with various state laws or regulations, governmental agencies often establish specific regulatory requirements for measuring, recognizing, and reporting financial transactions. The use of a regulatory basis of accounting often assists the regulatory agencies in monitoring financial activity and legal compliance of the entities subject to their jurisdiction.

Limitations of Special Purpose Financial Statements

Although the use of a special purpose framework may be an acceptable financial reporting framework in specific circumstances, may meet the needs of intended financial statement users, and may offer some benefits to certain governmental entities compared with the use of GAAP, special purpose framework accounting and financial reporting also has its limitations, including the following:

- Special purpose financial statements are not intended to be a comprehensive measure of the government's complete economic financial condition and changes therein. Cash basis and regulatory basis financial statements report only certain financial statement elements that are applicable to the special purpose framework applied. As a result, they are limited to only reporting revenues and expenditures or expenses and related assets and liabilities when the transactions meet the timing requirements or limitations of that framework. Consequently, special purpose financial statements are not intended to be a comprehensive measure of a government's complete economic condition and changes therein.
- Special purpose financial statements may not meet the needs of all potential users. Because special purpose financial statements do not report all assets, deferred outflows, liabilities, deferred inflows of resources, inflows (such as revenues), and outflows (such as expenditures or expenses) of the government, certain potential financial statement users, such as investors, creditors, and credit rating agencies, may not readily receive the information they need to evaluate the creditworthiness of the government (that is, the ability of the government to pay short-term and long-term obligations as they become due). As the government competes with other governments that provide complete GAAP-basis financial information, the availability of only special purpose financial statements could affect the government's ability to borrow or could have a negative impact on debt ratings or interest

rates on debt if lenders and rating agencies are unable to obtain their needed information through other means.

- ▶ Special purpose financial statements can make financial decision-making problematic. Government officials could inadvertently rely on financial information prepared in accordance with a special purpose framework to make certain management or policy decisions that would be better made with GAAP financial information. Decision makers who rely on information prepared in accordance with a special purpose framework could make inappropriate funding or financing decisions because this information does not always include timely financial information on the complete economic financial condition, including certain long-term obligations of the government and complete results of operations. For example, consider decision makers making a decision on the adequacy of service charge rates without determination of the full costs of service in accordance with GAAP or not knowing the sufficiency of resources set aside to finance accrued compensated absences because they are unaware of the actual amount of those liabilities.
- ▶ Special purpose framework financial condition and results can be more easily manipulated. Because the cash basis of accounting recognizes financial activity only when that activity results from cash receipt and disbursement transactions or events, cash basis financial results can be easily manipulated by speeding up or slowing down the receipt and disbursement of cash.

Engagement Acceptance Considerations

AU-C section 210, *Terms of Engagement* (AICPA, *Professional Standards*), requires an auditor to determine the acceptability of the applicable financial reporting framework when making engagement acceptance considerations with regard to a financial statement audit. When applied to an audit of special purpose financial statements, AU-C section 800 expands upon these requirements and requires the auditor to

- ▶ obtain an understanding of the purpose for which the financial statements have been prepared, the intended users of the statements, and the steps taken by management to determine that the applicable special purpose framework is acceptable in the circumstances.
- ▶ as a precondition to accepting the audit, obtain an agreement with management that it acknowledges and understands its responsibilities to include all informative disclosures that are appropriate for the special purpose framework.

For special purpose financial statements, the needs of the intended users of the financial statements should be a factor in determining the acceptability of the applicable special purpose framework. For example, in a small local government in which the primary users of the financial statements are management and the governing body, and the financial statements are primarily used for determining short-term budgetary financial condition and compliance, the cash basis of accounting could be considered an acceptable financial reporting framework.

However, consider a local government that has previously been consistently applying GAAP and whose intended financial statement users include bond investors and credit rating agencies. In determining whether to accept the engagement, paragraph .06a of AU-C section 210 requires the auditor to determine the acceptability of the financial reporting framework applied in the preparation of the financial statements. If in the year of applicability of a new accounting pronouncement, government management elects to prepare cash-basis financial statements to avoid reporting a significant new liability resulting from that pronouncement, the auditor may decline to accept an engagement to audit such financial statements under the circumstances.



Practice Pointer: Presumed Acceptability of Regulatory Basis Frameworks.

In absence of indications to the contrary, when determining the acceptability of a special purpose framework in the circumstances applicable to the entity, it can be presumed that a regulatory basis framework is acceptable because it has been prescribed by law or regulation that is applicable to the entity.



Practice Pointer: Special Purpose Frameworks—Effect on Low Risk Auditee Determination for Government Entities Subject to Single Audit Requirements.

Pursuant to the Office of Management and Budget requirements found in Title 2 U.S. Code of Federal Regulations (CFR) Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance), auditees subject to the single audit requirements in the Uniform Guidance must meet certain conditions contained in 2 CFR 200.520 to be considered low risk auditees for the purpose of major program determination (Note: such determination has a direct impact on the scope of the audit work required over federal awards). Under the Uniform Guidance, in order to be considered a low-risk auditee, the auditor's opinion on whether the financial statements were prepared in accordance with GAAP or a basis of accounting required by state law must be unmodified for each of the two prior periods. Therefore, unless required by state law, an auditee that prepares its financial statements on a non-GAAP basis of accounting, such as the cash basis or modified cash basis of accounting, does not qualify as a low-risk auditee.

Recognition and Measurement Issues in Special Purpose Financial Statements of State and Local Governments

Introduction

As discussed in chapter 1, “Background and Overview,” of this practice aid, AU-C section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks* (AICPA, *Professional Standards*), identifies five bases of accounting that are considered special purpose frameworks, including those commonly referred to as other comprehensive basis of accounting (OCBOA). Two of these special purpose frameworks, or bases of accounting, are common to state and local governments:

- ▶ Cash basis, including modifications to the cash basis
- ▶ Regulatory basis

For purposes of this practice aid, the cash basis of accounting will be discussed as two separate bases of accounting: pure cash basis and modified cash basis. Therefore, this practice aid will focus on three special purpose frameworks, or bases of accounting, commonly applied to the financial statements of state and local governments: pure cash basis, modified cash basis, and regulatory basis.

The determination of what information should be reported in financial statements and when to recognize transactions or events (recognition), how to record transactions or events and at what amounts (measurement), and the form and content of the financial statements or what to present and disclose (presentation and disclosure) varies depending on the type of special purpose framework applied. This chapter focuses on the definition and application of cash basis, modified cash basis, and regulatory basis frameworks in the context of recognition, measurement, presentation, and disclosure requirements for state and local government accounting and financial reporting.

Cash Basis of Accounting

As previously noted, the cash basis of accounting, although used extensively in many smaller governments, is not specifically defined in any U.S. professional accounting standards. However, the IPSASB's standard, *Financial Reporting Under the Cash Basis of Accounting* (IPSASB cash basis standard), does define *cash* as cash on hand, demand deposits, and cash equivalents and further defines the *cash basis of accounting* as a basis of accounting that recognizes transactions and other events only when cash is received or paid. AU-C section 800 defines *cash basis* as a basis of accounting the entity uses to record cash receipts and disbursements and modifications of the cash basis having substantial support.

A literal or pure interpretation of the phrase *cash receipts and disbursements* implies that only cash and cash equivalents, and changes therein resulting from receipts and disbursements, should be reported in accordance with this cash basis of accounting (hereafter referred to as either the cash basis or pure cash basis of accounting in this practice aid).



Practice Pointer: Cash Basis Outflows. With the pure cash basis of accounting, the use, or outflow, of cash to purchase a capital asset or to loan cash to another fund should be reported as a cash disbursement, not an asset.

Past practice by many accounting professionals has resulted in a wide array of financial presentations that are referred to as cash basis. For example, cash basis financial statement presentations often have included accounts other than cash, such as investment securities, interfund receivables and payables, and deferred revenue, among other accounts in the balance sheet or statement of financial position. This varying practice in defining and referencing the cash basis of accounting has resulted in inconsistent application of special purpose framework accounting principles and incomparable financial reporting by governments purporting to be applying the same basis of accounting.

To be consistent with the AU-C section 800 definition and the IPSASB cash basis standard, to provide for a more consistent application of the cash basis of accounting, and to clearly distinguish between the pure cash basis and modified cash basis, a strict definition of the cash basis of accounting is required. Therefore, for purposes of this practice aid, *cash basis* is defined as follows: the cash basis of accounting involves the recognition, measurement, presentation, and disclosure of cash and cash equivalents and the changes therein resulting from cash receipt and disbursement transactions or events.

Essentially, the only assets reported on this pure cash basis presentation in a statement of net position—cash basis (or balance sheet—cash basis) would be cash and cash equivalents. (Cash equivalents would include short-term, highly liquid investments, as defined by GASB in section 2450.106–108 of its *Codification of Governmental Accounting and*

Financial Reporting Standards.) There would be no other assets or deferred outflows of resources reported nor would there be any liabilities or deferred inflows of resources reported. The statement of activities—cash basis (or cash basis change statement) would report receipts and disbursements or the changes in cash and cash equivalents. In addition to illustration 2-1 that presents an example cash basis presentation for a single fund or activity, see illustration B in appendix B, “Illustrative Special Purpose Financial Statements of State and Local Governments,” of this practice aid for an example cash basis financial statement presentation.

Illustration 2-1: Example Cash Basis Presentation—Single Proprietary Fund

<i>Statement of Net Position—Cash Basis</i>	
Assets:	
Cash and cash equivalents	<u>\$246,305</u>
Net Position:	
Restricted for debt service	\$102,105
Unrestricted	<u>144,200</u>
Total Net Position	<u><u>\$246,305</u></u>



Practice Pointer: In-Substance Two-Step Cash Transactions. On occasion, a single-step transaction or event may occur that does not directly involve an inflow or outflow of an entity’s cash but may nevertheless be reported as an in-substance two-step cash transaction or event under the pure cash basis of accounting. For example, one government entity might make a payment of cash to a third party on behalf of another government entity (for example, a state contribution paid directly by the state to a local government’s pension plan). Questions often arise about whether this transaction or event can or should be reported in accordance with the pure cash basis of accounting. This single-step transaction may be reported as an in-substance two-step cash transaction or event by the benefitting local government as a cash receipt contribution received from the state and a cash disbursement for the contribution paid to the pension plan. Also, with regard to equipment purchasing and financing, a government entity may acquire some equipment by merely signing a note with a financial institution and having the financial institution directly pay the vendor for the purchase of the equipment. This single-step transaction or event, although not directly resulting in a cash inflow or outflow to the government entity signing the note and purchasing the asset, may be recorded as an in-substance two-step cash transaction or event as a cash receipt resulting from the note proceeds and a cash disbursement for the purchase of

the equipment. However, care should be taken in applying this in-substance two-step cash transaction or event concept to other noncash transactions or events that do not involve an in-substance cash transaction, such as the donation of noncash assets or the signing of a capital lease agreement when the seller and lender are the same party.



Practice Pointer: Unavailable or Constrained Cash Resources. Often, state and local governments receive cash that is held for others or not available for use until a future period. For example, a municipality may collect taxes in a year prior to the year for which they were levied and available for use, a county government may receive taxes collected and held on behalf of other governments for subsequent disbursement, or a utility authority may collect and hold utility deposits that are held for later return to customers. Under the pure cash basis of accounting, these cash inflows do not result in the reporting of a liability. However, financial statement users would benefit from a disclosure of any such cash received and held that is not available for use by the government in the reporting period. The reporting of these unavailable net cash resources in fiduciary funds would provide sufficient disclosure of the limitations on the use of these resources. However, if accounted for in governmental or proprietary funds, it is recommended that such amounts be reported as an appropriate constraint on the cash basis fund balance or net position in order to disclose the fact that this cash is held on behalf of others or not available for use by the government in the reporting period. This reporting of the constraint could be either on the face of the financial statements or in a note disclosure that communicates the substance of the constraint.

For example, the amount of taxes collected prior to the year for which they were levied and, therefore, unavailable for use in the current reporting period, pursuant to enabling legislation, would be appropriately reported as cash basis net position (or fund balance, as appropriate)—restricted for subsequent fiscal year on the face of the financial statements or in a note disclosure that communicates the substance of the restriction.

Any departure or deviation from this pure cash basis presentation of cash and cash equivalent balances and changes in such balances, such as the reporting of long-term debt arising from cash transactions, the capitalization and depreciation of capital assets acquired with cash, or the reporting of investments or receivables and payables resulting from cash transactions, should be considered a modification to the cash basis of accounting. Such a departure or deviation requires evaluation about whether the modification meets the definition of a *modified cash basis of accounting*, as subsequently discussed.

Modified Cash Basis of Accounting

The most difficult special purpose framework to define is the modified cash basis of accounting because professional standards do not technically have a separate definition for *modified cash basis of accounting*. The phrase *modified cash basis* has merely been used in practice for identifying a special purpose framework that represents a modification of the pure cash basis of accounting. As previously noted, professional standards define *cash basis* as a basis of accounting the entity uses to record cash receipts and disbursements and modifications of the cash basis having substantial support (for example, recording depreciation on fixed assets). Although this definition does not specifically identify what constitutes modifications of the cash basis having substantial support, the modifications have evolved through common usage and practice.

For modifications to be considered to have substantial support, the modifications to the pure cash basis of accounting should

- ▶ be made to cash receipt or disbursement transactions or events.
- ▶ have substantial support in GAAP or other accounting literature.
- ▶ be logical.



Practice Pointer: Modified Cash Basis Premise. Modifications to the pure cash basis of accounting generally result when cash receipts or cash disbursements are considered to provide a benefit or an obligation that covers multiple reporting periods, and the reporting of the cash transaction or event would be more meaningful to financial statement users if spread out over those multiple periods. For example, a modification to report capital assets would involve recording and depreciating capital assets that result from cash transactions or events and depreciating them as a logical allocation of the cash basis asset cost over the assets' useful lives.



Practice Pointer: Modifications to Cash Transactions or Events. The modified cash basis of accounting involves substantial support modifications to transactions or events that are derived from cash receipts (cash inflows) or cash disbursements (cash outflows). For example, a modification to report capital assets would involve recording and depreciating capital assets that result from cash transactions or events. This modification should generally not involve the recording and depreciating of capital assets resulting from capital lease transactions or donated capital assets because the acquisition of these assets did not involve a cash inflow or outflow at the time of acquisition or

receipt. Many financial statement preparers and auditors struggle with this concept because it seems odd and, at times, inappropriate to exclude such significant assets from the financial statements, especially when they are material. However, application of the cash basis and modified cash basis of accounting comes with inherent limitations, and such special purpose financial statements are not intended to be representative of the complete economic financial position of the entity. Many significant assets and liabilities are excluded from cash basis and modified cash basis financial statements. If management elects to apply special purpose frameworks in the preparation of their external financial statements, they elect to report within those limitations.

Differences in professional opinion have existed about the definition of the *modified cash basis of accounting*. Some aspects of special purpose framework guidance have been interpreted by some as providing substantial support for modifications that involve the accrual of revenues and expenses and the recording of the related receivables and payables. However, a fundamental aspect of modifications to the cash basis of accounting is that, although the modifications should have substantial support in GAAP or other accounting literature, they should be made only to amounts derived from cash transactions or events and should not involve accruals or other noncash transactions.



Practice Pointer: Substantial Support Modifications Versus Full GAAP Treatment.

The definition of *cash basis* in paragraph .07 of AU-C section 800 begins by stating that it is “a basis of accounting that the entity uses to record cash receipts and disbursements.” It then also includes the wording “and modifications of the cash basis having substantial support” (commonly referred to as modified cash basis). This definition language (“modifications of the cash basis”) supports the notion that the substantial support modifications should be made “only to cash receipt and disbursement transactions or events” because the pure cash basis involves the accounting of only cash receipts and disbursements. The modified cash basis has often been misinterpreted as a mixing of framework principles through the application of cash basis treatment to certain financial statement elements while applying full GAAP-basis treatment to other elements. This mixing of different framework principles is discouraged; therefore, the modified cash basis is narrowly constructed as “logical substantial support modifications to cash receipt and disbursement transactions or events.” Simply stated, modifications in the modified cash basis of accounting apply “GAAP or other accounting literature treatment to cash transactions or events.” For example, investment securities recorded as an asset in a modified cash basis framework would be recorded at cost (the amount of the cash outflow to acquire the investment), not adjusted to fair

value as required in GAAP. Similar to the modified accrual basis of accounting in governmental GAAP, which begins with an accrual basis transaction as its root and then works back to modify the recognition based on cash inflows or outflows, the modified cash basis of accounting begins with a cash transaction or event as its root and works its way forward with a substantial support modification “of the cash transaction or event.”

For purposes of this practice aid, the suggested definition of the *modified cash basis* is as follows: the modified cash basis of accounting involves the recognition, measurement, presentation, and disclosure of cash and cash equivalents and certain other financial statement elements arising from substantial support modifications to cash receipt and disbursement transactions or events, and the changes therein.



Practice Pointer: No Single Modified Cash Basis of Accounting. It should be noted that unlike the *pure cash basis of accounting*, defined in this practice aid as the reporting of cash and cash equivalents and changes therein, there is no single modified cash basis of accounting. One entity’s modified cash basis of accounting framework might only be the pure cash basis of accounting modified for the reporting of only certain assets arising from cash transactions or events, but another entity’s modified cash basis of accounting framework might modify the pure cash basis of accounting to consistently report all assets, liabilities, and deferred inflows and outflows of resources arising from cash transactions or events.

A significant challenge to preparing financial statements in accordance with a modified cash basis of accounting is developing the appropriate accounting policy that results in financial statements that meet the needs of the primary users of the statements and then consistently applying that policy to cash transactions and events in order to keep the financial statements from being misleading for the purposes for which they are intended. Although there is no single modified cash basis of accounting, financial statements prepared in accordance with a modified cash basis can be more meaningful if they are comparable with similar financial statements. Some preparers have inappropriately considered the modified cash basis of accounting as a free for all in which they can arbitrarily pick the modifications they will apply. For example, a preparer may decide to prepare financial statements in accordance with a modified cash basis of accounting that records assets arising from cash transactions or events, including investments, inventories, and capital assets, but does not record short-term and long-term liabilities and other obligations

arising from cash transactions or events. Such inconsistent uses of a modified cash basis framework should be avoided for general use financial statements because the inconsistencies will normally result in financial statements that are misleading for general users. However, modified cash basis financial statements prepared for certain special use purposes may be prepared using inconsistent modifications that meet the needs of the specified intended users, provided they are labeled appropriately, and the special purpose is properly disclosed in the financial statements or notes thereto.



Practice Pointer: GFOA Small Government Program for Modified Cash Basis Reports. The Government Finance Officers Association (GFOA) has developed an award program for eligible small governments for which financial reporting in accordance with GAAP is not a viable option. The objective of the GFOA program is to improve the quality and consistency of small government annual financial reports by providing guidelines that standardize the format and content of annual reports prepared using a modified cash basis of accounting. In conjunction with this program, the GFOA has developed and made available a series of financial reporting and disclosures checklists that facilitate the preparation of modified cash basis financial statements for small governments. Regardless of whether a small government is eligible for participation in the GFOA award program, the program's resource materials can be useful for any government interested in preparing modified cash basis financial statements. More information about this GFOA program, including access to the program's checklists, is available at www.gfoa.org/cashbasis.



Practice Pointer: Inappropriate Modifications. Although substantially supported in GAAP and thought by many to be "logical," the accruals of earned but uncollected revenues and incurred but unpaid expenditures or expenses do not involve modifications to transactions or events derived from cash receipts or disbursements and would, therefore, be inappropriate modifications to the pure cash basis of accounting. Other inappropriate modifications are discussed later in this chapter.



Practice Pointer: Appropriate Modifications. Modifications to the pure cash basis of accounting that report capital assets acquired with cash and related depreciation on such assets, when applicable, in addition to liabilities related to long-term debt arising from cash transactions or events in financial statements when these items are appropriate (for example, in government-wide statements and proprietary and fiduciary fund statements), are considered appropriate substantial support modifications made to transactions or events derived from cash receipts and disbursements.

Modifications to the pure cash basis of accounting that report receivables and payables that arise from cash transactions or events are also considered appropriate substantial support modifications. For example, a receivable and payable resulting from an interfund loan of cash could be reported in accordance with a modified cash basis of accounting because it involves a source and use of cash and is substantially supported in GAAP and logical.

With the needs of the primary financial statement users in mind, when preparing financial statements in accordance with a modified cash basis of accounting, the preparer should consider modifying the following cash transactions or events, among others, when material:

- ▶ Recording of receivables resulting from an outflow of cash, such as interfund cash loans
- ▶ Recording of investments in marketable securities acquired resulting from an outflow of cash
- ▶ Recording of inventories acquired resulting from an outflow of cash
- ▶ Recording of capital assets arising from cash transactions or events and depreciating the assets when appropriate
- ▶ Recording of deferred outflows and deferred inflows of resources resulting from cash transactions or events
- ▶ Recording of liabilities resulting from short-term cash borrowings or other cash transactions or events
- ▶ Recording of long-term bonds, notes, and other debt arising from cash transactions or events
- ▶ Recording of any other material assets, liabilities, revenues, and expenses resulting from cash transactions or events

If the financial statements are prepared in accordance with a modified cash basis accounting policy that records one or more of the preceding but not all, the preparer should be prepared to defend how the decision to modify or not modify is a logical and consistent application of the accounting policy and does not result in misleading financial statements for the purposes for which they are intended.

A number of transactions or events are not appropriate modifications to the cash basis of accounting. Generally, these transactions or events should not be recorded in accordance with a modified cash basis of accounting because they do not involve cash inflows or

outflows, are illogical, or are not substantially supported in GAAP or other accounting literature. The following are common transactions or events that should not be recorded in financial statements prepared in accordance with a modified cash basis of accounting:

- ▶ Recording of accounts receivable, including billed and unbilled, resulting from services provided or goods sold when no cash inflows or outflows are involved
- ▶ Recording of grant and other accrued receivables when cash inflows and outflows are not involved
- ▶ Recording interfund receivables and payables resulting from interfund service billings when no cash inflows or outflows are involved
- ▶ Recording investments for which cash outflows were not involved
- ▶ Recording of donated capital assets or capital assets acquired through capital lease agreements when the seller and lender are the same party and when cash outflows were not involved
- ▶ Not recording depreciation of depreciable capital assets arising from cash transactions or events
- ▶ Recording of accounts payable for goods or services received when no cash outflow was involved
- ▶ Recording accrued compensated absences, accrued interest expense, other accrued expenses, and related liabilities
- ▶ Recording long-term notes, bonds, and other obligations, including net pension and other postemployment benefit (OPEB) liabilities, when no cash outflows were involved
- ▶ Adjusting marketable investments acquired with cash to fair value by recording adjustments for unrealized gains and losses
- ▶ Recording derivative investments when cash inflows or outflows were not involved, and adjusting the derivative for fair value changes



Practice Pointer: Defined Benefit Pension and OPEB Costs and Obligations. Questions often arise about the accounting treatment for defined benefit pension and other post-employment benefit costs and obligations in pure cash basis and modified cash basis financial statements. GAAP treats pension and OPEB benefits as a form of deferred compensation earned by the employee in return for their employment efforts, not to be paid until after the employee's tenure with the government has concluded and vesting and age

requirements have been met. The government employer has a present obligation to pay these deferred benefits in the future (referred to as total pension or OPEB liability) once they are earned; and, therefore, in GAAP basis financial statements, these costs and obligations should be accrued when earned, regardless of when paid. However, under the pure cash basis and modified cash basis of accounting, pension and OPEB costs, obligations, and deferred inflows and outflows of resources, should be recognized in the financial statements only when such costs and obligations arise from cash transactions or events. Therefore, pure cash basis or modified cash basis pension and OPEB costs are limited to the amounts paid by the government into the plans during the financial statement period and net pension or OPEB liability is not recognized on the face of the financial statements.

In addition, as noted in chapter 3, required supplementary information (RSI) applicable to GAAP financial statements is not applicable to special purpose financial statements. As a result, if preparers of cash basis and modified cash basis financial statements elect to include pension and OPEB supplementary schedules, such schedules would be considered supplementary information or other information rather than required supplementary information.

See the practice pointers and examples in chapter 3 regarding the applicability of pension and OPEB disclosure requirements to special purpose financial statements.

It should be noted that the impact of GAAP pension and OPEB standards on regulatory basis financial statements will depend on the measurement, recognition, presentation and disclosure requirements as established by the regulatory authority in defining its regulatory basis framework.



Practice Pointer: Treatment of Payroll Related Liabilities on a Modified Cash Basis. With the use of a cash basis of accounting that includes modifications to report expenses and expenditures and liabilities resulting from cash transactions or events related to employee payroll, questions often arise from the application of this modified cash basis framework as to which, if any, expenses and expenditures and payroll liabilities resulting from the pay earned by employees at period end should be reported.

For example, assume a pay period ends June 30 and the only cash payments made at June 30 are those payments made directly to employees for their net pay. Also assume that the other payroll obligations resulting from the June 30 payroll related to payroll withholdings (such as withheld taxes, employee pension plan contributions, and employee share of benefit costs) and employer

associated costs (such as the employer share of social security and Medicare, unemployment taxes, employer matching contributions, and employer share of benefit costs) are not paid until after June 30. Under the assumptions above, the only payroll cash outflows that have occurred for the period ended June 30 are the payments made to the employees for their net pay. Therefore, these net pay amounts are the only expenses/expenditures that should be reported at June 30 in a modified cash basis presentation. The other payroll related payments that are paid after June 30, including those related to employee withholdings and those related to employer payroll costs, are not liabilities directly resulting from a cash outflow through period end, and therefore should not be reported until paid, which is after June 30 in this example.

A common misconception is that the employee withholdings and even certain employer payroll costs are expenses/expenditures and liabilities arising from cash transactions and should therefore be reported on a modified cash basis at period end, even if unpaid. However, these expenses/expenditures and payroll liabilities are in reality the result of the accrual of costs incurred resulting from the services provided by the employees through period end, and not the direct result of cash outflows.

Another way to look at this concept is to assume that at period end, no payroll payments are made, and all cash outflows or payments for the full gross payroll and related payroll costs, including employee net pay amounts, are not paid until after period end. In this scenario, under an accrual basis framework, the expenses/expenditures and related liabilities, including amounts due employees for net pay and the amounts due to others for withholdings and employer share of costs, are accrued and reported in the statements at period end because the services have been provided and the obligations incurred. However, under a modified cash basis framework, there have been no cash outflows at period end and therefore it is inappropriate to accrue any of these costs. In other words, in this scenario, the payment of all payroll costs, including net pay to the employees, are cash outflows resulting from the accrual of payroll costs and obligations, and are reported when paid under a modified cash basis framework.

In the example described above where the June 30 payroll results in the net check being recognized as expenses/expenditures when paid at June 30 and the expenses/expenditures for the related payroll withholdings and employer share of payroll costs paid after June 30 being recognized in a subsequent period, management might consider adopting an accounting policy of consistently dating the month-end paychecks the first day of the following month, and in doing so have all the expense/expenditures related to the month-end payroll reported in one reporting period.



Practice Pointer: Modified Cash Basis Versus GAAP Departures. Because modified cash basis frameworks do not involve financial statement elements resulting from accruals and noncash transactions or events, it is unlikely that an acceptable modified cash basis framework would ever be materially equivalent to GAAP. However, it is important for financial statement preparers to avoid attempting to make certain modifications to what would otherwise be GAAP financial statements and then referring to them as modified cash basis financial statements. For example, if the modified cash basis framework applied involves reporting accruals of revenues and expenses or applies GAAP, except for the reporting of net pension or OPEB liabilities, then the framework should not be considered a modified cash basis framework and should instead be considered a GAAP framework with departures.

Illustration 2-2 applies a cash basis of accounting modified to record assets, liabilities, and deferred inflows and outflows of resources that arose from cash transactions or events. Each modification is made to transactions or events derived from cash receipts or disbursements and is considered to have substantial support.

Illustration 2-2: Example Modified Cash Basis Presentation—Single Proprietary Fund

Statement of Net Position—Modified Cash Basis

Assets:

Cash and cash equivalents	\$ 246,305
Investments	1,400,000

Capital Assets:

Land and construction in progress	891,000
Other capital assets—net	5,230,100
Total Assets	7,767,405
	<i>(continued)</i>

Statement of Net Position—Modified Cash Basis

Liabilities:

Long-Term Liabilities:

Due in one year	210,000
Due in more than one year	<u>1,890,000</u>
Total Liabilities	<u><u>2,100,000</u></u>

Deferred Inflows of Resources:

Deferred service concession arrangement receipts	
Net Position:	<u>1,000,000</u>
Net investment in capital assets	4,021,100
Restricted for debt service	102,105
Unrestricted	<u>544,200</u>
Total Net Position	<u><u>\$4,667,405</u></u>



Practice Pointer: Write-Downs or Write-Offs Under the Modified Cash Basis.

Questions often arise in the application of a modified cash basis about whether reported assets and liabilities derived from cash transactions or events should ever be written down or written off once they are recorded at their original cash basis value. For example, in applying a modified cash basis framework that reports investments resulting from cash outflows, one question often asked is whether it would ever be appropriate to write down or write off that investment for declines in the fair value of the investment or if the investment becomes worthless. The answer is that temporary changes in the fair value of an asset or a liability should not be recognized in applying the modified cash basis of accounting, and all recognized assets and liabilities should be measured and reported at their original cash value (net of any accumulated depreciation or amortization, when applicable), unless they have been permanently impaired and have no future cash value or represent no future obligation against cash. If modified cash basis assets or liabilities have been permanently impaired and have no future cash value or represent no future obligation against cash, then it would be appropriate to write down or write off such amounts in modified cash basis financial statements.



Practice Pointer: Bank Overdrafts. Generally, bank overdrafts may be netted with other cash balances. If the result is an overall negative cash balance, in accordance with the pure cash basis of accounting, the bank overdraft would simply be shown as negative cash on hand at the end of the period. In financial statements prepared in accordance with a modified cash basis of accounting, the bank overdraft should be classified as either a current liability in a non-pooled cash environment or, if the entity uses a pooled cash system, an interfund loan from a fund with a positive share of the pooled cash.



Practice Pointer: Modifications for Cash Held on Behalf of Others. As noted in a previous practice pointer, certain governments may have cash inflows that represent cash resources collected and held on behalf of other governments, organizations, or individuals. In a pure cash basis of accounting, there would be no liabilities reported for these amounts held on behalf of others. If these amounts are not reported in fiduciary funds, it is recommended under a modified cash basis of accounting that these cash inflows be reported as liabilities to provide sufficient disclosure of the limitations on the use of these resources. However, if the modified cash basis framework used does not modify cash transactions to report these inflows as liabilities, it is recommended that such amounts be reported as a constraint on cash basis net position or fund balance in order to disclose the fact that this cash is held on behalf of others and is not available for use by the holding government.

See illustrations A, D, and E in appendix B of this practice aid for additional example financial presentations on a modified cash basis of accounting.

Regulatory Basis of Accounting

AU-C section 800 defines a *regulatory basis of accounting* as a basis of accounting the entity uses to comply with the requirements or financial reporting provisions of a regulatory agency to whose jurisdiction the entity is subject. For example, a school district within a specific state may be required by law or regulation to prepare its annual financial statements in accordance with a special purpose framework established by the state's department of education to facilitate the state's gathering of comparable information that meets its specific needs.

There can be no single way to describe the recognition, measurement, presentation, and disclosure requirements of a regulatory basis special purpose framework because such framework criteria are established by, and unique to, each different regulatory authority or agency. Even within a single state, there could exist different regulatory bases of

accounting frameworks established for the different types of political subdivisions within the state, such as municipalities, counties, school districts, and special districts. For purposes of this practice aid, the regulatory basis of accounting framework is broadly defined as follows: the regulatory basis of accounting represents a basis of accounting an entity uses in the preparation of its financial statements to comply with the recognition, measurement, presentation, and disclosure requirements established through law or regulation by a regulatory agency to whose jurisdiction the entity is subject.

For the purposes of defining *regulatory basis of accounting*, regulatory agencies could include: state legislators; local governing bodies; state government departments; and other government agencies, such as a state auditor or an inspector's office.



Practice Pointer: Regulatory Basis Financial Statements Based on a GAAP Framework. Financial statements prepared under a regulatory basis of accounting may actually be based on a general purpose framework (that is, GAAP). For example, a state law may provide a requirement or voluntary option for the state or any of its political subdivisions to prepare financial statements in accordance with GAAP, with the exception of applying a specific GAAP pronouncement. In such cases, if the omitted GAAP is material to the financial statements, the financial statements should clearly indicate they are prepared in accordance with a special purpose framework and not imply they are prepared in accordance with a general purpose framework (GAAP) in order for them to be reported on by the auditor in accordance with the guidance in AU-C section 800. If the financial statements purport to be prepared in accordance with GAAP, and such financial statements are materially misstated because of the omitted GAAP, AU-C section 705, *Modifications to the Opinion in the Independent Auditor's Report* (AICPA, *Professional Standards*), applies, and a qualified or an adverse opinion regarding GAAP is appropriate.



Practice Pointer: Regulatory Basis Cannot Be Cash or Tax Basis. Paragraph .A5 of AU-C section 800 indicates that the cash basis and tax basis of accounting are not regulatory bases of accounting. In some circumstances, a regulatory agency may prescribe requirements or allow entities subject to their jurisdiction to follow the cash basis or modified cash basis of accounting without any further description of specific recognition, measurement, presentation, or disclosure requirements. In these cases, the financial statements should be considered prepared under the cash basis or modified cash basis of accounting, not a regulatory basis of accounting.

Although there can be no single way to describe the recognition, measurement, presentation, and disclosure requirements of a regulatory basis special purpose framework, illustration 2-3 demonstrates an example presentation that could be required by a regulatory agency that presents, in a single summarized presentation, unencumbered cash balances and changes therein for all funds.

Illustration 2-3: Example Regulatory Basis Presentation

Statement of Financial Position and Changes in Financial Position—Regulatory Basis

<i>Fund</i>	<i>Beginning Cash</i>	<i>Receipts</i>	<i>Disbursements</i>	<i>Outstanding Encumbrances</i>	<i>Ending Unencumbered Cash</i>
General Fund	\$2,753,644	1,222,746	1,371,555	55,640	\$2,549,195
Building Fund	988,125	183,941	75,692	25,740	1,070,634
Debt Service Fund	163,527	256,824	245,110	—	175,241
Total All Funds	<u>\$3,905,296</u>	<u>1,663,511</u>	<u>1,692,357</u>	<u>81,380</u>	<u>\$3,795,070</u>

Illustrations C-1 and C-2 in appendix B of this practice aid provide illustrated examples of regulatory basis financial statements for a county government.

Chapter 3

Presentation and Disclosure Issues in Special Purpose Financial Statements of State and Local Governments

Introduction

The determination of the form and content of the financial statements or which financial statements to present and what to include and disclose (presentation and disclosure) varies depending on the type of special purpose framework applied.

One commonly asked question is whether the basic financial statement presentation requirements of GASB, such as those defined in GASB Statement No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*, are mutually exclusive from presentation requirements for basic financial statements prepared in accordance with a special purpose framework. The answer to this question is “No.”

Simply preparing the basic financial statements in accordance with a special purpose framework does not mean that the basic financial statement presentation may vary in substance from the requirements of the GASB reporting model. This chapter addresses financial statement presentation and disclosure issues for special purpose financial statements of state and local government entities, including the presentation requirements for government-wide and fund financial statements and related notes, and supplementary information (SI).

Special Purpose Financial Statement Presentation Issues

According to paragraphs .A34–.A35 of AU-C section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks* (AICPA, *Professional Standards*), and chapter 16, “Financial Statements Prepared in Accordance With a Special Purpose Framework,” of the AICPA Audit and Accounting Guide *State and Local Governments*, if GAAP sets forth requirements that apply to the presentation of financial statements, then a complete set of cash basis and modified cash basis financial statements (not regulatory basis financial statements) may either comply with those

requirements or provide information that communicates the substance of those requirements. Presentation requirements for financial statements prepared in accordance with a regulatory basis of accounting are dictated by the specific laws or regulations applicable to the entity and may be different from GAAP presentation requirements.



Practice Pointer: Presentation Requirements for Cash Basis and Modified Cash Basis Financial Statements. If the presentation is intended to be a complete set of financial statements for the governmental reporting entity, then cash basis and modified cash basis financial statements should meet the presentation requirements of GAAP, including government-wide and fund financial statements and related notes. However, nothing prohibits the presentation of, and auditor reporting on, a single financial statement, such as a columnar statement of cash receipts and disbursements and changes in cash balances by fund that is presented on the cash basis.

It should be noted that, pursuant to the guidance in paragraphs .A34–.A35 of AU-C section 800, the substance of certain GAAP presentation requirements may be communicated in a special purpose presentation using qualitative information and without modifying the special purpose financial statement format.



Practice Pointer: Cash Flow Statements in Special Purpose Financial Statements. Suppose proprietary fund financial statements using the cash basis of accounting include a presentation consisting entirely of cash receipts and disbursements. Such a presentation need not include a statement of cash flows, as would be included in a GAAP basis presentation, because all cash flow information is, in substance, already presented in the statement of cash receipts and disbursements. However, if the financial statements are presented in accordance with a modified cash basis of accounting, a cash flow statement may be appropriate. When a cash flow statement is presented in modified cash basis financial statements, the statement may either conform to the requirements for a GAAP presentation or communicate their substance. For example, it is appropriate for a statement of cash flows in special purpose financial statements to present on the face of the cash flow statement or disclose in the notes cash flows by appropriate categories, as defined in GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*. In financial statements prepared in accordance with a regulatory basis of accounting, the specific law or regulations applicable to the entity may dictate whether the statement of cash flows should be presented.



Practice Pointer: Net Position or Fund Balance Presentation in Special Purpose Financial Statements. Cash basis and modified cash basis financial statements of a state or local government should communicate, in substance, net position and fund balance within the GAAP classification categories. For example, the amount of net position reported in government-wide and proprietary fund statements should be classified as net investment in capital assets, restricted and unrestricted, to the extent applicable. Fund balance of governmental funds should be classified by level of constraint, including non-spendable, restricted, committed, assigned, and unassigned, to the extent applicable. However, in special purpose financial statements, these classifications and constraints may be communicated in the notes to the financial statements rather than on the face of the financial statements. Presentation requirements for net position or fund balance in regulatory basis financial statements will be dictated by the applicable laws or regulations and may differ from GAAP presentations.



Practice Pointer: Captions in Special Purpose Financial Statements. There is no requirement to modify standard GAAP financial statement captions in special purpose financial statements. If modifications are desired, common examples for special purpose financial statements of state and local governments could include “Revenue Collected Over (Under) Expenditures/ Expenses Paid,” “Net Income—Modified Cash Basis,” “Regulatory Basis Cash Receipts,” and similar caption modifications appropriate to the special purpose framework applied.

An Overview of GASB Financial Reporting Requirements for State and Local Governments

The GAAP financial reporting requirements applicable to state and local governments were significantly transformed with the issuance of GASB Statement No. 34 and subsequent amendments to this statement.

The minimum requirements of GAAP financial reporting for state and local governments, to the extent applicable, include the following components:

- *Management's discussion and analysis (MD&A).* MD&A is a component of required supplementary information (RSI) in GAAP financial statements, an introduction to the basic financial statements, and an analytical overview of the government's financial activities.

- *Basic financial statements.* The basic financial statements comprise the following three components:
 - Government-wide financial statements that display financial information for the government as a whole, except for fiduciary funds, in separate columns for governmental activities and business-type activities of the primary government, as well as discretely presented component units.
 - Fund financial statements that present financial information of the primary government's governmental, proprietary, and fiduciary funds. For governmental and enterprise funds, major funds are displayed in separate columns, and nonmajor funds are aggregated in a single column. Internal service funds are also aggregated in a single column on the appropriate fund financial statements. Fiduciary fund financial statements include financial information for fiduciary funds by type and similar component units.
 - Notes to the financial statements applicable to the basis of accounting presented are part of the basic financial statements.
- *RSI other than MD&A.* Except for MD&A, RSI generally is included immediately following the notes to the GAAP financial statements. RSI generally includes financial information such as the required budgetary comparison schedule for the general fund and major special revenue funds, defined benefit pension and other postemployment benefit (OPEB) plan supplementary information, and other RSI.

The applicability of these various required components of the GAAP financial reporting model to state and local governments preparing special purpose financial statements is discussed in the following sections of this chapter.

The Applicability to Special Purpose Financial Statements of the Basic Financial Statement Requirements of GAAP

The GAAP financial presentation requirements applicable to the basic financial statements of a state or local government are also applicable, in substance, to a complete set of cash basis and modified cash basis financial statements. Therefore, it would be inappropriate for cash basis or modified cash basis presentations intended to be a complete set of financial statements to omit required basic financial statements required by GAAP that are relevant to the basis of accounting used. Instead, the preparer may substitute substantially similar information for required display within those financial statements.

Generally, complete cash basis and modified cash basis financial statement presentations should include the following, if applicable:

- ▶ Government-wide statement of net position and statement of activities
- ▶ Fund financial statements for governmental, proprietary, and fiduciary funds
- ▶ Notes to the financial statements

The GASB financial reporting model for state and local governments generally requires that basic financial statements present government-wide financial statements separated by columns for governmental activities, business-type activities, and discretely presented component units; fund financial statements with columnar presentations based on major funds and non-major funds in the aggregate; and other specific reporting requirements, such as separate identification of special and extraordinary items. A complete set of cash basis and modified cash basis financial statements for a state or local government reporting entity should include similar government-wide financial statements and columnar presentations of major funds, to the extent applicable. In special purpose financial statements, major funds are determined in the same manner as GAAP financial statements. In a cash basis or modified cash basis presentation, certain financial statement presentation requirements related to a required display of elements (for example, display requirements of special and extraordinary items) could be met by disclosure in a note to the financial statements rather than display on the face of the special purpose financial statements. In addition, cash basis and modified cash basis government-wide financial statements should eliminate internal activity and balances similar to GAAP.



Practice Pointer: Combining Certain Special Purpose Basic Financial Statements. In a cash basis or modified cash basis presentation, required basic financial statements may be combined, as long as the substance of the GAAP requirements are met. For example, in a simplified cash basis presentation, the statement of net position and statement of activities could be combined into a single financial statement if all the required display elements are included, as illustrated in illustration B-5 in appendix B, “Illustrative Special Purpose Financial Statements of State and Local Governments,” of this practice aid. Also, a single-program government engaged only in governmental activities (such as an emergency services district) could combine the government-wide and fund financial statements into a single combined presentation, as illustrated in illustrations D-1–D-3 in appendix B of this practice aid.



Practice Pointer: Special Purpose Basic Financial Statements for Certain Special Purpose Governments. For a special purpose government engaged only in business-type activities (such as a utilities authority), the basic financial statements prepared in accordance with a modified cash basis of accounting would include the statement of net position; statement of revenues, expenses, and changes in net position; statement of cash flows; and related notes. See illustrations E-1–E-3 in appendix B of this practice aid for example special purpose financial statements for a single-program government entity (a solid waste authority) engaged only in business-type activities.



Practice Pointer: Special Purpose Basic Financial Statements for Governments Using a Regulatory Basis Framework. The presentation requirements for financial statements prepared in accordance with a regulatory basis of accounting will generally be dictated by the specific laws or regulations applicable to the entity, and such presentation requirements may differ from GAAP. See illustrations C-1 and C-2 in appendix B of this practice aid for example special purpose financial statements of a county government prepared in accordance with a regulatory basis framework.

If a cash basis or modified cash basis presentation is intended to be a complete set of financial statements, and some of the applicable basic financial statements are not presented (such as the government-wide statements, when applicable) or if information that would be provided by applicable display elements (such as the breakdown of net position into its applicable elements of net investment in capital assets, restricted and unrestricted) is not communicated within the basic financial statements, including the notes, it would be appropriate for the auditor to modify the opinion(s) on the cash basis or modified cash basis financial statements of the affected opinion units or, potentially, on the financial statements as a whole.

See chapter 4, “Auditor Reporting on Special Purpose Financial Statements of State and Local Governments,” of this practice aid for further discussion of auditor reporting issues related to special purpose financial statements, and see illustrations 6 and 8 in appendix C, “Example Auditor Reports on Special Purpose Financial Statements of State and Local Governments,” of this practice aid for example auditor’s reports that express adverse audit opinions on certain opinion units or special purpose financial statements as a whole because of the omission of certain applicable basic financial statements.

Applicability to Special Purpose Financial Statements of MD&A and Other Required Supplementary Information

AU-C section 730, *Required Supplementary Information* (AICPA, *Professional Standards*), defines RSI as information that a designated accounting standard setter (a body designated by the AICPA Council to establish GAAP and limited to FASB, GASB, the FASAB, and the IASB) requires to accompany an entity's basic financial statements. In GAAP financial statements, RSI is not part of the basic financial statements; however, a designated GAAP accounting standard setter considers the information to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. In addition, authoritative guidelines for the methods of measurement and presentation of the information have been established by these bodies.

Because special purpose framework accounting and financial reporting standards applicable to state and local governments have not been established by GASB (that is, the designated GAAP standard setter for state and local governments in the United States), any such RSI required by GASB in GAAP basis financial statements is not considered RSI that must accompany special purpose financial statements. Therefore, in special purpose financial statements for state and local governments, there are no RSI requirements because there is no designated standard setter for such special purpose frameworks. However, state and local government financial statement preparers "may include" such GAAP RSI in their special purpose financial statements. In such circumstances, the information would be considered supplementary information that is required by law or regulation to be presented or supplementary information presented at the election of the preparer. Examples of such GAAP RSI that may be included in special purpose financial statements are MD&A budgetary comparison information (if not presented within the basic financial statements), pension and OPEB supplementary information, or information on the modified approach for reporting infrastructure assets. See chapter 4 for guidance pertaining to auditor reporting on supplementary information accompanying basic financial statements prepared in accordance with a special purpose framework.



Practice Pointer: Encouraged SI for Special Purpose Financial Statements.

Although GAAP RSI does not exist in special purpose financial statements, the information contained in such RSI would be a valuable addition to special purpose basic financial statements when included as SI or OI. For example, when a government has a legally adopted budget for its general fund or other major special revenue funds, and management has elected not to include such information within the basic financial statements, as allowed by footnote 1

of section 2400.102 of the GASB *Codification of Governmental Accounting and Financial Reporting Standards*, the inclusion of budgetary comparison information as an accompaniment to the special purpose basic financial statements as SI or OI is appropriate and could enhance the overall financial report.

In addition, the voluntary inclusion of MD&A that follows the auditor's report and precedes the basic financial statements is always an added benefit for the readers of special purpose financial statements and is encouraged.

SI and OI That May Accompany Special Purpose Financial Statements

AU-C section 720, *Other Information in Documents Containing Audited Financial Statements* (AICPA, *Professional Standards*), defines OI as financial and nonfinancial information (other than the financial statements and auditor's report thereon) that is included in a document containing audited financial statements and the auditor's report thereon, excluding RSI. AU-C section 725, *Supplementary Information in Relation to the Financial Statements as a Whole* (AICPA, *Professional Standards*), defines SI as information presented outside the basic financial statements, excluding RSI, that is not considered necessary for the financial statements to be fairly presented in accordance with the applicable financial reporting framework. Such information may be presented in a document containing the audited financial statements or separate from the financial statements.

In addition to the voluntary reporting of information that is considered RSI in a GAAP presentation, as previously described, special purpose basic financial statements may also be accompanied by other voluntary information, such as introductory information (such as a letter of transmittal), combining and individual nonmajor fund financial statements and schedules, and statistical tables. This other voluntary information would also be considered SI or OI for purposes of special purpose basic financial statements.



Practice Pointer: Allowable Bases of Accounting or Criteria for Preparing SI and OI to Accompany Special Purpose Basic Financial Statements. In special purpose presentations, SI and OI that accompany the basic financial statements may be prepared in accordance with the requirements of the applicable special purpose framework, such as the cash basis or modified cash basis of accounting; regulatory or contractual requirements; GAAP; management's criteria; or other requirements. For example, an SI schedule of state grant award activity could be presented in accordance with the regulatory requirements of the applicable granting agency, even if those requirements differ from the special purpose framework applied in the preparation of the basic financial statements.

Auditor reporting requirements with regard to SI and OI accompanying special purpose basic financial statements are addressed in chapter 4 of this practice aid.

Appropriate Disclosures in Special Purpose Financial Statements

Similar to GAAP financial statements, in order to achieve fair presentation, special purpose financial statements, including the related notes, should include all informative disclosures that are appropriate for the applicable special purpose framework, including all matters that affect the financial statements' use, understanding, and interpretation. Appropriate special purpose financial statement disclosures can generally be categorized as follows:

- ▶ Informative disclosures similar to GAAP for items contained in the special purpose financial statements that are the same as, or similar to, GAAP to the extent applicable to the special purpose framework applied
- ▶ Additional general disclosures related to matters not specifically identified on the face of the financial statements
- ▶ Other disclosures considered necessary to achieve a fair presentation

Informative Disclosures Similar to GAAP

When special purpose financial statements contain elements or items that are the same or similar to GAAP financial statements, special purpose statements should contain disclosures similar to those applicable to GAAP. Examples of such GAAP-similar disclosures would include

- ▶ summary of significant accounting policies.
- ▶ deposit and investment risk disclosures for cash, cash equivalents, and investments.
- ▶ capital assets and long-term debt disclosures when the cash basis has been modified to report such balances, or the regulatory basis requires such reporting.
- ▶ internal and interfund balances and transfers.
- ▶ fund balance purpose classifications within nonspendable, restricted, committed, assigned, and unassigned categories if not presented on the face of the statements.
- ▶ pension and OPEB plan participation, commitments, and contributions.

- risk management disclosures.
- accounting changes and correction of errors.
- tax abatement disclosures.

However, these GAAP-similar disclosures should be modified based on the application of the special purpose framework. In other words, GAAP disclosure requirements that are not relevant to the special purpose framework, as applied to an item within the financial statements, need not be considered. For example, in cash basis or modified cash basis financial statements, the GAAP disclosures related to defined benefit pension and OPEB plans would only be relevant to the extent they apply to cash basis or modified cash basis measurement and recognition criteria. Therefore, although cash basis and modified cash basis financial statement notes should disclose a description of the plan, types of benefits provided, the funding policy, contribution requirements and rates, and actual cash contributions made, there would be no requirements to disclose further GAAP disclosure requirements or RSI pertaining to actuarial information, including actuarial methods and assumptions, actuarial-required contributions, net pension or OPEB expense and liabilities, trend data, plan funded status, and similar accrual basis related information that is not applicable to a cash basis or modified cash basis framework.



Practice Pointer: Defined Benefit Pension and OPEB Disclosures. Questions often arise about the appropriate disclosures in special purpose financial statements with regards to defined benefit pension and OPEB costs and obligations. Many GAAP required disclosures for such costs and obligations are related to actuarial and accrual type measurement and recognition, and are therefore not applicable to financial statements prepared in accordance with the cash basis or modified cash basis of accounting.

Specifically, GAAP required disclosures that are considered not applicable to cash basis and modified cash basis financial statements include (1) significant assumptions employed in the measurement of net pension or OPEB liability; (2) descriptions of benefit changes and changes in assumptions; (3) assumptions related to the discount rate and impact on total pension or OPEB liability of a 1 percentage point increase or decrease in the discount rate; (4) net pension or OPEB liability and deferred outflows and inflows of resources; (5) the beginning and ending balances of net pension or OPEB liability; and (6) the effects of changes in the balances from such items as service cost, benefit changes, and actual investment earnings. However, certain GAAP required disclosures are considered applicable to cash basis and modified cash basis

financial statements and include a description of the plan and benefits provided, the funding policy, contribution requirements and rates, actual cash contributions made, and other general plan disclosures.

Though not applicable to or required in cash basis or modified cash basis financial statements, the government entity could optionally include disclosure of available pension or OPEB obligation information, including actuarial information and amounts calculated as total pension or OPEB liability and net pension or OPEB liability within the notes to the financial statements as commitments. However, care should be exercised in such disclosure to not confuse the reader of the financial statements; it should be made clear that these obligations are disclosed as commitments and not reported on the face of the financial statements as liabilities because of the use of the cash or modified cash basis framework.

See related practice pointer in chapter 2 regarding the applicability of pension and OPEB accounting and financial reporting requirements to special purpose financial statements.

It should be noted that the impact of GAAP pension and OPEB disclosure requirements on regulatory basis financial statements, will depend on the disclosure requirements as established by the regulatory authority in defining its regulatory basis framework.

Example 3-1: Defined Benefit Pension Plan Note—Modified Cash Basis

Note X. Law Enforcement Employee Cost-Sharing Multiple-Employer Defined Benefit Pension Plan

General Information about the Plan *(Considered applicable disclosures for modified cash basis framework)*

Plan description. Eligible law enforcement employees of the Municipality are provided with pensions through the Law Enforcement Employee Pension Plan (LEEPP)—a cost-sharing multiple-employer defined benefit pension plan administered by the State Law Enforcement Retirement System (LERS). Article 11 of the State Statutes grants the authority to establish and amend the benefit terms to the LERS Board of Trustees (LERS Board). LEEPP issues a publicly available financial report that can be obtained at [Internet address].

Benefits provided. LEEPP provides retirement, disability, and death benefits. Retirement benefits are determined as 2.5 percent of the employee's final 3-year average compensation times the employee's years of service. Employees with 10 years of continuous service are eligible to retire at age 60. Employees are eligible for service-related disability benefits regardless of length of service. Five years of service is required for nonservice-related disability eligibility. Disability benefits are determined in the same manner as retirement benefits but are payable immediately without an actuarial reduction. Death benefits equal two times the employee's final full-year salary.

Contributions. Per Article 11 of the State Statutes, contribution requirements of the active employees and the participating local governments are established and may be amended by the LERS Board. Employees are required to contribute 8.00 percent of their annual pay. The employing local governments' contractually required contribution rate for the year ended June 30, 20X9, was 12.00 percent of annual payroll, actuarially determined as an amount that, when combined with employee contributions, is expected to finance the costs of benefits earned by employees during the year, with an additional amount to finance any unfunded accrued liability. Contributions to the pension plan from the Municipality were \$22,090 for the year ended June 30, 20X9.

Information about the Municipality's Proportionate Share of Pension Obligation (*Considered optional disclosures for modified cash basis framework*)

Commitment Related to Proportionate Share of Net Pension Liability. At June 30, 20X9, the LEEPP, as a whole, reported a total net pension liability of \$17,114,910 of which the Municipality's proportionate share amounted to \$44,210. Because of the use of a modified cash basis of accounting framework in the preparation of these financial statements, this proportionate share of the LEEPP net pension liability is not reported in the Municipality's financial statements as a liability, and is instead disclosed herein as a commitment. In accordance with the modified cash basis of accounting, pension expense or expenditures are only reported when contributions are paid by the Municipality to the LEEPP.

The LEEPP net pension liability was measured as of December 31, 20X8, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The Municipality's proportion of the net pension liability was based on a projection of the Municipality's long-term share of contributions to the pension plan relative to the projected contributions of all participating local governments, actuarially determined. At December 31, 20X8, the Municipality's proportion was 0.25 percent, which was an increase of 0.01 from its proportion measured as of December 31, 20X7.

Actuarial assumptions. Actuarial assumptions used in the determination of net pension liability, including mortality rates and life expectancies, long-term expected rate of return, discount rate and sensitivity of the net pension liability to changes in discount rate are available in the separately issued LEEPP financial report that can be obtained at [Internet address].

Disclosure of Differences Between GAAP and Special Purpose Frameworks

An important disclosure for all special purpose financial statements is the description of the applicable special purpose framework selected and applied, including a description of how the special purpose framework differs from GAAP. Although these differences from GAAP should be qualitatively described, they need not be quantitatively described. For example, disclosing that the cash basis or modified cash basis of accounting does not include the reporting of accrued receivables and payables is sufficient disclosure without having to quantify the amounts of such omitted accruals.

This special purpose framework description is especially important in modified cash basis financial statements. Because modified cash basis financial statements can vary among governments based on which modifications are made to the cash basis, a well-written and comprehensive disclosure of the modifications made to the cash basis within the special purpose framework applied is essential for user understanding. Examples 3-2 – 3-4, following, outline how the cash, modified cash, and regulatory bases of accounting may differ from GAAP.

Example 3-2: Example Basis of Accounting Note—Pure Cash Basis

Note X. Basis of Accounting

The financial statements are presented in accordance with a cash basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America (GAAP) as established by the Governmental Accounting Standards Board. This basis of accounting involves the reporting of only cash and cash equivalents and the changes therein resulting from cash inflows (cash receipts) and cash outflows (cash disbursements) reported in the period in which they occurred.

This cash basis of accounting differs from GAAP primarily because revenues (cash receipts) are recognized when received in cash rather than when earned and susceptible to accrual, and expenditures or expenses (cash disbursements) are recognized when

paid rather than when incurred or subject to accrual. As a result, only cash and cash equivalents and related net position or fund balances arising from cash transactions are reported in the statements of net position and balance sheets. All other economic assets, deferred outflows of resources, liabilities, and deferred inflows of resources that would be reported in GAAP basis financial statements are not reported in this cash basis presentation.

Example 3-3: Example Basis of Accounting Note—Modified Cash Basis

Note X. Basis of Accounting

The financial statements are presented in accordance with a modified cash basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America (GAAP) as established by the Governmental Accounting Standards Board. This basis of accounting involves modifications to the cash basis of accounting to report in the statement of net position or balance sheet cash transactions or events that provide a benefit or result in an obligation that covers a period greater than the period in which the cash transaction or event occurred. Such reported balances include investments, inventories, receivables, capital assets, deferred outflows of resources, short-term liabilities, long-term liabilities, and deferred inflows of resources arising from cash transactions or events.

This modified cash basis of accounting differs from GAAP primarily because certain assets and their related revenues (such as accounts receivable and revenue for billed or provided services not yet collected, and other accrued revenue and receivables) and certain liabilities and their related expenses or expenditures (such as accounts payable and expenses for goods or services received but not yet paid, and other accrued expenses and liabilities) are not recorded in these financial statements. In addition, other economic assets, deferred outflows, liabilities, and deferred inflows of resources that do not arise from a cash transaction or event that would be reported in GAAP basis financial statements (such as donated assets and pension or postemployment benefit liabilities) are not reported in this modified cash basis presentation, and the measurement of reported assets and liabilities does not involve adjustment to fair value.

Example 3-4: Example Basis of Accounting Note—Regulatory Basis

Note X. Basis of Accounting

The financial statements are presented in accordance with a regulatory basis of accounting, which is a basis of accounting other than accounting principles generally

accepted in the United States of America (GAAP) as established by the Governmental Accounting Standards Board. This regulatory basis of accounting involves the reporting of cash and cash equivalents, certain marketable investments, certain accounts payable, and encumbrance obligations and the changes therein to meet the financial reporting requirements of the State Department of Local Government Affairs.

This regulatory basis of accounting differs from GAAP primarily because the financial statement format does not include the GAAP presentations of government-wide and fund financial statements, revenues are recognized when received in cash rather than when earned and susceptible to accrual, and expenditures or expenses are recognized when payable or committed through an encumbrance rather than when incurred or subject to accrual. As a result, all economic assets, deferred outflows of resources, liabilities, and deferred inflows of resources that would be reported in GAAP basis financial statements are not reported in this regulatory basis presentation.

The applicability of GAAP-similar note disclosures to special purpose financial statements related to capital assets, changes in capital assets and accumulated depreciation and related depreciation expense, long-term debt, and changes in long-term debt and long-term debt maturities will vary depending on the specific special purpose framework selected and applied.

In a pure cash basis of accounting, the GAAP disclosures for capital assets and long-term debt are not necessary because the capital asset and long-term debt items are not presented in the financial statements.

In a modified cash basis of accounting, the GAAP disclosures related to capital assets and long-term debt may be necessary depending on whether the cash basis of accounting is modified for reporting such elements. If the modified cash basis of accounting results from modifications to the cash basis that involve the reporting of capital assets and long-term debt in the financial statements, the capital asset and long-term debt GAAP-similar disclosures would be appropriate.

In a regulatory basis of accounting, the specific laws' or regulations' guidance should dictate the accounting treatment and disclosure requirements for capital assets and long-term debt. However, if the regulatory basis of accounting involves the reporting of capital assets and long-term debt as elements within the regulatory basis financial statements, the GAAP-similar disclosures for capital assets and long-term debt is appropriate.



Practice Pointer: Although special purpose financial statements that contain items that are the same as, or similar to, those items in financial statements prepared in accordance with GAAP should include similar informative disclosures, special purpose financial statements may substitute qualitative information for some of the quantitative information applicable to GAAP financial statements or may provide information that communicates the substance of those GAAP disclosures. For example, disclosure of repayment terms for long-term debt in modified cash basis financial statements may, in substance, communicate the necessary information about future principal reduction without providing the summary of principal reduction over the next five years and through maturity.

Additional General Disclosures

Special purpose financial statements should also contain other disclosures that are generally applicable to GAAP financial statements and related to matters that are not specifically identified on the face of the financial statements to the extent applicable. Examples of these disclosures would include

- ▶ material noncompliance.
- ▶ restrictions on assets.
- ▶ sales and pledges of future revenue.
- ▶ segment information.
- ▶ related-party transactions.
- ▶ guarantees.
- ▶ subsequent events.
- ▶ commitments and contingencies.
- ▶ tax abatement disclosures.

Example 3-5: Commitment and Contingency Note—Modified Cash Basis

Note Z. Commitments and Contingencies—Landfill Closure

The Authority closed a landfill site on September 1, 20X1, in accordance with state and federal laws. This closure requires the Authority to place a final cover on its

landfill site and to perform certain maintenance and monitoring functions at the site for eight years after closure. Although postclosure care costs will be paid after the date the landfill stops accepting waste, the Authority estimates the remaining postclosure care costs to be \$XXX,XXX at June 30, 20X7, based upon two remaining years of monitoring. This amount is based upon what it would cost to perform all postclosure care in 20X7. Actual costs may be higher due to inflation, changes in technology, or changes in regulations. Due to the Authority's application of the modified cash basis of accounting, this long-term obligation is not reported as a liability in the financial statements.



Practice Pointer: Commitment Disclosures in Special Purpose Financial Statements. An argument can be made that in disclosing the reporting entity's commitments in notes to special purpose financial statements, disclosure of material long-term debt or financial obligations (both capital and operating debt, including lease obligations) should be included because it is a form of commitment on future cash resources. Such disclosures could be useful to users of special purpose financial statements and appropriate for achieving fair presentation.

Other Informative Disclosures

Any other disclosures that are considered necessary to achieve fair presentation should be included in special purpose financial statements, such as disclosures of

- ▶ significant risks and uncertainties.
- ▶ significant concentrations and dependencies.
- ▶ going concern considerations.
- ▶ other informative disclosures for items or conditions not evident on the face of the financial statements.



Practice Pointer: Using Note Disclosures to Compensate for Inherent Limitations of Special Purpose Frameworks. Special purpose frameworks come with inherent presentation and disclosure limitations because they represent alternative non-GAAP frameworks. In an effort to enhance the value of special purpose financial statements, the notes to the financial statements can often be used to compensate for certain of these limitations. For example, when the financial statements are presented in accordance with a cash basis that is modified to report marketable security investments as an asset, the notes could disclose the fair value of such investments when materially different from the carrying value to enhance the information provided to the financial statement users. In addition, the notes could include other qualitative information, such as the existence of material donated assets, derivative instruments and risks, and long-term obligations that are not presented on the face of the financial statements.

Example 3-6: Significant Concentrations and Dependencies—Modified Cash Basis

Note Z. Concentrations and Dependencies—XYZ Manufacturing Plant Revenue

In 20X1 and 20X2, the Authority's largest utility customer, XYZ Manufacturing Plant, accounted for 58 percent and 52 percent, respectively, of the Authority's utility service charges revenue. In 20X2, XYZ Manufacturing Plant laid off 25 percent of its local workforce, and utility service charges to XYZ Manufacturing Plant decreased by \$XXX,XXX in 20X2 from the prior year.

See illustration A in appendix B of this practice aid for example note disclosures applicable to a complete set of modified cash basis financial statements of an example municipal government.

Special Purpose Financial Statement Titles

When preparing special purpose financial statements, preparers should consider avoiding titles that could be confusing. Terms such as *balance sheet*; *statement of net position*; *statement of financial position*; *statement of revenues, expenses, and changes in net position*; *statement of activities*; and *statement of cash flows* or similar unmodified titles are generally understood to be applicable only to financial statements that are intended to present financial position, changes in financial position, or cash flows in accordance with a general

purpose framework, such as GAAP. Consequently, it is a good practice to avoid unmodified financial statement titles in financial statements prepared in accordance with a special purpose framework.



Practice Pointer: Examples of Inappropriate Special Purpose Financial Statement Titles.

Statement of financial position arising from cash transactions of governmental funds should not be titled “Balance Sheet” (without any modification).

The government-wide financial statements in a special purpose framework presentation should not be titled “Statement of Net Position” and “Statement of Activities” (without any modification).

In a special purpose framework presentation, a regulatory basis financial statement of grant fund operations that includes encumbrances as expenditures should not be titled “Statement of Revenues and Expenditures” (without any modification).



Practice Pointer: Examples of Appropriate Special Purpose Financial Statement Titles.

Special purpose financial statement titles should be appropriately modified to inform the user that the statements are prepared in accordance with a special purpose framework. These modifications may be made in a number of ways. The following, although not all-inclusive, are examples of appropriate special purpose financial statement titles:

- ▶ A cash basis financial statement of changes in financial position might be appropriately titled “Statement of Cash Receipts and Disbursements and Changes in Cash and Cash Equivalents.”
- ▶ Modified cash basis proprietary fund financial statements might be titled “Statement of Net Position Arising From Modified Cash Basis Transactions” and “Statement of Revenues and Expenses, and Changes in Net Position Arising From Modified Cash Basis Transactions.”
- ▶ Modified cash basis government-wide financial statements might be suitably titled “Statement of Net Position—Modified Cash Basis” and “Statement of Activities—Modified Cash Basis.”
- ▶ A financial statement prepared in accordance with a statutory or regulatory basis might be appropriately titled “Statement of Income and Expense—Regulatory Basis.”

Chapter 4

Auditor Reporting on Special Purpose Financial Statements of State and Local Governments

Introduction

Many auditors have found it challenging to find answers to the following questions regarding auditor reporting on special purpose financial statements applicable to state and local governments:

- ▶ Does *Government Auditing Standards* (the Yellow Book) issued by the Comptroller General of the United States or Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (the Uniform Guidance), issued by the Office of Management and Budget (OMB) preclude the preparation of special purpose financial statements or the rendering of audit opinions on such statements that cite the Yellow Book?
- ▶ Do the materiality and opinion unit concepts applicable to reporting on GAAP financial statements contained within the AICPA Audit and Accounting Guide *State and Local Governments* apply to forming opinions and reporting on special purpose financial statements?
- ▶ Is it appropriate for an auditor to issue unmodified opinions on special purpose financial statements, or should the auditor's report always express a modified opinion for departures from GAAP?
- ▶ Is it appropriate for an auditor's report on special purpose financial statements to always contain a restricted-use paragraph that indicates the report is intended solely for certain specified parties?
- ▶ How does an auditor modify an auditor's report on special purpose financial statements that includes material misstatements resulting from departures from the special purpose framework criteria selected and applied?
- ▶ How should an auditor report on a financial statement presentation that uses more than one financial reporting framework within the basic financial statements, such as presenting both special purpose and GAAP financial statements within a single reporting entity's presentation?

This chapter will answer each of these frequently asked questions and provide further guidance for auditors reporting on special purpose financial statements.

Authoritative Guidance for Reporting on Special Purpose Financial Statements

The primary source of guidance for auditors reporting on special purpose financial statements is essentially the same guidance for reporting on GAAP financial statements and can be found in the following auditing standards:

- ▶ AU-C section 700, *Forming an Opinion and Reporting on Financial Statements* (AICPA, *Professional Standards*)
- ▶ AU-C section 705, *Modifications to the Opinion in the Independent Auditor's Report* (AICPA, *Professional Standards*)
- ▶ AU-C section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report* (AICPA, *Professional Standards*)

This primary guidance is then further expanded upon and tailored to special purpose financial statements in AU-C section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks* (AICPA, *Professional Standards*). Essentially, the primary difference in reporting on special purpose financial statements and GAAP financial statements is the applicable financial reporting framework upon which the auditor evaluates fair presentation of the financial statements. In audits of general purpose financial statements, the auditor evaluates fair presentation with respect to GAAP, but in audits of special purpose financial statements, the auditor evaluates fair presentation with respect to the applicable accounting principles embodied within the special purpose framework (such as a cash basis special purpose framework).



Practice Pointer: Special Purpose Financial Statements and the Yellow Book. The Yellow Book does not prohibit the preparation of special purpose financial statements or the rendering of audit opinions citing the Yellow Book on such statements. The Yellow Book provides audit guidance for audits subject to its standards and does not provide authoritative accounting or financial reporting guidance with regard to the preparation of the financial statements. Therefore, special purpose financial statements can be audited and opined upon under the Yellow Book.



Practice Pointer: Special Purpose Financial Statements and the Uniform Guidance. Similarly, OMB's Uniform Guidance does not prohibit the preparation of special purpose financial statements or the rendering of related audit opinions on such statements in conjunction with a single audit. However, as discussed in the practice pointer "Special Purpose Frameworks—Effect on Low Risk Audittee Determination for Government Entities Subject to Single Audit Requirements" presented in chapter 1, an entity's use of a special purpose framework in the preparation of its financial statements, except for a regulatory basis required by state law, would disqualify the entity from being a low risk auditee in a single audit.

Materiality Guidance for Certain Special Purpose Financial Statements¹

Chapter 4, "General Auditing Consideration," of the AICPA Audit and Accounting Guide *State and Local Governments* provides guidance for both preparers and auditors of state and local government GAAP-basis financial statements. It also describes how materiality determinations for purposes of preparing a government's basic financial statements differ from materiality determinations for purposes of planning, performing, evaluating the results of, and reporting on the audit of a government's basic financial statements. This guidance may also be applicable to certain special purpose financial statement presentations.



Practice Pointer: Applicability of Opinion Unit Guidance to Special Purpose Financial Statements. The materiality and opinion unit guidance in the AICPA Audit and Accounting Guide *State and Local Governments* applicable to GAAP financial statements is also applicable to a complete set of special purpose financial statements presented in accordance with the cash basis or modified cash basis of accounting. Such guidance may or may not apply to regulatory basis financial statements or statements not intended to be a complete presentation of the reporting entity. The materiality level and opinion units for regulatory basis financial statements is generally determined by the accounting and presentation requirements of the regulatory authority. See the discussion in the "Regulatory Basis Materiality and Opinion Unit Issues" section of this practice aid. Professional judgment, similar to that needed for regulatory presentations, should be exercised in determining materiality for a single special purpose financial statement presentation or other special purpose presentation not intended to be a complete set of financial statements.

1. The guidance presented in this section has been adapted from chapter 4, "General Auditing Considerations," of the AICPA Audit and Accounting Guide *State and Local Governments* and modified for its applicability to special purpose framework financial reporting.

Governmental Accounting Standards Board Guidance to Preparers on Materiality

Chapter 7 of GASB's *Comprehensive Implementation Guide* explains how financial statement preparers view materiality in the preparation of governmental GAAP-basis financial statements. Generally, that same guidance is also appropriate for applications to a government's complete set of financial statements prepared in accordance with the cash basis or modified cash basis of accounting because these special purpose financial statements generally meet the substance of the presentation requirements for GAAP-basis financial statements.

The GASB guidance indicates that preparers make separate materiality evaluations for governmental activities, business-type activities, and each major governmental and enterprise fund because those reporting units are considered to be quantitatively material. The guidance also discusses the assessment of the significance of major discretely presented component units and the relationship with the primary government. Additionally, it states that the components of the remaining fund information—non-major governmental and enterprise funds, internal service funds, and fiduciary funds—may or may not be quantitatively material. In addition, guidance states that the preparer's view of the data presented for those reporting units for purposes of materiality evaluations are based on professional judgment, considering relevant qualitative factors and the relationship of the remaining fund and component unit reporting units to other appropriate information in the financial statements.

AICPA Guidance to Auditors on Materiality

Financial reporting frameworks often discuss the concept of materiality in the context of the preparation and fair presentation of the financial statements. As previously described, GASB does provide materiality guidance for the preparation of financial statements of a state or local government's GAAP-basis financial statements. In addition, AU-C section 320, *Materiality in Planning and Performing an Audit*, and AU-C section 450, *Evaluation of Misstatements Identified During the Audit* (AICPA, *Professional Standards*), provide general guidance to the auditor in making materiality determinations in auditing and reporting on governmental financial statements. This guidance indicates that the auditor's consideration of materiality is a matter of professional judgment and is affected by the auditor's perceptions of the financial information needs of users of the financial statements. Because of the unique nature of governmental financial reporting and the

financial reporting framework requirements and guidance from GASB, the AICPA Audit and Accounting Guide *State and Local Governments* has adopted an opinion unit approach to materiality for purposes of auditor reporting, as outlined in chapter 4 of that guide. Because, as discussed in chapter 3, “Presentation and Disclosure Issues in Special Purpose Financial Statements of State and Local Governments,” of this practice aid, cash basis and modified cash basis financial statements of a state or local government substantially meet the financial statement presentation requirements of GAAP. Therefore, it is appropriate for the auditor’s consideration of whether a government’s complete set of basic financial statements are presented fairly, in all material respects, in accordance with the cash basis or modified cash basis of accounting applied, to also be based on *opinion units*, as defined in the AICPA Audit and Accounting Guide *State and Local Governments*.

Generally, the opinion units in a government’s basic financial statements are, as applicable, governmental activities; business-type activities; aggregate discretely presented component units; each major governmental and enterprise fund; and aggregate remaining fund information (non-major governmental and enterprise funds, the internal service fund type, and the fiduciary fund types).

It is also appropriate for auditors to determine opinion units for audits of a special purpose government’s cash basis or modified cash basis basic financial statements in the same manner as cash basis or modified cash basis presentations for general purpose governments, to the extent applicable.

Governments engaged in a single governmental program that combines their fund financial statements and government-wide financial statements, as provided in paragraph 136 of GASB Statement No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*, could have an opinion unit for each major governmental fund; an opinion unit for their aggregate non-major governmental funds, if any; and an opinion unit for the government-wide total column, which represents governmental activities.

Governments engaged only in business-type activities may have more than one opinion unit. For example, a utility district with more than one enterprise fund (one each for its water, sewer, electric, and trash operations) could have an opinion unit for each major enterprise fund and another opinion unit for its aggregate non-major enterprise funds, if any.

Governments engaged only in fiduciary activities generally have only one opinion unit that represents, in effect, remaining fund information.

Regulatory Basis Materiality and Opinion Unit Issues

Because the format and presentation of regulatory basis financial statements vary depending on the specific regulatory requirements, the application of the AICPA Audit and Accounting Guide *State and Local Governments* concepts of materiality and opinion units cannot be determined uniformly. Ideally, the regulatory agency defines, within its laws, regulations, or related guidance, the materiality thresholds to be considered in the preparation and audit of its regulatory basis financial statements. However, if such guidance is not provided, it is appropriate for the auditor and audit client to come to an agreement on the materiality thresholds to be applied. If the regulatory basis financial statements present financial information for opinion units in a format similar to the presentation required by GASB for GAAP-basis financial statements, the materiality and opinion unit guidance presented in this chapter is appropriate to apply to the regulatory basis financial statements. However, if the regulatory basis financial statements result in a different presentation, it is appropriate for the auditor to consult the regulations and their related guidance to determine if materiality and opinion levels are addressed or defined. If not defined in the regulations, it is appropriate for the auditor to discuss materiality alternatives with the audit client and apply professional judgment.



Practice Pointer: Regulatory Basis Materiality Considerations. If a regulatory provision requires the presentation of a statement of cash receipts and disbursements for each individual fund of a governmental entity, and the regulations do not address materiality or opinion unit issues, the auditor could consider each fund a major fund and, therefore, a separate opinion unit, or all funds could be combined for purposes of making materiality judgments and determining opinion units. Although it is best for the regulatory agency to provide the necessary guidance on materiality and audit scope, if it is not defined in the regulations, it is appropriate for the auditor to discuss materiality alternatives with the audit client and apply professional judgment.

Forming an Opinion and Reporting on Special Purpose Financial Statements

Paragraph .13 of AU-C section 700 requires the auditor to form an opinion on whether the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework. In state and local government special purpose financial statements, the applicable financial reporting framework would be the cash basis, modified cash basis, or regulatory basis of accounting selected and applied by management in the preparation of the financial statements. In making the fair presentation evaluation

of special purpose financial statements required by paragraph .13 of AU-C section 700, the auditor may consider whether

- ▶ the financial statements are suitably titled, considering the special purpose framework selected and applied.
- ▶ the overall presentation, structure, and content of the financial statements are consistent with the applicable special purpose framework criteria and free of material misstatements or potential material misstatements in relation to that criteria.
- ▶ the financial statements include a summary of significant accounting policies that adequately describe the policies selected and applied, including a description of the special purpose framework applied and how it differs from GAAP.
- ▶ the accounting policies selected and applied are consistent with the applicable special purpose framework and appropriate under the circumstances.
- ▶ any accounting estimates made by management in the special purpose financial statements are reasonable.
- ▶ the information presented in accordance with a special purpose framework is relevant, reliable, comparable, and understandable.
- ▶ the special purpose financial statements provide adequate disclosures to enable intended users to understand the effect of material special purpose transactions and events, including informative disclosures similar to GAAP for items that are the same or similar to those presented in GAAP financial statements, and any other disclosures necessary to achieve fair presentation.

Some of the unique reporting requirements applicable to an auditor's report on special purpose financial statements are discussed in the following items (1)–(3), and other specific reporting requirements are discussed in the "Modifications to the Auditor's Opinion on Special Purpose Financial Statements" and "Emphasis-of-Matter and Other-Matter Paragraphs in Auditor's Reports on Special Purpose Financial Statements" sections of this practice aid:

1. Paragraph .18a of AU-C section 800 states that in the auditor's report on special purpose financial statements, the explanation of management's responsibility for the financial statements should also make reference to its responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances when management has a choice of financial reporting frameworks in the preparation of such financial statements.

Example 4-1: Management's Responsibility Paragraph—Management Has Choice of Frameworks (Modified Cash Basis Selected) Basis of Accounting Paragraph

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the modified cash basis of accounting described in Note X; this includes determining that the cash basis of accounting is an acceptable basis for the preparation of the financial statements in the circumstances. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error.

2. When the special purpose financial statements are prepared in accordance with a regulatory basis of accounting, Paragraph .18b of AU-C section 800 states that the auditor's report should also describe the purpose for which the financial statements are prepared or refer to a note in the special purpose financial statements that contains that information when the financial statements are prepared in accordance with a regulatory basis of accounting.

Example 4-2: Management's Responsibility Paragraph—Regulatory Basis Purpose

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the financial reporting provisions of Section Y of Regulation Z of Any State Statutes, as described in Note X. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

3. In all situations, the wording of the introductory and opinion paragraphs of the auditor's report on special purpose financial statements should be sufficiently clear to inform the reader of the *opinion unit(s)* considered by the auditor, as defined in the AICPA Audit and Accounting Guide *State and Local Governments*. In addition, the opinion paragraph(s) should make it clear that the opinions are based on the fair presentation of the financial statements in accordance with the special purpose framework applied, not a GAAP framework.

Example 4-3: Introductory Paragraph

We have audited the accompanying modified cash basis financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Example, Any State, as of and for the year ended June 30, 20XX, and the notes to the financial statements, which collectively comprise the city's basic financial statements as listed in the table of contents.

Example 4-4: Unmodified Opinion Paragraph

In our opinion, the modified cash basis financial statements referred to above present fairly, in all material respects, the respective modified cash basis financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Example, Any State, as of June 30, 20XX, the respective changes in modified cash basis financial position; and, where applicable, cash flows thereof for the year then ended in accordance with the modified cash basis of accounting described in Note X.

An unmodified audit opinion for an opinion unit is appropriate when the special purpose financial statements fairly present, in all material respects, the opinion unit's financial position, changes in financial position, and cash flows, when applicable, in accordance with the applicable special purpose framework (the special purpose framework selected and applied by management). In other words, unmodified opinions on the opinion units of special purpose financial statements are appropriate when the auditor concludes that the financial statements, including disclosures, of that opinion unit are presented fairly, in all material respects, in accordance with the special purpose framework.



Practice Pointer: No Modification of Auditor's Report for Exclusion of GAAP-Required Supplementary Information in Special Purpose Financial Statements. It is important to note that an auditor's report on special purpose financial statements is not modified for the exclusion of GAAP-required supplementary information (RSI). As discussed in chapter 3 of this practice aid, in cash basis and modified cash basis financial statements, there are no RSI requirements because there is no designated standard setter for such special purpose frameworks. Therefore, the exclusion of such information is not considered a departure from the special purpose framework. However, as also noted in chapter 3 of this practice aid, preparers may include such GAAP-RSI in their special purpose financial statements, but that information is considered supplementary information for purposes of the special purpose basic financial statements.

Illustrations 1–4 in appendix C, “Example Auditor Reports on Special Purpose Financial Statements of State and Local Governments,” of this practice aid present example auditor reports that express unmodified audit opinions on all opinion units within financial statements applying the cash basis, modified cash basis, and regulatory basis of accounting frameworks.

Modifications to the Auditor’s Opinion on Special Purpose Financial Statements

As in GAAP, the basic financial statements in cash basis and modified cash basis presentations intended to be a complete set of financial statements represent the minimum financial statements that are prepared and reported upon and may include multiple opinion units. The basic financial statements generally contain government-wide financial statements, fund financial statements, and notes to the financial statements, when applicable to the special purpose framework presentation.

The primary objective of the audit of special purpose financial statements is the expression of an audit opinion or opinions on the fairness with which the basic financial statements present, in all material respects, financial information as of the date and for the period identified in accordance with the requirements of the applicable special purpose framework applied. Auditors should plan, perform, and evaluate the results of audit procedures on a government’s special purpose basic financial statements based on applicable special purpose framework assertions and the materiality guidance for opinion units, as previously discussed.



Practice Pointer: Varying Opinions for Different Opinion Units in Special Purpose Financial Statements. In applying the auditor reporting guidance from the AICPA Audit and Accounting Guide *State and Local Governments* to special purpose basic financial statement presentations of state and local governments, the auditor may express an unmodified opinion on the special purpose financial statements of one or more opinion units and modified opinions or disclaimers of opinion on one or more of the other opinion units. For example, the opinion on a major fund might be modified for a material misstatement within that fund, but the remaining opinion units are fairly presented in all material respects, resulting in the expression of an unmodified opinion on the other opinion units.



Practice Pointer: Single Opinion Unit for Certain Special Purpose Government's Special Purpose Financial Statements. The special purpose financial statements for some special purpose governments engaged only in business-type activities and for special purpose governments engaged only in fiduciary activities may only have a single opinion unit; thus, the auditor will express a single opinion on those financial statements.

AU-C section 705 explains that modified opinions may be expressed in the form of qualified, adverse, and disclaimer of opinions on the basic financial statements. This audit standard applies to both special purpose and GAAP financial statements. The decision to modify an auditor's opinion and which type of modification is appropriate depends on the

- ▶ nature of the matter giving rise to the modification (that is, whether the financial statements are materially misstated, or because of an inability to obtain sufficient appropriate audit evidence, the financial statements may be materially misstated).
- ▶ auditor's judgment about the pervasiveness of the effects or possible effects of the matter on the financial statements.

In accordance with paragraph .20 of AU-C section 700, the auditor should modify the opinion(s) in the auditor's report on special purpose financial statements if (a) the auditor concludes, based on the audit evidence obtained, that the financial statements of an opinion unit or the statements as a whole are materially misstated, or (b) the auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements for an opinion unit or the financial statements as a whole are free from material misstatement.

The following section of the practice aid explains certain conditions that may lead to a qualified opinion, an adverse opinion, or a disclaimer of opinion in reporting on special purpose financial statements of a state or local government. The following analysis has been adapted from the auditor reporting guidance in chapter 15, "Audit Reporting," of the AICPA Audit and Accounting Guide *State and Local Governments* and has been modified for its applicability to auditor reporting on special purpose financial statements.

Inability to Obtain Sufficient Appropriate Audit Evidence

A lack of sufficient appropriate audit evidence resulting from management-imposed limitations on the scope of the audit of the special purpose financial statements for an opinion unit may lead the auditor to modify the opinion or disclaim an opinion on that opinion unit. In these situations, the auditor is unable to achieve certain audit objectives and

conclude about the fair presentation of certain financial statement elements or components of a governmental reporting entity presented in the financial statements. A scope limitation that arises from a lack of sufficient appropriate audit evidence to support a special purpose financial statement assertion may involve circumstances in which a government's accounting systems, processes, and records or reports from other auditors on component units or fund information do not provide sufficient information to enable the auditor to conclude about the fair presentation of such items as

- ▶ restrictions on cash balances,
- ▶ classifications of net position or fund balance,
- ▶ eliminations of internal activity and balances in the government-wide financial statements,
- ▶ capital assets or long-term debt arising from cash transactions or events when a cash basis presentation purports to be modified for the recording of capital assets and long-term debt, or
- ▶ component unit financial statement information.

Qualified Opinion Resulting From the Inability to Obtain Sufficient Appropriate Audit Evidence

When the auditor expresses a qualified opinion resulting from the inability to obtain sufficient appropriate audit evidence, the auditor should follow the requirements in AU-C section 705 applicable to qualified opinions.

In accordance with paragraph .17 of AU-C section 700, when the auditor modifies the opinion on the financial statements, the auditor should, in addition to the specific elements required by AU-C section 700, include a paragraph in the auditor's report immediately preceding the opinion paragraph and use a heading that includes "Basis for Qualified Opinion," "Basis for Adverse Opinion," or "Basis for Disclaimer of Opinion," as appropriate. In accordance with paragraph .21 of AU-C section 705, if the modification results from an inability to obtain sufficient appropriate audit evidence, the auditor should include in the basis for modification paragraph the reasons for that inability.

Example 4-5 provides example wording to describe the basis for a qualified opinion resulting from the exclusion of one material component unit (but not all component units) from the aggregate discretely presented component units' opinion unit.

Example 4-5: Basis for Qualified Opinion Paragraph

Basis for Qualified Opinion on the Aggregate Discretely Presented Component Units

The financial statements of Example Component Unit (ECU) have not been audited, and we were not engaged to audit the ECU financial statements as part of our audit of the city's basic financial statements. ECU's financial activities are included in the city's basic financial statements as a discretely presented component unit and represent XX percent and XX percent of cash and cash equivalents and cash receipts, respectively, of the city's aggregate discretely presented component units.

In the opinion paragraph, under the heading "Qualified Opinion," in accordance with paragraph .24 of AU-C section 705, the auditor should use the corresponding phrase "except for the possible effects of the matters described in the basis for qualified opinion paragraph, the financial statements [of the applicable opinion unit(s)] are presented fairly in all material respects, in accordance with [the applicable special purpose framework]."

Example 4-6 provides example wording for a qualified opinion resulting from the exclusion of a material component unit (but not all component units) from the aggregate discretely presented component units' opinion unit.

Example 4-6: Qualified Opinion Paragraph

Qualified Opinion

In our opinion, except for the possible effects of the matters described in the "Basis for Qualified Opinion on the Aggregate Discretely Presented Component Units" paragraph, the modified cash basis financial statements referred to above present fairly, in all material respects, the modified cash basis financial position of the aggregate discretely presented component units for City of Example, Any State, as of June 30, 20XX, and the changes in modified cash basis financial position thereof for the year then ended in accordance with the modified cash basis of accounting described in Note X.

Illustration 5 in appendix C of this practice aid provides an example auditor's report on special purpose financial statements that contains a qualified opinion on the discretely presented component units' opinion unit when a government does not obtain an audit of one or more (but not all) material discretely presented component units included in the special purpose financial statements, and the auditor determines a qualified opinion is appropriate on that opinion unit. See the "Omission of Component Units" section for further discussion about reports on the primary government only.

Disclaimer of Opinion Resulting From the Inability to Obtain Sufficient Appropriate Audit Evidence

A disclaimer of opinion states that the auditor does not express an opinion on the special purpose financial statements for one or more opinion units (or the financial statements as a whole). A disclaimer of opinion is appropriate when the auditor is unable to obtain sufficient appropriate audit evidence to the extent that possible effects on the financial statements of undetected misstatements could be both material and pervasive to the special purpose financial statement opinion units or the financial statements as a whole, and the auditor has elected not to withdraw from the engagement. When disclaiming an opinion on an opinion unit or the financial statements as a whole, the auditor should follow the requirements in AU-C section 705 applicable to disclaimers of opinion.

When disclaiming an opinion due to the inability to obtain sufficient appropriate audit evidence, an auditor should include a paragraph in the auditor's report immediately preceding the opinion paragraph and under a heading that includes "Basis for Disclaimer of Opinion" that describes the inability to obtain sufficient appropriate audit evidence and the reasons for that inability. In addition, the auditor should describe in this Basis for Disclaimer of Opinion paragraph any other matters of which the auditor is aware that would have resulted in a modification to the opinion(s) and the effects thereof and should consider the need for an emphasis-of-matter or other-matter paragraph(s) to describe any other matters of which the auditor is aware that would have resulted in additional communications in the auditor's report that are not opinion modifications.

Example 4-7 provides example wording for the basis of a disclaimer of opinion resulting from the inability to obtain sufficient appropriate audit evidence related to a discretely presented component unit considered material and pervasive to the aggregate discretely presented component units, and the auditor determines that a disclaimer of opinion on that opinion unit is appropriate.

Example 4-7: Basis for Disclaimer of Opinion Paragraph

Basis for Disclaimer of Opinion on the Aggregate Discretely Presented Component Units

The financial statements of Example Component Unit (ECU) have not been audited, and we were not engaged to audit the ECU financial statements as part of our audit of the city's basic financial statements. ECU's financial activities are included in the city's basic financial statements as a discretely presented component unit and represent XX

percent and XX percent of cash and cash equivalents and cash receipts, respectively, of the city's aggregate discretely presented component units.

Example 4-8 provides example wording for a disclaimer of opinion resulting from the inability to obtain sufficient appropriate audit evidence related to a discretely presented component unit considered material and pervasive to the aggregate discretely presented component units.

Example 4-8: Disclaimer of Opinion Paragraph

Disclaimer of Opinion

Because of the significance of the matters described in the “Basis for Disclaimer of Opinion on the Aggregate Discretely Presented Component Units” paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements of the aggregate discretely presented component units of the City of Example, Any State. Accordingly, we do not express an opinion on these financial statements.

When disclaiming an opinion due to the inability to obtain sufficient appropriate audit evidence, in accordance with paragraph .28 of AU-C section 705, the auditor should also amend the introductory paragraph of the auditor's report to state that the auditor “was engaged to audit the financial statements [of the applicable opinion unit(s) or the financial statements as a whole]” rather than stating the auditor audited the financial statements. In addition, the auditor should amend the description of the auditor's responsibility and description of the audit scope to indicate the following:

Because of the matter(s) described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion [on the applicable opinion unit(s) or the financial statements as a whole].



Practice Pointer: Appropriateness of Adverse Opinions on Special Purpose Financial Statements. Adverse opinions are not appropriate auditor report modifications resulting from the inability to obtain sufficient appropriate audit evidence. Adverse opinions should be expressed when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements within the special purpose financial statements, individually or in the aggregate, are both material and pervasive to an opinion unit or the financial statements as a whole. Appendix C of this practice aid provides three examples of auditor's reports where an adverse opinion is expressed.

Illustration 9 in appendix C of this practice aid provides an example auditor's report on special purpose financial statements that contains a disclaimer of opinion on an opinion unit because of the inability to obtain sufficient appropriate audit evidence.

Material Misstatements Resulting From Special Purpose Framework Departures

A material misstatement resulting from a departure from the accounting and financial reporting requirements of the special purpose framework applied to the financial statements for an opinion unit may lead the auditor to qualify the opinion or express an adverse opinion on that opinion unit. Some misstatements, depending on the pervasiveness of the effect of those misstatements, might require an opinion modification for more than one opinion unit or on the financial statements as a whole. Examples of material misstatements within special purpose financial statements include

- ▶ cash basis financial statements fail to include material cash equivalents.
- ▶ material investments reported in modified cash basis financial statements are reported at fair value.
- ▶ cash basis or modified cash basis financial statements include material accruals of revenues or expenses or expenditures and related receivables or payables.
- ▶ elements are reported within regulatory basis financial statements that are not included as part of the regulatory basis framework.
- ▶ financial information for a fund, a department, an agency, or a program or one or more (but not all) component units is omitted from the financial statements.
- ▶ financial information for a fund, a department, an agency, a program, or a component unit is presented in accordance with a basis of accounting other than the special purpose framework used for the remainder of the reporting entity (for example, a component unit is presented in accordance with GAAP, but the rest of the reporting entity is presented in accordance with a special purpose framework).
- ▶ certain general capital assets, such as infrastructure, arising from cash transactions are omitted from the government-wide financial statements when the special purpose framework applied is the cash basis of accounting, with modifications for reporting capital assets.
- ▶ the cash basis or modified cash basis fund financial statements do not report one or more governmental or enterprise funds as major, in accordance with the quantitative criteria of the GASB financial reporting model.

- ▶ a material note disclosure applicable to the special purpose framework applied is omitted or not presented substantially similar to GAAP financial statements within the constraints of the special purpose framework applied, such as GAAP-similar deposit risk disclosures applicable to cash basis financial statements.

Qualified Opinion—Material Misstatements Resulting From Special Purpose Framework Departures

When the auditor expresses a qualified opinion due to material misstatements resulting from departures from the applicable special purpose framework, the auditor should follow the requirements in AU-C section 705 applicable to qualified opinions.

When expressing a qualified opinion due to a material misstatement, in accordance with paragraph .17 of AU-C section 705, the auditor should include a paragraph in the auditor's report immediately preceding the opinion paragraph and use a heading that includes "Basis for Qualified Opinion." In accordance with paragraph .18 of AU-C section 705, the auditor should include in the basis for modification paragraph a description and quantification of the financial statement effects of the misstatement. If not practical to quantify the financial effect, the auditor should so state this fact.

Example 4-9 provides example wording for the basis of a qualified opinion on the business-type activities' opinion unit for a material misstatement resulting from a special purpose framework departure related to the omission of the financial activity of a material fund (but not all funds) that would normally be reported within the business-type activities' opinion unit.

Example 4-9: Basis for Qualified Opinion Paragraph

Basis for Qualified Opinion on Business-Type Activities

As described in Note Y, management has not included the Example Memorial Hospital Fund in the city's financial statements. Accounting principles applicable to the city's modified cash basis of accounting require the Example Memorial Hospital Fund to be presented as a major enterprise fund and financial information about the Example Memorial Hospital Fund to be part of the business-type activities, thus increasing the activities' cash and cash equivalents, cash receipts, and disbursements and changing its modified cash basis net position. The amount by which this departure would affect the cash and cash equivalents, net position, and cash receipts and disbursements of the business-type activities and the omitted major fund has not been determined.

When expressing a qualified opinion due to a material misstatement, in the opinion paragraph, under the heading “Qualified Opinion,” the auditor should use modifying language, such as “except for the effects of the matters described in the Basis for Qualified Opinion paragraph, the financial statements [of the applicable opinion unit(s)] are presented fairly, in all material respects, in accordance with [the applicable special purpose framework].”

Example 4-10 provides example wording for a qualified opinion on the business-type activities’ opinion unit for a material misstatement resulting from a special purpose framework departure related to the omission of the financial activity of a material fund (but not all funds) that would normally be reported within the business-type activities’ opinion unit.

Example 4-10: Qualified Opinion Paragraph

Qualified Opinion

In our opinion, except for the effects of the matter described in the “Basis for Qualified Opinion on Business-Type Activities” paragraph, the financial statements referred to above present fairly, in all material respects, the modified cash basis financial position of the business-type activities of the City of Example, Any State, as of June 30, 20XX, and the changes in modified cash basis financial position thereof for the year then ended in accordance with the modified cash basis of accounting described in Note X.

Illustration 6 in appendix C of this practice aid provides an example auditor’s report on special purpose financial statements that contains a qualified opinion on the business-type activities’ opinion unit for a material misstatement resulting from a special purpose framework departure related to the omission of the financial activity of a material fund.

Adverse Opinion—Material Misstatements Resulting From Special Purpose Framework Departures

An adverse opinion states that the special purpose financial statements for an opinion unit (or the financial statements as a whole) do not present fairly the financial position, changes in financial position, or cash flows, when applicable, in accordance with the special purpose framework applied. When the auditor expresses an adverse opinion due to material misstatements resulting from departures from the applicable special purpose framework, the auditor should follow the requirements in AU-C section 705 applicable to adverse opinions.

Adverse opinions are appropriate when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements within the special purpose financial statements, individually or in the aggregate, are material and pervasive to an opinion unit or the financial statements as a whole.



Practice Pointer: Quantitative and Qualitative Factors in Evaluating Misstatements or Omissions in Special Purpose Financial Statements.

The auditor generally considers quantitative and qualitative factors in determining whether a misstatement or an omission warrants an opinion modification and, if so, whether the modification warrants a qualified or an adverse opinion. For example, because a city or county government's general infrastructure assets (in a cash basis framework modified to report capital assets) are presumed to be material to their governmental activities, unless demonstrated otherwise, an adverse opinion usually is appropriate for the governmental activities' opinion unit when such infrastructure assets derived from cash transactions or events are omitted. Such a presumption does not exist for all special purpose governments because some special purpose governments, such as school districts, generally have little or no general infrastructure assets. Further, some auditors may conclude that the omission of general infrastructure assets causes the special purpose financial statements as a whole to not be presented fairly in accordance with the modified cash basis framework; therefore, an adverse opinion on the financial statements as a whole is appropriate.

When expressing an adverse opinion due to a material misstatement, in accordance with paragraph .17 of AU-C section 705, the auditor should include a paragraph in the auditor's report immediately preceding the opinion paragraph and under a heading that includes "Basis for Adverse Opinion." In accordance with paragraph .18 of AU-C section 705, the auditor should include in the basis for modification paragraph a description and quantification of the financial statement effects of the misstatement. If not practical to quantify the financial effect, the auditor should so state this fact.

Example 4-11 provides example wording for the basis of an adverse audit opinion on an opinion unit due to a misstatement related to excluded general infrastructure assets that is considered material and pervasive to the governmental activities' opinion unit.

Example 4-11: Basis for Adverse Opinion Paragraph

Basis for Adverse Opinion on Governmental Activities

As described in Note X to the financial statements, although the City's cash basis of accounting has been modified to include capital assets and related accumulated depreciation and depreciation expense, management has not recorded certain general

infrastructure assets in governmental activities' financial statements and, accordingly, has also not recorded depreciation expense on those assets. Accounting principles applicable to such a modified cash basis of accounting require that those general infrastructure assets derived from cash transactions or events be capitalized and depreciated, which would increase the modified cash basis assets, net position, and expenses of the governmental activities. The amounts by which this departure affects the modified cash basis assets, net position, and expenses of the governmental activities have not been determined.

In accordance with AU-C section 705, when the auditor expresses an adverse opinion due to a material misstatement, in the opinion paragraph, under the heading "Adverse Opinion," the auditor should state that "in the auditor's opinion, because of the significance of the matter(s) discussed in the Basis for Adverse Opinion paragraph, the financial statements are not presented fairly in accordance with [the applicable special purpose framework]."

Example 4-12 provides example wording for an adverse audit opinion on the governmental activities' opinion unit due to a misstatement related to excluded general infrastructure assets that is considered material and pervasive to that opinion unit.

Example 4-12: Adverse Opinion Paragraph

Adverse Opinion

In our opinion, because of the significance of the matter discussed in the "Basis for Adverse Opinion on Governmental Activities" paragraph, the financial statements referred to above do not present fairly, the modified cash basis financial position of the governmental activities of the City of Example, Any State, as of June 30, 20XX, and the changes in modified cash basis financial position thereof for the year then ended in accordance with the modified cash basis of accounting described in Note X.



Practice Pointer: Adverse Opinions on Special Purpose Financial Statements Resulting From Known Misstatements Versus Possible Misstatements. Adverse opinions are appropriate when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements within special purpose financial statements, individually or in the aggregate, are both material and pervasive to an opinion unit or the financial statements as a whole. Adverse opinions are not appropriate when modifying the auditor's report for the inability to obtain sufficient appropriate audit evidence. In such cases, a qualified opinion or disclaimer of opinion may be appropriate.

When expressing an adverse opinion due to a material misstatement, in accordance with paragraph .27 of AU-C section 705, the auditor should amend the description of the auditor's responsibility and to state that the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's adverse opinion.

Illustration 7 in appendix C of this practice aid provides an example auditor's report on special purpose financial statements that contains an adverse audit opinion on an opinion unit due to a misstatement that is considered material and pervasive to that opinion unit.

Adverse Opinion or Disclaimer of Opinion on Financial Statements as a Whole for Certain Egregious Situations

For entities with more than one opinion unit, certain egregious situations could result in the auditor expressing an adverse opinion or a disclaimer of opinion on the special purpose financial statements as a whole. For example, the auditor should express

- ▶ an adverse opinion on the special purpose financial statements as a whole intended to be a complete set of financial statements when the required government-wide or fund financial statements are not presented, and the substance of the presentations is not otherwise met.
- ▶ an adverse opinion on the special purpose financial statements as a whole intended to be a complete set of financial statements when adverse opinions are appropriate for both the governmental activities' and business-type activities' opinion units (or for only the governmental activities' opinion unit if that is the only applicable presentation for the primary government in the reporting entity's government-wide financial statements).
- ▶ a disclaimer of opinion, if the auditor has elected not to withdraw from the engagement, on the special purpose financial statements as a whole intended to be a complete set of financial statements when disclaimers of opinion are appropriate for both the governmental activities' and business-type activities' opinion units (or for only the governmental activities' opinion unit if that is the only applicable presentation for the primary government in the reporting entity's government-wide financial statements).

Other situations occur in which adverse opinions or disclaimers of opinion on one or more opinion units are appropriate. In those situations, the auditor should use professional judgment to evaluate the facts and circumstances of those opinion modifications to determine whether the special purpose financial statement presentation is of such a nature that the financial statements, as a whole, are not presented fairly in accordance with the special purpose framework, or if it is appropriate to disclaim an opinion on the financial statements as a whole.

Illustration 8 in appendix C of this practice aid provides an example auditor's report that expresses an adverse opinion on special purpose financial statements as a whole when a government presents only fund financial statements and does not present government-wide financial statements in a special purpose framework presentation intended to be a complete set of financial statements.

Omission of Component Units

Governments sometimes present special purpose financial statements that omit the financial information of one or more (but not all) component units. Similar to GAAP financial statements, the auditor's response to this omission depends on the materiality of the omission in relation to the relevant opinion unit(s). When an omitted component unit should have been presented as a blended component unit, the auditor considers (a) whether the omitted component unit would have been presented as a major fund or, instead, as part of the opinion unit that includes the aggregate remaining fund information and (b) quantitative and qualitative factors in evaluating the materiality of the omission in the context of the relevant opinion unit. When the omitted component unit is fiduciary in nature, the auditor considers the omission within the context of the opinion unit that includes the aggregate remaining fund information. When the omitted component unit should have been discretely presented, the auditor considers the omission within the context of the opinion unit that includes the aggregate discretely presented component units.

However, when the auditor is asked to render an opinion on special purpose basic financial statements of the primary government, excluding all component units, under certain circumstances, the auditor could issue unmodified audit opinions on the primary government's special purpose financial statements. In these circumstances, the auditor should consult and follow the guidance in chapter 15 of the AICPA Audit and Accounting Guide *State and Local Governments* applicable to such reporting.

Use of Multiple Frameworks Within a Reporting Entity's Basic Financial Statements

Governments sometimes present special purpose basic financial statements for the reporting entity that include financial information for a fund, a department, an agency, or a component unit that is presented in accordance with a basis of accounting other than the special purpose framework used for the rest of the reporting entity. For example, management of a municipal government might present financial statements for a discretely presented business-type activity component unit (such as a utility authority) within the reporting entity's basic financial statements on a GAAP basis, but the remainder of the reporting entity (that is, the primary government) is presented in accordance with a cash basis or modified cash basis of accounting. Questions often arise about the appropriate auditor reporting on these financial statements that use more than one financial reporting framework for the financial information reported within the reporting entity's basic financial statements.

Unless required to do so by an applicable regulatory basis framework, it is discouraged for a government to use multiple financial reporting frameworks (such as mixing special purpose framework statements with GAAP framework statements) within a single reporting entity's basic financial statements and for the auditor to issue unmodified opinions for all the opinion units within such presentation about these different frameworks. In such cases when mixing of frameworks is not required by an applicable regulatory basis framework, management and the auditor are encouraged to consider the following options if the use of different frameworks is elected:

1. Preparing, auditing, and reporting on separate basic financial statements for the reporting units that follow the same financial reporting framework (for example, one set of financial statements and accompanying auditor's report on the special purpose financial statements of the primary government and other separate sets of financial statements and accompanying auditor's reports on the GAAP financial statements of discretely presented component units)
2. Including the special purpose and GAAP financial statements within the same presentation, with the auditor expressing a qualified or an adverse opinion on the opinion unit's basic financial statements presented that do not follow the financial reporting framework used for the majority of the reporting entity's presentation (for example, expressing a qualified or an adverse opinion on the discretely presented component unit opinion unit that includes a GAAP-basis presentation for a discretely presented component unit when the remainder of the financial reporting entity is presented in accordance with a special purpose framework)

If option 1 is selected, it would be considered acceptable to include the separate sets of financial statements and auditor's reports within the same reporting package, provided they are clearly presented as separate presentations with separate auditor reports. In other words, the audit would be considered separate financial statement audits, each with their own statements, disclosures, and auditor reports.

See illustration 10 in appendix C of this practice aid for an example auditor's report that implements option 2 and includes an adverse opinion on an opinion unit that presents financial statements in accordance with GAAP along with unmodified opinions on all other opinion units that apply a special purpose framework.



Practice Pointer: Reconciling Special Purpose Basic Financial Statements and Supplementary Information Using Different Frameworks.

As previously noted, it is discouraged to mix financial reporting frameworks within the basic financial statements of a financial reporting entity unless it is done to meet the requirements of a regulatory basis framework. However, it is considered acceptable to present SI that accompanies the special purpose basic financial statements on a financial reporting framework other than that used in the special purpose basic financial statements, provided the preparer can reconcile the SI to the special purpose basic financial statements or the underlying accounting and other records used in preparing the special purpose basic financial statements. For example, it would be considered acceptable to present an SI Schedule of Expenditures of Federal Awards (SEFA) pursuant to single audit requirements on a GAAP-basis framework when the basic financial statements are presented in accordance with a special purpose framework, provided the preparer can reconcile the SEFA to the underlying accounting and other records used in preparing the special purpose basic financial statements. The presentation of a GAAP basis SEFA to accompany basic financial statements prepared in accordance with a special purpose framework does not change the fact that the auditee cannot be considered a low-risk auditee for purposes of major program determination in a single audit, as discussed in chapter 1, because of the use of a non-required special purpose framework.

Emphasis-of-Matter and Other-Matter Paragraphs in Auditor's Reports on Special Purpose Financial Statements

AU-C section 706 discusses the circumstances when it is required or appropriate to include emphasis-of-matter or other-matter paragraphs in the auditor's report. Emphasis-of-matter and other-matter paragraphs are intended to draw report users' attention to matters either presented or disclosed in the financial statements or other matters not presented or disclosed that are fundamental or relevant to the users' understanding of the financial statements.

The requirements of AU-C section 800 expand upon the requirements of AU-C section 706 by adding the following additional reporting requirements relevant to emphasis-of-matter and other-matter paragraphs for auditor's reports on special purpose financial statements:

- When the special purpose financial statements are prepared in accordance with a cash basis, modified cash basis, or regulatory basis of accounting (when the regulatory basis statements and auditor's report are not intended for general use), in accordance with paragraph .19 of AU-C section 800, the auditor's reports should include an emphasis-of-matter paragraph under an appropriate heading and immediately after the opinion paragraph that indicates the financial statements are prepared in accordance with the applicable special purpose framework and states that the framework is a basis other than GAAP.

Example 4-13: Emphasis-of-Matter Paragraph—Use of a Special Purpose Framework

Basis of Accounting

We draw attention to Note X of the financial statements that describes the basis of accounting. The financial statements are prepared in accordance with the modified cash basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our opinions are not modified with respect to this matter.

- If the financial statements are prepared in accordance with the requirements or financial reporting provisions of a governmental regulatory agency to whose jurisdiction the entity is subject (regulatory basis), and the financial statements and

auditor's report are not intended for general use, in accordance with paragraph .20 of AU-C section 800, the auditor's report should also include an other-matter paragraph under an appropriate heading and immediately after the opinion paragraph and any emphasis-of-matter paragraph that restricts the use of the auditor's report solely to those within the entity and the regulatory agencies to whose jurisdiction the entity is subject. This restricted-use language is appropriate even when the auditor's report cites that the audit was performed in accordance with the Yellow Book and is appropriate for use rather than the alert language that describes the purpose communication and that it is not suitable for any purpose as discussed in AU-C section 905, *Alert That Restricts the Use of the Auditor's Written Communication* (AICPA, *Professional Standards*).

Example 4-14: Other-Matter Paragraph—Regulatory Basis Restricted Use

Restriction on Use

This report is intended solely for the information and use of the governing body and management of City of Example, Any State, and for the State Division for Local Governments and is not intended to be and should not be used by anyone other than these specified parties.

See illustration 3 in appendix C of this practice aid for an example auditor's report on regulatory basis financial statements that are not intended for general use.

Reporting on Regulatory Basis Financial Statements Intended for General Use

When special purpose financial statements are prepared in accordance with a regulatory basis of accounting, and the financial statements and auditor's report are intended for general use, in accordance with paragraph .21 of AU-C section 800, the auditor's reports do not include the emphasis-of-matter paragraph or other-matter paragraph illustrated in the preceding examples 4-13 and 4-14. Instead, the auditor should express a qualified or adverse opinion indicating that the special purpose financial statements are not presented fairly, in accordance with GAAP, and then, in a separate paragraph, under an appropriate heading, the auditor should express an opinion or opinions about whether the financial statements are prepared in accordance with the regulatory basis of accounting.

Example 4-15: Opinion-Related Paragraphs—Regulatory Basis Statements Intended for General Use

Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles

As described in Note X to the financial statements, the financial statements are prepared by ABC Government Authority on the basis of the financial reporting provisions of Section Y of Regulation Z of Any State Statutes, which is a basis of accounting other than accounting principles generally accepted in the United States of America, to meet the requirements of [*identify to the applicable entity*].

The effects on the financial statements of the variances between the regulatory basis of accounting described in Note X and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.

Adverse Opinion on U.S. Generally Accepted Accounting Principles

In our opinion, because of the significance of the matter discussed in the “Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles” paragraph, the financial statements referred to above do not present fairly, in accordance with accounting principles generally accepted in the United States of America, the financial position of ABC Government Authority as of December 31, 20XX, or the changes in net position and cash flows thereof for the year then ended.

Unmodified Opinion on Regulatory Basis of Accounting

In our opinion, the financial statements referred to above present fairly, in all material respects, the regulatory basis net position of ABC Government Authority as of December 31, 20XX, and the regulatory basis changes in net position and regulatory basis cash flows thereof for the year then ended in accordance with the financial reporting provisions of Section Y of Regulation Z of Any State Statutes described in Note X.

See illustration 4 in appendix C of this practice aid for an example auditor’s report on regulatory basis financial statements intended for general use.

Reporting on SI and OI Accompanying Special Purpose Basic Financial Statements

A government may present its special purpose basic financial statements in a document that includes various financial and nonfinancial information presented outside the basic financial statements. As discussed in chapter 3 of this practice aid, information that GASB requires to accompany a government's basic financial statements is not applicable to special purpose financial statements. However, special purpose basic financial statements may voluntarily be accompanied by this type of information, such as management's discussion and analysis and certain budgetary comparisons, pension and other postemployment benefit plan schedules, risk financing information, and capital asset condition assessment information, to the extent applicable. Governments may also voluntarily include additional OI, such as introductory information (including a letter of transmittal), combining and individual non-major fund financial statements or schedules, and statistical tables to further supplement and expand upon the special purpose basic financial statements.

The auditor's responsibilities for reporting on SI or OI accompanying basic special purpose financial statements will depend on the nature of the information and the terms of the auditor's engagement. Generally, the auditor's responsibilities for OI are addressed in AU-C section 720, *Other Information in Documents Containing Audited Financial Statements* (AICPA, *Professional Standards*), that indicates the objective of the auditor is to respond appropriately when the auditor becomes aware that documents containing audited financial statements and the auditor's report thereon include OI that could undermine the credibility of those financial statements and the auditor's report.

However, if the auditor is engaged to provide an opinion on whether such OI is fairly stated, in all material respects, in relation to the special purpose basic financial statements, it is appropriate for the auditor to follow the guidance in AU-C section 725, *Supplementary Information in Relation to the Financial Statements as a Whole* (AICPA, *Professional Standards*). When engaged to report on SI or OI in relation to the financial statements as a whole, the auditor's objective is to evaluate the presentation and report on whether the SI is fairly stated, in all material respects, in relation to the financial statements as a whole. For the auditor to be able to report on whether SI is fairly stated in relation to the financial statements as a whole, a number of conditions are applicable, including conditions that the SI is derived from, and directly relates to, the underlying accounting records and other records used to prepare the financial statements and the information to the same period as the financial statements. Therefore, in a typical complete set of financial statements for a state or local government, voluntary combining and individual non-major fund financial statements could be considered SI reported on in relation to the financial statements as a whole, pursuant to AU-C section 725, but statistical tables with information from multiple fiscal years could be considered OI, pursuant to AU-C section 720.

Example 4-16: Report Paragraph—Supplementary and Other Information

Other Matters

Supplementary and Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements as a whole that collectively comprise the City of Example's basic financial statements. The budgetary comparison information, combining and individual non-major fund financial statements, and the other information, such as management's discussion and analysis, introductory information and statistical schedules are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The budgetary comparison information and combining and individual non-major fund financial statements is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the budgetary comparison information and combining and individual non-major fund financial statements are fairly stated in all material respects in relation to the basic financial statements as a whole on the basis of accounting described in Note X.

Management's discussion and analysis, introductory information, and statistical schedules have not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Chapters 4 and 15 of the AICPA Audit and Accounting Guide *State and Local Governments* should be consulted for additional guidance on the auditor's reporting choices regarding SI and OI accompanying basic financial statements.

See illustration 2 in appendix C of this practice aid for an example auditor's report that includes an other matter paragraph on other information accompanying the special purpose basic financial statements.

Appendix A

Answers to Frequently Asked Questions

These questions and answers have not been acted upon by any technical committees of the AICPA and do not represent an official position of the AICPA.

1. What constitutes a pure cash basis of accounting?

A pure cash basis of accounting involves the measurement of cash and cash equivalents and the changes therein resulting from cash receipt and disbursement transactions and events. Essentially, the only assets reported on this pure cash basis presentation in a statement of net position (or balance sheet) would be cash and cash equivalents. The statement of activities (or change statement) would be limited to reporting cash receipts and disbursements (in other words, the sources and uses of cash and cash equivalents).

2. What constitutes a modified cash basis of accounting?

AU-C section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks* (AICPA, *Professional Standards*), does not directly define modified cash basis of accounting but indicates that the cash basis of accounting includes modifications of the cash basis having substantial support. For modifications to be considered having substantial support, the modifications to the pure cash basis of accounting should

- ▶ be made to cash receipt or disbursement transactions or events.
- ▶ have substantial support in GAAP or other accounting literature.
- ▶ be logical.

3. What constitutes a regulatory basis of accounting?

AU-C section 800 defines *regulatory basis of accounting* as a basis of accounting the entity uses to comply with the requirements or financial reporting provisions of a regulatory agency to whose jurisdiction the entity is subject. For example, a state law or regulation may require a columnar financial presentation by fund of revenues and expenditures and changes in fund balance on a basis of accounting that recognizes revenues when they result from cash transactions

and that recognizes expenditures when the disbursement, encumbrance, or accounts payable is incurred.

4. Should capital assets and long-term debt be reported in special purpose financial statements of state and local governments?

Not necessarily. In a pure cash basis of accounting, such accounting treatment would not be applicable because the pure cash basis presentation is limited to reporting cash and cash equivalents and changes therein resulting from cash receipt and disbursement transactions and events. In a modified cash basis of accounting, capital assets and long-term debt arising from cash transactions or events would be reported if management elects to modify the cash basis of accounting for such GAAP-similar treatment of these transactions or events. In a regulatory basis of accounting, the specific regulations generally dictate the treatment and disclosure requirements for capital assets and long-term debt. (See the following related question on note disclosure requirements.)

5. What note disclosures are appropriate for financial statements prepared in accordance with a special purpose framework?

Special purpose financial statements intended to be a complete set of financial statements include in the accompanying notes a summary of significant accounting policies that discusses the special purpose framework applied and how the special purpose framework differs from GAAP. In addition, when special purpose financial statements contain items that are the same as, or similar to, those in financial statements prepared in conformity with GAAP, similar informative disclosures are appropriate to the extent applicable to the special purpose framework. Special purpose financial statements intended to be a complete set of financial statements may either provide the relevant disclosure that would be applicable for those items in a GAAP presentation or provide information that communicates the substance of that disclosure. Additionally, appropriate disclosures for special purpose financial statements include any other disclosures related to matters not specifically identified on the face of the financial statements or other disclosures considered necessary to achieve fair presentation.

6. How should an entity report the proceeds of capital debt issuances within the government-wide statement of activities in accordance with a pure cash basis framework?

On a pure cash basis (or a modified cash basis where cash basis is not modified for the reporting of debt obligations arising from cash transactions), the proceeds of capital debt represent cash inflows that should be reported as receipts or cash basis

revenues, rather than as a liability, in the government-wide statement of activities. These debt proceeds could be reported (1) as a program receipt (revenue) on a program line item reported under a column labeled “Capital Grants, Contributions and Debt Proceeds,” or (2) as a general receipt (revenue) labeled “Proceeds of Capital Debt.”

7. Do the GASB financial statement presentation requirements for state and local governments apply to financial statements of those entities prepared in accordance with a special purpose framework?

Generally, yes. Appendix B, “Fair Presentation and Adequate Disclosures,” of AU-C section 800 and chapter 16, “Financial Statements Prepared in Accordance With a Special Purpose Framework,” of the AICPA Audit and Accounting Guide *State and Local Governments* indicate that if GAAP set forth requirements that apply to the presentation of financial statements, then special purpose financial statements intended to be a complete set of financial statements may either comply with those requirements or provide information that communicates the substance of those requirements.

As a result, GASB financial reporting requirements for the basic financial statements, including the presentation of the government-wide financial statements and fund financial statements, including applicable notes, are applicable to a complete set of cash basis and modified cash basis financial statements. Appropriate presentation requirements for regulatory basis financial statements are determined by the specific regulatory authorities to whose jurisdiction the entity is subject.

8. How should special purpose financial statements be titled?

Terms such as *balance sheet*, *statement of net position*, *statement of activities*, and *statement of cash flows*, or similar unmodified titles are generally understood to be applicable only to financial statements that are intended to present net position, changes in net position, or cash flows in accordance with GAAP. However, such titles would be appropriate if modified to sufficiently inform the reader that the financial statements are prepared in accordance with a special purpose framework, not in accordance with GAAP.

For example, “Statement of Net Position—Modified Cash Basis” and “Statement of Activities—Modified Cash Basis” would be acceptable titles for the government-wide statements within the basic special purpose financial statements.

9. Can an auditor issue unmodified opinions on special purpose financial statements?

Yes. Unmodified audit opinions are appropriate when the special purpose financial statements of an opinion unit present fairly the financial position, changes in financial position, and cash flows, when applicable, of that opinion unit in accordance with the accounting and financial reporting requirements of the applicable special purpose framework applied. In other words, the special purpose financial statements have no known misstatements that materially affect the fair presentation of the statements in accordance with the special purpose framework assertions. An unmodified audit opinion on special purpose financial statements should meet the specific reporting requirements addressed in AU-C section 700, *Forming an Opinion and Reporting on Financial Statements* (AICPA, *Professional Standards*), and AU-C section 800.

However, if the special purpose financial statements are regulatory basis financial statements that are intended for general use, not merely for filing with a regulatory agency, unmodified audit opinions on the regulatory basis framework may be issued but only after a qualified or an adverse opinion is expressed on the presentation in accordance with GAAP. (See illustration 4 in appendix C, “Example Auditor Reports on Other Comprehensive Basis of Accounting Financial Statements of State and Local Governments,” of this practice aid.)

10. Can an auditor issue a qualified opinion, adverse opinion, or disclaimer of opinion on special purpose financial statements?

Yes. Similar to GAAP financial statements, scope limitations that result in the inability to obtain sufficient appropriate audit evidence and misstatements resulting from departures from the assertions applicable to the special purpose framework applied, if material, can result in qualified opinions, adverse opinions, or disclaimers of opinion on special purpose financial statements. Limitations on audit scope resulting in the inability to obtain sufficient appropriate audit evidence can result in qualified opinions or disclaimers of opinion, depending on their significance to the affected opinion units. Qualified or adverse opinions are appropriate for material misstatements resulting from departures from the assertions applicable to the special purpose framework applied.

11. Should an auditor’s report on special purpose financial statements always contain a restricted-use paragraph that indicates the report is intended solely for certain specified parties?

No. Although a restricted-use paragraph is appropriate for auditor reports on certain regulatory basis of accounting presentations, it is not applicable to cash basis

or modified cash basis presentations. It is also not required for regulatory basis financial statements that are intended for general use purposes (i.e., in this case an adverse GAAP opinion is included instead). However, if the financial statements are prepared in accordance with a regulatory basis of accounting and are not intended for general use, a separate other-matter paragraph should be included after the opinion paragraph and any emphasis-of-matter paragraph stating that the report is intended solely for the information and use of those within the entity and the regulatory agencies to whose jurisdiction the entity is subject and is not intended to be and should not be used by anyone other than these specified parties. (See illustration 3 in appendix C of this practice aid.) This restricted-use language is appropriate even when the auditor's report cites that the audit was performed in accordance with *Government Auditing Standards* (the Yellow Book) of the Comptroller General of the United States. While AU-C section 905, *Alert That Restricts the Use of the Auditor's Written Communication* (AICPA, *Professional Standards*), provides that certain reports issued in accordance with *Government Auditing Standards* include a purpose alert, versus a restricted use alert, auditor reports on general use regulatory basis financial statements do not meet the criteria for the alternative purpose alert language.

12. Does the Yellow Book preclude the preparation of special purpose financial statements or the rendering of audit opinions on such statements that cite the Yellow Book?

No. The Yellow Book does not prohibit the preparation of special purpose financial statements by state and local governments nor does it prohibit the rendering of audit opinions on such statements in auditor reports that cite the Yellow Book. The Yellow Book provides audit guidance for audits of financial statements subject to its standards and does not provide authoritative accounting or financial reporting guidance. Therefore, special purpose financial statements can be audited under the Yellow Book.

13. Does the Office of Management and Budget's (OMB) Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards (Uniform Guidance), preclude the preparation of special purpose financial statements in meeting its single audit requirements?

Similar to the answer to question 12 with regard to meeting Yellow Book standards, the OMB Uniform Guidance does not preclude the preparation of special purpose financial statements or the rendering of audit opinions on such statements in conjunction with a single audit conducted in accordance with its audit requirements. However, an entity's use of a special purpose framework in the preparation of its financial statements, except for a required regulatory basis, would disqualify

the entity from low risk auditee consideration for purposes of major program determination in a single audit.

14. Do the materiality and opinion unit concepts applicable to auditor reporting on GAAP financial statements contained within the AICPA Audit and Accounting Guide *State and Local Governments* apply to auditor reports on special purpose financial statements?

The materiality and opinion unit guidance in the AICPA Audit and Accounting Guide *State and Local Governments* applicable to GAAP financial statements may also be applicable to special purpose financial statements presented in accordance with the cash basis or modified cash basis of accounting because such special purpose statements meet the presentation requirements, in substance, applicable to GAAP financial statements. Therefore the opinion units concept can be applied to such special purpose statements in the same manner as GAAP financial statements. However, such materiality guidance may or may not apply to regulatory basis financial statements because the regulatory authority may prescribe financial statement presentation requirements that differ from the GAAP financial reporting model; therefore, the opinion units concept may not apply. The materiality level and opinion units for regulatory basis financial statements are generally determined by the financial reporting requirements of the regulatory authority's framework.

15. Can an auditor express unmodified opinions on all opinion units in a reporting entity's financial statements that mix financial reporting frameworks, such as GAAP and special purpose?

Unless required to do so by an applicable regulatory basis framework, it is discouraged for a government to use multiple financial reporting frameworks (such as mixing special purpose statements with GAAP statements) within a single reporting entity's basic financial statements and for the auditor to issue unmodified opinions for all the opinion units within such presentation. In such cases when mixing of frameworks is not required by an applicable regulatory basis framework, management and the auditor would generally have the following options to consider if the use of different frameworks is elected:

- Preparing, auditing, and reporting on separate basic financial statements for the reporting units that follow the same financial reporting framework (for example, one set of financial statements and accompanying auditor's report on the special purpose financial statements of the primary government and other separate sets of financial statements and accompanying

auditor's reports on the GAAP financial statements of discretely presented component units)

- ▶ Including the special purpose and GAAP financial statements within the same presentation, with the auditor expressing a qualified or an adverse opinion on the opinion unit's basic financial statements presented that do not follow the financial reporting framework used for the majority of the reporting entity's presentation

Appendix B

Illustrative Special Purpose Financial Statements of State and Local Governments

This appendix contains illustrative examples of special purpose financial statements for different types of state and local governmental entities. These financial statements illustrate the major points of discussion from chapter 1, “Background and Overview”; chapter 2, “Recognition and Measurement Issues in Special Purpose Financial Statements of State and Local Governments”; and chapter 3, “Presentation and Disclosure Issues in Special Purpose Financial Statements of State and Local Governments,” of this practice aid. The author’s key points applicable to the example financial statements precede each group of examples.

Example special purpose financial statements include the following:

<i>Illustration</i>	<i>Type of Government</i>	<i>Basis of Accounting</i>
A	City Government	Modified Cash Basis
B	School District	Cash Basis
C	County Government	Regulatory Basis
D	Single Program Government (Governmental Activity)	Modified Cash Basis
E	Single Program Government (Business-Type Activity)	Modified Cash Basis

Illustration A — Illustrated Modified Cash Basis Financial Statements of a City Government

Illustrated Entity—City Government

These illustrative financial statements provide a complete example of the annual financial statements of a hypothetical city government, including the basic financial statements and notes to the basic financial statements and **voluntary** supplementary information (SI). They are illustrative only and should not be considered authoritative. **This illustration assumes management has voluntarily elected to include management’s discussion and analysis and SI to accompany the basic financial statements because such information is not required to accompany special purpose basic financial statements.**

These financial statements have been prepared in accordance with a modified cash basis of accounting that recognizes certain assets, deferred outflows of resources, liabilities, deferred inflows of resources, revenues, and expenditures or expenses when they arise from cash transactions or events, including the reporting of depreciation expense on capital assets in the government-wide financial statements for all activities and in the fund financial statements for proprietary funds. Therefore, the financial statements do not include receivables or payables resulting from accruals or any other financial statement elements unless they result from cash transactions or events.

The financial statement components illustrated in this example include the following:

Management's Discussion and Analysis A—MD&A

Basic Financial Statements:

Statement of Net Position—Modified Cash Basis A-1

Statement of Activities—Modified Cash Basis A-2

Balance Sheet—Modified Cash Basis—Governmental Funds A-3

Statement of Revenues, Expenditures, and Changes in Fund Balances—
Modified Cash Basis—Governmental Funds A-4

Statement of Net Position—Modified Cash Basis—Proprietary Fund A-5

Statement of Revenues, Expenses, and Changes in Fund Net Position—
Modified Cash Basis—Proprietary Fund A-6

Statement of Cash Flows—Modified Cash Basis—Proprietary Fund A-7

Notes to Basic Financial Statements A-7—Notes

Supplementary Information:

Budgetary Comparison Schedule—Modified Cash Basis—General Fund A-8

Notes to Budgetary Comparison Schedule A-8—Notes

Combining Balance Sheet—Modified Cash Basis—Non-major Governmental Funds A-9

Combining Statement of Revenues, Expenditures, and Changes in Fund Balance— Modified Cash Basis—Non-major Governmental Funds A-10

Budgetary Comparison Schedule—Modified Cash Basis—Budgeted Non-major Governmental Funds A-11

Illustration A—MD&A

(VOLUNTARY SUPPLEMENTARY INFORMATION)
CITY OF EXAMPLE, ANY STATE
MANAGEMENT'S DISCUSSION AND ANALYSIS
JUNE 30, 20X3

Our discussion and analysis of the City of Example's financial performance provides an overview of the City's financial activities for the fiscal year ended June 30, 20X3, within the limitations of the City's modified cash basis of accounting. Please read it in conjunction with the City's financial statements that begin on page XX.

FINANCIAL HIGHLIGHTS

The City's total revenues exceeded total expenses, on the modified cash basis of accounting, by \$179,436 for the year, resulting in an increase in total net position of 6 percent over the previous year. Most of the increase is attributed to the City's operation of its governmental activities.

The City was awarded a \$75,000 Water Resources Board Emergency grant to help fund a raw water supply project.

The City's General Fund ended the year with an unassigned fund balance of \$211,047 that represents 22 percent of recurring revenue of the Fund.

The PWA Enterprise Fund reported a \$60,636 increase in net position on a modified cash basis and ended the year with \$447,974 in the unrestricted component of net position.

USING THIS ANNUAL REPORT

This annual report is presented in a format consistent with the presentation requirements of the Governmental Accounting Standards Board, as applicable to the City's modified cash basis of accounting.

Report Components

This annual report consists of the following four parts:

1. *Government-wide financial statements.* The Statement of Net Position and the Statement of Activities (on pages XX–XX) provide information about the activities of the City government-wide (or as a whole) and present a longer-term view of the City's finances.
2. *Fund financial statements.* Fund financial statements (starting on page XX) focus on the individual parts of the City government. Fund financial statements also report the City's operations in more detail than the government-wide statements by providing information about the City's most significant (major) funds. For governmental activities, these statements tell how these services were financed in the short term, as well as what remains for future spending. For proprietary activities, these statements offer short-term and long-term financial information about the activities the City operates like businesses, such as the water, sewer, and sanitation services.
3. *Notes to the financial statements.* The notes to the financial statements are an integral part of the government-wide and fund financial statements and provide expanded explanation and detail regarding the information reported in the statements.
4. *Supplementary information.* The annual report includes optional financial information, such management's discussion and analysis, budgetary comparison schedules, and combining statements for non-major funds (that are added together and shown in the fund financial statements in a single column). This other supplemental financial information is provided to address certain specific needs of various users of the City's annual report.

Basis of Accounting

The City has elected to present its financial statements on a modified cash basis of accounting. This modified cash basis of accounting is a basis of accounting other than accounting principles generally accepted in the United States of America. Basis of accounting is a reference to when financial events are recorded, such as the timing for recognizing revenues, expenses, and their related assets and liabilities. In accordance with the City's modified cash basis of accounting, revenues and expenses and certain related assets, liabilities, and deferred inflows and outflows of resources are recorded when they result from cash transactions or events, except for certain modifications, such as the recording of depreciation expense on capital assets in the government-wide financial statements for all activities and in the fund financial statements for proprietary fund activities.

As a result of the use of this modified cash basis of accounting, certain assets and their related revenues (such as accounts receivable and revenue for billed or provided services not yet collected) and certain liabilities and their related expenses (such as accounts payable and expenses for goods or services received but not yet paid and accrued expenses and liabilities) are not recorded in these financial statements. Therefore, when reviewing the financial information and discussion within this annual report, the reader should keep in mind the limitations resulting from the use of the modified cash basis of accounting.

Reporting the City as a Whole

The City's Reporting Entity Presentation

This annual report includes all activities for which the City of Example City Council is fiscally responsible. These activities, defined as the City's reporting entity, are operated within separate legal entities that make up the primary government and another separate legal entity that is included as a component unit.

The primary government includes the following separate legal entities:

- ▶ The City of Example
- ▶ The City of Example Public Works Authority

The component unit column presentation includes the following legal entity:

- ▶ The City of Example Airport Authority

The Government-Wide Statement of Net Position and the Statement of Activities

Our financial analysis of the City as a whole begins on page XX. The government-wide financial statements are presented on pages XX and XX. One of the most important questions asked about the City's finances is, "Is the City as a whole better off or worse off as a result of the year's activities?" The Statement of Net Position and Statement of Activities report information about the City as a whole and its activities in a way that helps answer this question. These statements include all the City's assets, liabilities, and deferred inflows and outflows resulting from the use of the modified cash basis of accounting, as further defined in the notes to the financial statements.

These two statements report the City's net position and changes therein. Keeping in mind the limitations of the modified cash basis of accounting, you can think of the City's net position—the difference among assets, deferred outflows of resources, liabilities, and deferred inflows—as one way to measure the City's financial health or financial position. Over time, increases or decreases in the City's net position are one indicator of whether its financial health is improving or deteriorating. You will need to consider other nonfinancial factors, however, such as changes in the City's sales tax base and the condition of the City's roads, to assess the overall health of the City.

In the Statement of Net Position and Statement of Activities, we divide the City into three kinds of activities:

1. *Governmental activities.* Most of the City's basic services are reported here, including the police, fire, general administration, streets, parks, cemetery, and senior citizens. Sales taxes, franchise fees, fines, and state and federal grants finance most of these activities.
2. *Business-type activities.* The City, through the Public Works Authority, charges a fee to customers to help it cover all or most of the cost of certain services it provides. The City's water, sewer, and sanitation systems are reported here.
3. *Component unit activities.* Although the Airport Authority is a separate legal entity, the City includes its activities because the City is financially accountable for the Authority.

Reporting the City's Most Significant Funds

The Fund Financial Statements

Our analysis of the City's major funds begins on page XX. The fund financial statements begin on page XX and provide detailed information about the most significant funds, not the City as a whole. Some funds are required to be established by State law and bond covenants. However, the City Council establishes certain other funds to help it control and manage money for particular purposes or to show that it is meeting legal responsibilities for using certain taxes, grants, and other money. The City's two kinds of funds—governmental and proprietary—use different accounting approaches:

► *Governmental funds.* Most of the City's basic services are reported in governmental funds that focus on how money flows into and out of those funds and the balances left at year-end that are available for spending. These funds report the acquisition of capital assets and payments for debt principal as expenditures, not changes to

asset and debt balances. The governmental fund statements provide a detailed short-term view of the City's general government operations and the basic services it provides. Governmental fund information helps you determine (through a review of changes to fund balance) whether there are more or fewer financial resources that can be spent in the near future to finance the City's programs. We describe the relationship (or differences) between governmental activities (reported in the Statement of Net Position and Statement of Activities) and governmental funds in a reconciliation at the bottom of the fund financial statements. The City considers the General Fund and Capital Improvement Fund to be its significant, or major, governmental funds. All other governmental funds are aggregated in a single column titled "Non-major Funds."

- *Proprietary funds.* When the City charges customers for the services it provides, these services are generally reported in proprietary funds. Proprietary funds are reported in the same way all activities are reported in the Statement of Net Position and Statement of Activities. For example, proprietary fund capital assets are capitalized and depreciated, and principal payments on long-term debt are recorded as a reduction to the liability. In fact, the City's proprietary (enterprise) fund financial statements are essentially the same as the business-type activities we report in the government-wide financial statements, but the fund statements provide more detail and additional information, such as cash flows. The City only has one enterprise fund: the Public Works Authority Utilities Fund.

The City currently has no fiduciary funds. Fiduciary funds are often used to account for assets that are held in a trustee or fiduciary capacity, such as pension plan assets, assets held per trust agreements, and similar arrangements.

A FINANCIAL ANALYSIS OF THE CITY AS A WHOLE

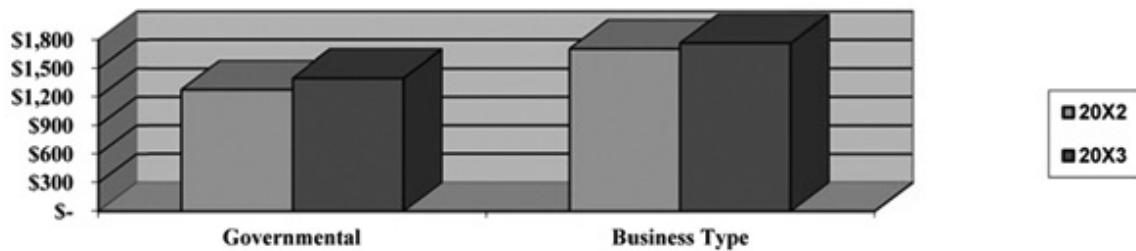
Net Position—Modified Cash Basis

The City's combined net assets resulting from modified cash basis transactions or events increased from approximately \$3.0 million to \$3.2 million between fiscal years 20X2 and 20X3. Looking at the net position and net expenses of governmental and business-type activities separately, governmental activities had a larger increase than business-type activities.

	<i>Governmental Activities</i>			<i>Business-Type Activities</i>			<i>Total Percentage Change</i>
	<i>20X2</i>	<i>20X3</i>	<i>20X2</i>	<i>20X3</i>	<i>20X2</i>	<i>20X3</i>	
Current and other assets	\$ 524,267	\$ 608,256	\$ 429,343	\$ 568,951	\$ 953,610	\$ 1,177,207	23.4 %
Capital assets	762,134	1,005,084	2,247,741	2,161,133	3,009,875	3,166,217	5.2 %
Total assets	1,286,401	1,613,340	2,677,084	2,730,084	3,963,485	4,343,424	9.6 %
Long-term debt outstanding	—	211,049	972,313	964,677	972,313	1,175,726	20.9 %
Other liabilities	4,937	2,027	—	—	4,937	2,027	(58.9)%
Total liabilities	4,937	213,076	972,313	964,677	977,250	1,177,753	20.5 %
Net position							
Net investment in capital assets	762,134	794,035	1,326,767	1,249,991	2,088,901	2,044,026	(2.1)%
Restricted	87,413	50,975	73,111	67,442	160,524	118,417	(26.2)%
Unrestricted	431,917	555,254	304,893	447,974	736,810	1,003,228	36.2 %
Total net position	\$1,281,464	\$1,400,264	\$1,704,771	\$1,765,407	\$2,986,235	\$3,165,671	6.0 %

Net position of the City's governmental activities increased 9.3 percent to \$1.4 million. However, \$845,010 of this amount either is restricted regarding the purposes it can be used for or is invested in capital assets (buildings, roads, bridges, and so on). Consequently, unrestricted amounts showed only \$555,254 at the end of this year.

Net Position—Modified Cash Basis
(in 000s)



Changes from 20X2 to 20X3 reflect a favorable increase of 6.0 percent in total activities and an increase of 9.3 percent for governmental activities and 3.6 percent for business-type activities.

Changes in Net Positions—Modified Cash Basis

For the year ended June 30, 20X3, net position of the primary government (resulting from modified cash basis transactions or events) changed as follows:

	<i>Governmental Activities</i>		<i>Business-Type Activities</i>		<i>Total</i>	<i>Total</i>	<i>Percentage Change</i>
	<i>20X2</i>	<i>20X3</i>	<i>20X2</i>	<i>20X3</i>			
Revenues							
Program revenues	\$ 61,624	\$ 62,647	\$723,299	\$782,090	\$ 784,923	\$ 844,737	7.6 %
Charges for services					145,728	127,622	(12.4) %
Operating grants and contributions	138,777	127,622	6,951	—			
Capital grants and contributions	58,615	23,434	100,000	34,234	158,615	57,668	(63.6) %
General revenues	644,069	773,308	—	—	644,069	773,308	20.1 %
Sales tax							
Franchise and public service taxes	69,268	66,619	—	—	69,268	66,619	(3.8) %
E-911 taxes	26,281	27,194	—	—	26,281	27,194	3.5 %
Other taxes	2,176	—	—	—	2,176	—	(100.0) %
Other intergovernmental	42,598	42,500	—	—	42,598	42,500	(0.2) %
Investment income	15,985	17,725	14,681	8,392	30,666	26,117	(14.8) %
Miscellaneous	40,938	29,569	478	1,514	41,416	31,083	(24.9) %
Total revenues	\$1,100,331	\$1,170,618	\$845,409	\$826,230	\$1,945,740	\$1,996,848	2.6 %

(continued)

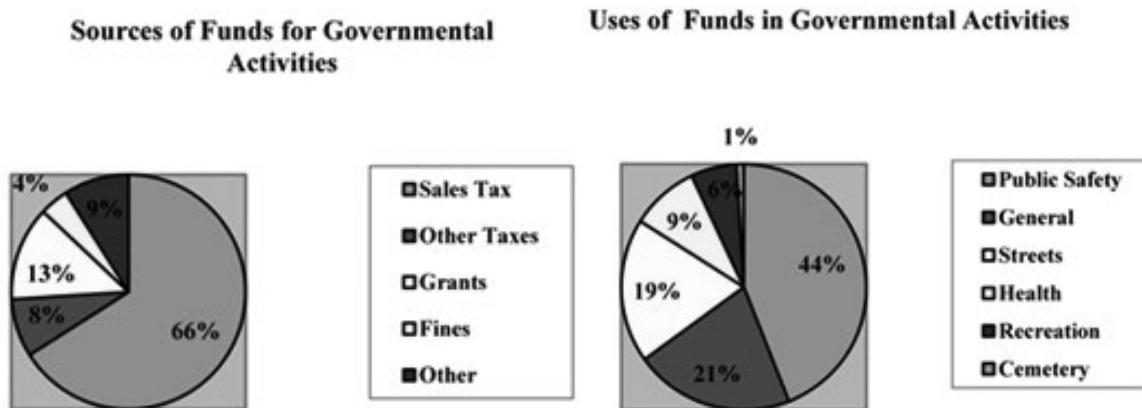
	<i>Governmental Activities</i>			<i>Business-Type Activities</i>			<i>Total</i>	<i>Total Percentage Change</i>
	<i>20X2</i>	<i>20X3</i>	<i>20X2</i>	<i>20X3</i>	<i>20X2</i>	<i>20X3</i>		
Expenses								
General government	199,410	202,449	—	—	199,410	202,449	1.5 %	
Public safety	383,943	417,781	—	—	383,943	417,781	8.8 %	
Cemetery	9,950	8,500	—	—	9,950	8,500	(14.6) %	
Streets and public works	173,595	175,551	—	—	173,595	175,551	1.1 %	
Health and welfare	74,716	85,659	—	—	74,716	85,659	14.6 %	
Culture and recreation	57,987	59,896	—	—	57,987	59,896	3.3 %	
Water	—	—	481,118	477,092	481,118	477,092	(0.8) %	
Sewer	—	—	173,317	144,525	173,317	144,525	(16.6) %	
Sanitation	—	—	188,730	239,959	188,730	239,959	27.1 %	
Total expenses	899,601	949,836	843,165	861,576	1,742,766	1,811,412	3.9 %	
Excess (deficiency) before transfers	200,730	220,782	2,244	(35,346)	202,974	185,436	(8.6) %	
Transfers	(5,670)	(101,982)	(330)	95,982	(6,000)	(6,000)	—	
Increase in net position	\$ 195,060	\$ 118,800	\$ 1,914	\$ 60,636	\$ 196,974	\$ 179,436	(8.9) %	

The City implemented a utility rate increase in the past year and passed a $\frac{1}{2}$ cent additional sales tax, resulting in the 7.6 percent increase in charges for services and the 20.1 percent increase in sales tax revenue, respectively. The increase in sanitation expenses of 27.1 percent was the result of the privatization of solid waste collection and disposal services.

Governmental Activities

To aid in the understanding of the Statement of Activities, some additional explanation is given. Of particular interest is the format that is significantly different from a typical Statement of Revenues, Expenses, and Changes in Fund Balance. You will notice that expenses are listed in the first column, with revenues from that particular program reported to the right. The result is a Net (Expense)/Revenue. This type of format highlights the relative financial burden of each of the functions on the City's taxpayers. It also identifies how much each function draws from the general revenues or if it is self-financing through fees and grants or contributions. All other governmental revenues are reported as general. It is important to note that all taxes are classified as general revenue, even if restricted for a specific purpose.

For the year ended June 30, 20X3, the City's governmental activities were funded as follows:



For the year ended June 30, 20X3, total expenses for governmental activities resulting from modified cash basis transactions or events amounted to \$949,836. Of these total expenses, taxpayers and other general revenues funded only \$736,133, and those directly benefiting from the program funded \$151,056 from grants and other contributions and \$62,647 from charges for services.

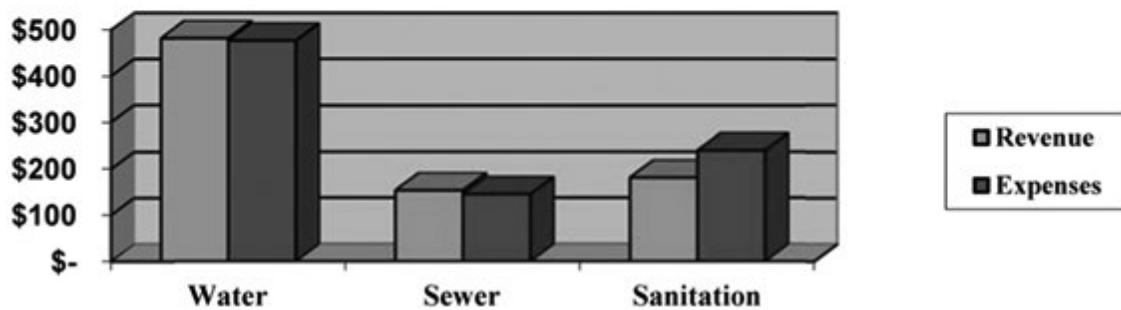
Net Cost of City of Example's Governmental Activities—Modified Cash Basis

	<i>Total Cost of Services</i>		<i>Percentage Change</i>	<i>Net Cost of Services</i>		<i>Percentage Change</i>
	<i>20X2</i>	<i>20X3</i>	<i>X2-X3</i>	<i>20X2</i>	<i>20X3</i>	<i>X2-X3</i>
General government	\$199,410	\$202,449	1.5 %	\$197,250	\$197,049	(0.1)%
Public safety	383,943	417,781	8.8 %	276,440	347,463	25.7 %
Cemetery	9,950	8,500	(14.6)%	7,060	4,605	(34.8)%
Streets and public works	173,595	175,551	1.1 %	114,211	129,915	13.7 %
Health and welfare	74,716	85,659	14.4 %	—	10,849	—
Culture and recreation	57,987	59,896	3.3 %	45,624	46,252	1.4 %
Total	\$899,601	\$949,836	5.6 %	\$640,585	\$736,133	14.9 %

Business-Type Activities

In reviewing the business-type activities' net (expense)/revenue resulting from modified cash basis transactions or events, certain activities need to be examined more closely. Although the water and sewer service activities reported net revenues of \$4,972 and \$8,830, respectively, the sanitation activity reported a net expense of \$59,054. Included in water revenue was a \$34,234 capital grant from OWRB. For the past few years, the practice of funding a portion of sanitation costs with net revenue from the water service activity has been the trend. Even with the privatization of the sanitation service during the current fiscal year, the sanitation activity still reported net expenses after allocation of indirect costs.

Business-Type Activities Revenue and Expense—Modified Cash Basis (in 000s)



A FINANCIAL ANALYSIS OF THE CITY'S FUNDS

Certain funds experienced noteworthy changes from the prior year and are highlighted as follows:

- ▶ In accordance with the modified cash basis of accounting, the General Fund reported revenues of \$972,141 and expenditures and net transfers of \$917,757, resulting in an increase in fund balance of \$54,384.
- ▶ An increase in sales tax revenue in the General Fund of \$129,239 from the prior year deserves some attention. In analyzing this increase, a majority of the increase can be attributed to an additional ½ cent sales tax approved by the citizens in October 20X2.
- ▶ The City's Public Works Authority Enterprise Fund reported a \$60,636 increase in net position on a modified cash basis and ended the year with \$447,974 in the unrestricted component of net position.

General Fund Budgetary Highlights

Over the course of the year, the City Council revised the General Fund budget at various times. The final adjusted budget, however, was consistent with the prior year budget. The only significant difference between the current and prior year budgets was an increase in the sales tax estimate from the prior year.

For the year ended June 30, 20X3, General Fund expenditures were \$34,554 above final appropriations, and actual resources available for appropriation were \$90,581 above the final budgeted amount.

Fund Balances—Governmental Funds

For the year ended June 30, 20X3, the City's governmental funds reported total fund balances on a modified cash basis of \$606,229, of which \$50,573 was restricted for specific purposes; \$13,988 was committed for specific purposes; and \$330,621 was assigned for specific purposes, leaving a remaining amount of \$211,047 as unassigned.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets—Modified Cash Basis

At June 30, 20X3, the City had \$3.2 million invested in capital assets, net of depreciation, on the modified cash basis of accounting, including police and fire equipment, buildings, park facilities, water lines, and sewer lines (see the following table). This represents a net increase of just over \$156,000, or 5.2 percent, over last year.

Primary Government Capital Assets—Modified Cash Basis (Net of Accumulated Depreciation)

	<i>Governmental Activities</i>		<i>Business-Type Activities</i>		<i>Totals</i>	
	<i>20X2</i>	<i>20X3</i>	<i>20X2</i>	<i>20X3</i>	<i>20X2</i>	<i>20X3</i>
Land	\$ 46,500	\$ 46,500	\$ 70,450	\$ 70,450	\$ 116,950	\$ 116,950
Buildings	150,669	157,064	286,195	276,433	436,864	433,497
Other improvements	97,842	98,460	—	—	97,842	98,460
Equipment	250,932	461,170	40,189	60,326	291,121	521,496
Infrastructure	—	69,749	—	—	—	69,749
Utility property	—	—	1,567,359	1,445,376	1,567,359	1,445,376
Construction in progress	216,191	172,141	283,548	308,548	499,739	480,689
Total	\$762,134	\$1,005,084	\$2,247,741	\$2,161,133	\$3,009,875	\$3,166,217

This year's more significant capital asset additions included the following:

Three Crown Victoria police cars	\$ 75,249
Kenworth fire truck and equipment	161,983
Street project	34,336

Long-Term Debt—Modified Cash Basis

At June 30, 20X3, the City had \$1,175,726 in long-term debt arising from modified cash basis transactions or events, compared with \$972,313 at June 30, 20X2. At June 30, 20X3, \$211,049 of the debt is related to governmental activities, and \$964,677 related to business-type activities (see the following table). This represents an increase of 21.9 percent.

Primary Government Long-Term Debt—Modified Cash Basis

	<i>20X2</i>	<i>20X3</i>
Refundable utility deposits	\$ 29,450	\$ 31,214
Capital note obligations	—	211,049
OWRB note payable	560,800	551,400
Bank notes payable	382,063	382,063
Total	\$972,313	\$1,175,726

ECONOMIC FACTORS AND NEXT YEAR'S BUDGET AND RATES

For the upcoming fiscal year ending June 30, 20X4, the City's budget is fairly consistent with this year.

For the year ended June 30, 20X3, the business-type activities operated for the first full year without the sanitation (garbage collection and disposal) department operations performed by City employees. Such activities have been outsourced to the County Solid Waste Authority.

For the year ending June 30, 20X4, the Public Works Authority is expecting to receive a grant or loan from Rural Development to construct a new wastewater treatment plant. The Public Works Authority increased utility rates and will receive an additional transfer of $\frac{1}{2}$ cent sales tax from the General Fund to meet the future loan obligations. No further rate increases are anticipated in the upcoming year.

The City was awarded a Department of Transportation grant of \$295,000 to replace sidewalks in the upcoming year.

CONTACTING THE CITY'S FINANCIAL MANAGEMENT

This report is designed to provide our citizens, taxpayers, customers, and creditors with a general overview of the City's finances and to demonstrate the City's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the City Clerk's office at 300 W. Main St., City of Example, Any State or telephone at (555) 555-5555.

Illustration A-1

CITY OF EXAMPLE, ANY STATE
STATEMENT OF NET POSITION—MODIFIED CASH BASIS
JUNE 30, 20X3

	<i>Primary Government</i>		<i>Component Unit</i>	
	<i>Governmental Activities</i>	<i>Business-Type Activities</i>	<i>Total</i>	<i>Airport Authority</i>
Assets				
Cash and cash equivalents	\$ 424,933	\$ 564,294	\$ 989,227	\$21,352
Investments	183,275	—	183,275	—
Due from other governments	48	4,657	4,705	—
Capital assets (Note 3.C.):				
Land and construction in progress	218,641	378,998	597,639	—
Other capital assets, net of accumulated depreciation	786,443	1,782,135	2,568,578	55,942
Total Assets	1,613,340	2,730,084	4,343,424	77,294
Liabilities				
Due to other governments	2,027	—	2,027	—
Long-term liabilities (Note 3.D.):				
Due within one year	43,755	392,263	436,018	—
Due in more than one year	167,294	572,414	739,708	—
Total Liabilities	213,076	964,677	1,177,753	—
Net Position				
Net investment in capital assets	794,035	1,249,991	2,044,026	55,942
Restricted for:				
Debt service	—	67,442	67,442	—
Other purposes	50,975	—	50,975	—
Unrestricted	555,254	447,974	1,003,228	21,352
Total Net Position	<u>\$1,400,264</u>	<u>\$1,765,407</u>	<u>\$3,165,671</u>	<u>\$77,294</u>

See accompanying notes to the basic financial statements.

Illustration A-2

CITY OF EXAMPLE, ANY STATE
STATEMENT OF ACTIVITIES—MODIFIED CASH BASIS
FOR THE FISCAL YEAR ENDED JUNE 30, 20X3

Functions/Programs	Expenses	Program Revenues			Net (Expense) Revenue and Changes in Net Position			
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Business-Type Activities	Total	Airport Authority	
Component Unit								
Primary Government								
Governmental activities:								
General Government	\$ 202,449	\$ 5,400	\$ —	\$ —	\$ (197,049)	\$ —	\$ (197,049)	
Public Safety	417,781	42,208	4,676	23,434	(347,463)	—	(347,463)	
Cemetery	8,500	3,895	—	—	(4,605)	—	(4,605)	
Streets and Public Works	175,551	—	45,636	—	(129,915)	—	(129,915)	
Health and Welfare	85,659	—	74,810	—	(10,849)	—	(10,849)	
Culture and Recreation	59,896	11,144	2,500	—	(46,252)	—	(46,252)	
Payments to Airport Authority	6,000	—	—	—	(6,000)	—	(6,000)	
Total governmental activities	955,836	62,647	127,662	23,434	(742,133)	—	(742,133)	
Business-type activities:								
Water	477,092	447,830	—	34,234	—	4,972	4,972	
Sewer	144,525	153,355	—	—	—	8,830	8,830	
Sanitation	239,959	180,905	—	—	—	(59,054)	(59,054)	
Total business-type activities	861,576	782,090	—	34,234	—	(45,252)	(45,252)	
Total primary government	\$1,817,412	\$844,737	\$127,622	\$57,668	\$ (742,133)	\$ (45,252)	\$ (787,385)	
Component Unit:								
Airport	\$ 9,631	\$ 2,495	—	—	—	—	\$ (7,136)	

Functions/Programs	Program Revenues			Net (Expense) Revenue and Changes in Net Position				Component Unit
	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Governmental Business-Type Activities	Total	Airport Authority		
General revenues:								
Taxes:								
Sales tax			773,308	—	—	773,308	—	
Franchise and public service taxes			66,619	—	—	66,619	—	
E-911 taxes restricted for public safety			27,194	—	—	27,194	—	
Intergovernmental revenue not restricted to specific programs			42,500	—	—	42,500	—	
Investment income			17,725	8,392	—	26,117	328	
Miscellaneous			29,569	1,514	31,083	—	653	
Transfers—Internal activity			(95,982)	95,982	—	—	—	
Payments from City			—	—	—	—	6,000	
Total general revenues and transfers			860,933	105,888	966,821	6,981		
Change in net position			118,800	60,636	179,436	(155)		
Net position—Beginning			1,281,464	1,704,771	2,986,235	77,449		
Net position—Ending			\$1,400,264	\$1,765,407	\$3,165,671	\$77,294		

See accompanying notes to the basic financial statements.

Illustration A-3

CITY OF EXAMPLE, ANY STATE
BALANCE SHEET—MODIFIED CASH BASIS—GOVERNMENTAL FUNDS
JUNE 30, 20X3

	<i>Capital</i> <i>General Fund</i>	<i>Improvement Fund</i>	<i>Other</i> <i>Governmental</i> <i>Funds</i>	<i>Total</i> <i>Governmental</i> <i>Funds</i>
Assets				
Cash and cash equivalents	\$150,015	\$218,549	\$56,369	\$ 424,933
Investments	65,244	111,670	6,361	183,275
Due from General Fund	—	—	2,185	2,185
Due from other governments	—	—	48	48
Total Assets	<u>\$215,259</u>	<u>\$330,219</u>	<u>\$64,963</u>	<u>\$ 610,441</u>
Liabilities and Fund Balances				
Liabilities:				
Due to other governments	\$ 2,027	\$ —	\$ —	\$ 2,027
Due to E-911 fund	2,185	—	—	2,185
Total Liabilities	<u>4,212</u>	<u>—</u>	<u>—</u>	<u>4,212</u>
Fund Balances (Note 3.F.):				
Restricted	—	—	50,573	50,573
Committed	—	—	13,988	13,988
Assigned	—	330,219	402	330,621
Unassigned	211,047	—	—	211,047
Total Fund Balances	<u>\$215,259</u>	<u>\$330,219</u>	<u>\$64,963</u>	<u>\$ 614,653</u>
Reconciliation to Statement of Net Assets:				
Amounts reported for governmental activities in the statement of net assets are different because capital assets used in governmental activities of \$2,017,924, net of accumulated depreciation of \$1,012,840, and not financial resources and, therefore, are not reported in the funds.				1,005,084
Some liabilities, including capital debt obligations payable, are not due and payable in the current period and, therefore, are not reported in the funds.				(211,049)
Net position of governmental activities	<u>—</u>	<u>—</u>	<u>—</u>	<u>\$1,400,264</u>

See accompanying notes to the basic financial statements.

Illustration A-4

CITY OF EXAMPLE, ANY STATE
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND
BALANCES—MODIFIED CASH BASIS—GOVERNMENTAL FUNDS
FOR THE FISCAL YEAR ENDED JUNE 30, 20X3

	<i>General Fund</i>	<i>Capital Improvement Fund</i>	<i>Other Governmental Funds</i>	<i>Total Governmental Funds</i>
Revenues:				
Taxes	\$ 839,927	\$ —	\$ 27,194	\$ 867,121
Intergovernmental	75,325	12,000	102,331	189,656
Charges for services	—	—	43,151	43,151
Fines and forfeitures	12,696	—	—	12,696
Licenses and permits	5,400	—	—	5,400
Investment income	6,424	9,727	1,574	17,725
Miscellaneous	32,369	—	2,500	34,869
Total Revenues	<u>972,141</u>	<u>21,727</u>	<u>178,750</u>	<u>1,170,618</u>
Expenditures:				
Current:				
General Government:				
Managerial	26,353	—	—	26,353
Judge	3,600	—	—	3,600
City clerk	31,361	—	—	31,361
Attorney	7,200	—	—	7,200
General government	122,329	—	90	122,419
Public Safety:				
Police	208,654	—	—	208,654
Fire	34,506	—	—	34,506
Civil defense	8,448	—	—	8,448
Animal control	22,273	—	—	22,273
E-911	—	—	91,285	91,285
Cemetery:				
Cemetery	8,500	—	—	8,500
Streets and Public Works:				
Streets	21,436	—	31,765	148,420
Health and Welfare:				
Nutrition program	—	—	80,498	80,498

(continued)

	<i>General Fund</i>	<i>Capital Improvement Fund</i>	<i>Other Governmental Funds</i>	<i>Total Governmental Funds</i>
Culture and Recreation:				
Senior citizens	21,436	—	—	21,436
Library	5,000	—	—	5,000
Park and recreation	—	—	25,461	25,461
Capital outlay	14,946	332,426	—	347,372
Debt service—Principal	183	26,000	—	26,183
Total Expenditures	631,444	358,426	229,099	1,218,969
Excess deficiency of revenues over expenditures	340,697	(336,699)	(52,349)	(48,351)
Other Financing Sources (Uses):				
Transfers in	338,663	169,331	15,000	522,994
Transfers out	(618,976)	—	—	(618,976)
Transfers to component unit	(6,000)	—	—	(6,000)
Capital debt proceeds	—	237,232	—	237,232
Total Other Financing Sources (Uses)	(286,313)	406,563	15,000	135,250
Net change in fund balances	54,384	69,864	(37,349)	86,899
Fund balances—Beginning	156,663	260,355	102,312	519,330
Fund balances—Ending	\$ 211,047	\$ 330,219	\$ 64,963	\$ 606,229
Reconciliation to the Statement of Activities:				
Net change in fund balances—Local governmental funds				\$ 86,899
Amounts reported for governmental activities in the Statement of Activities are different because repayment of debt principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the Statement of Net Assets.				
Capital debt obligation principal payments issuance of new capital debt obligations is recorded as capital debt proceeds in the government funds, but the proceeds create long-term liabilities in the Statement of Net Assets.				26,183
Capital debt proceeds governmental funds report capital outlays as expenditures, but governmental activities report depreciation expense to allocate those expenditures over the life of the assets.				(237,232)
Capital asset purchases capitalized				344,266
Depreciation expense				(101,316)
Change in Net Position of Governmental Activities				\$ 118,800

See accompanying notes to the basic financial statements.

Illustration A-5

CITY OF EXAMPLE, ANY STATE
STATEMENT OF NET POSITION—MODIFIED CASH BASIS—
PROPRIETARY FUND
JUNE 30, 20X3

*Public Works
Authority
Enterprise Fund*

Assets	
Current Assets:	
Cash and cash equivalents	\$ 443,317
Restricted cash and cash equivalents	13,436
Due from other governments	4,657
Total current assets	<u>461,410</u>
Noncurrent Assets:	
Restricted cash and cash equivalents	107,541
Land and construction in progress	378,998
Other capital assets, net of accumulated depreciation	1,782,135
Total noncurrent assets	<u>2,268,274</u>
Total Assets	<u>2,730,084</u>
Liabilities	
Current Liabilities:	
Notes payable—Current portion	392,263
Total current liabilities	<u>392,263</u>
Noncurrent Liabilities:	
Refundable deposits	31,214
Notes payable—Long-term portion	541,200
Total noncurrent liabilities	<u>572,414</u>
Total Liabilities	<u>964,677</u>
Net Position	
Net investment in capital assets	1,249,991
Restricted for debt service	67,442
Unrestricted	447,974
Total net position	<u>\$1,765,407</u>

See accompanying notes to the basic financial statements.

Illustration A-6

CITY OF EXAMPLE, ANY STATE STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET PO- SITION—MODIFIED CASH BASIS—PROPRIETARY FUND FOR THE FISCAL YEAR ENDED JUNE 30, 20X3

*Public Works
Authority
Enterprise Fund*

Operating Revenues:

Charges for services:	
Water	\$ 434,225
Sewer	148,677
Sanitation	175,420
Landfill	24
Penalties	23,744
Other	181
Total Operating Revenues	<hr/> 782,271

Operating Expenses:

Water treatment	166,025
Water maintenance	125,402
Sewer	63,796
Sanitation	183,509
Administration/general	122,902
Depreciation	156,957
Total Operating Expenses	<hr/> 818,591
Operating Income (Loss)	<hr/> (36,320)

Nonoperating Revenues (Expenses):

Investment income	8,392
Interest expense and fiscal agent fees	(41,077)
Loss on disposal of capital assets	(1,908)
Miscellaneous revenue	1,333
Total Nonoperating Revenues (Expenses)	<hr/> (33,260)
Net Income (Loss) Before Contributions and Transfers	<hr/> (69,580)
Capital contributions	34,234
Transfers in	434,645
Transfers out	(338,663)
Change in net position	60,636
Total net position—Beginning	<hr/> 1,704,771
Total net position—Ending	<hr/> \$1,765,407

See accompanying notes to the basic financial statements.

Illustration A-7

CITY OF EXAMPLE, ANY STATE
STATEMENT OF CASH FLOWS—MODIFIED CASH BASIS—
PROPRIETARY FUND
FOR THE FISCAL YEAR ENDED JUNE 30, 20X3

*Public Works
Authority Enterprise
Fund*

Cash Flows From Operating Activities	
Receipts from customers	\$ 782,022
Payments to suppliers	(407,082)
Payments to employees	(254,552)
Receipts of customer utility deposits	8,971
Refunds of customer utility deposits	(7,207)
Net Cash Provided by Operating Activities	<u>122,152</u>
Cash Flows From Noncapital Financing Activities	
Transfers to other funds	(338,663)
Transfers from other funds	<u>434,645</u>
Net Cash Provided by Noncapital Financing Activities	<u>95,982</u>
Cash Flows From Capital and Related Financing Activities	
Capital grant received for construction of capital assets	34,234
Purchases of capital assets	(72,257)
Principal paid on capital debt	(9,400)
Interest paid on capital debt	(40,327)
Fiscal agent fees paid on capital debt	(750)
Net Cash Provided by (Used in) Capital and Related Financing Activities	<u>(88,500)</u>
Cash Flows From Investing Activities	
Interest and dividends	<u>8,392</u>
Net Cash Provided by Investing Activities	<u>8,392</u>
Net Increase in Cash and Cash Equivalents	138,026
Balance—Beginning of the year	426,268
Balance—End of the year	<u>\$ 564,294</u>

(continued)

*Public Works
Authority Enterprise
Fund*

Reconciliation of operating income (loss) to net cash provided by operating activities:

Operating income (loss)	\$ (36,230)
Adjustments to reconcile operating income to net cash provided (used) by operating activities:	
Depreciation expense	156,957
Change in assets and liabilities:	
Due from other governments	(1,582)
Refundable deposits	1,764
Miscellaneous nonoperating receipts	1,333
Net cash provided by operating activities	\$ 122,152

See accompanying notes to the basic financial statements.

Illustration A-7—Notes

CITY OF EXAMPLE, ANY STATE
NOTES TO BASIC FINANCIAL STATEMENTS
JUNE 30, 20X3

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

As discussed further in Note 1.C, these financial statements are presented in accordance with a modified cash basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America (GAAP) established by the Governmental Accounting Standards Board (GASB). These modified cash basis financial statements generally meet the presentation and disclosure requirements applicable to GAAP, in substance, but are limited to the elements presented in the financial statements and the constraints of the measurement and recognition criteria of the modified cash basis of accounting.

1.A. FINANCIAL REPORTING ENTITY

The City's financial reporting entity comprises the following:

Primary Government: City of Example

Blended Component Unit: City of Example Public Works Authority

Discretely Presented Component Unit: City of Example Airport Authority

PRIMARY GOVERNMENT

The City of Example primary government is a general purpose local government formed as a council-manager form of municipal government under the laws of the State. The governing body is an elected five-member City Council, with the Mayor serving as the president of the Council. The City is managed by a City Manager appointed by the City Council, who serves as the City's CEO. The City operates the general government activities of the community, including police and fire protection, street and road maintenance, municipal cemetery operation, parks and other culture and recreation, health and welfare, and various administrative functions.

BLENDED COMPONENT UNIT

A *blended component unit* is a separate legal entity for which the elected officials of the primary government are financially accountable and that meets the blended component unit criteria. A blended component unit meets at least one of the following criteria: (a) the blended component unit's governing body is the same or substantially the same as the City Council, and there is a financial benefit or burden relationship with the City, or City management has operational responsibility for the component unit; (b) the component unit provides services entirely or almost entirely to the City; or (c) the component unit's debt is expected to be repaid entirely or almost entirely with resources of the City. The blended component unit's funds are blended into those of the City by appropriate fund type to constitute the primary government presentation. The City's blended component unit is presented subsequently:

<i>Component Unit</i>	<i>Brief Description/Inclusion Criteria</i>	<i>Fund Included In</i>
Public Works Authority (PWA)	Created August 3, 1961, to finance, develop, and operate the water, wastewater, and sanitation activities of the City. Current City Council serves as entire governing body (Trustees). Debt issued by Authority requires two-thirds approval of the City Council.	PWA Enterprise Fund

DISCRETELY PRESENTED COMPONENT UNIT

Discretely presented component units are separate legal entities that meet the financial accountability component unit criteria but do not meet the criteria for blending, as previously described. The component unit that is discretely presented in the City's report in a separate column is presented subsequently:

<i>Component Unit</i>	<i>Brief Description/Inclusion Criteria</i>
Airport Authority (AA)	Created December 5, 1963, to finance, develop, and operate the Municipal Airport. The AA governing body comprises five members appointed by the City Council, has separate management from the City, and is responsible for its own debts.

The AA does not issue separately audited component unit financial statements.

1.B. BASIS OF PRESENTATION

GOVERNMENT-WIDE FINANCIAL STATEMENTS

The Statement of Net Position and Statement of Activities display information about the reporting government as a whole within the limitations of the modified cash basis of accounting. They include all funds of the reporting entity except for fiduciary funds. The statements distinguish between governmental and business-type activities. Governmental activities generally are financed through taxes, intergovernmental revenues, and other nonexchange revenues. Business-type activities are financed, in whole or part, by fees charged to external parties for goods or services.

FUND FINANCIAL STATEMENTS

Fund financial statements of the reporting entity are organized into funds, each of which is considered to be a separate accounting entity. Each fund is accounted for by providing a separate set of self-balancing accounts that constitutes its assets, deferred outflows of resources, liabilities, deferred inflows of resources, net position or fund balance, revenues, and expenditures or expenses. The city's funds are organized into two major categories: governmental and proprietary. The City presently has no fiduciary funds. An emphasis is placed on major funds within the governmental and proprietary categories. A fund is considered major if it is the primary operating fund of the City or meets the following criteria:

- a.* Total assets, deferred outflows of resources, liabilities, deferred inflows of resources, revenues, or expenditures or expenses of that individual governmental or enterprise fund are at least 10 percent of the corresponding total for all funds of that category or type.
- b.* Total assets, deferred outflows of resources, liabilities, deferred inflows of resources, revenues, or expenditures or expenses of the individual governmental fund or enterprise fund are at least 5 percent of the corresponding total for all governmental and enterprise funds combined.

The funds of the financial reporting entity are described subsequently:

Governmental Funds

General Fund

The General Fund is the primary operating fund of the City and always classified as a major fund. It is used to account for all financial resources not accounted for and reported in another fund.

Special Revenue Funds

Special Revenue Funds are used to account for and report the proceeds of the specific revenue sources that are either restricted or committed to expenditures for specified purposes other than debt service or capital projects. The reporting entity includes the following special revenue funds, all of which are reported as non-major funds:

<i>Fund</i>	<i>Brief Description</i>
Park and Recreation Fund	Accounts for revenues received and expenditures paid for recreational services provided by the Park and Recreation Board pursuant to City ordinance.
Street and Alley Fund	Accounts for gasoline excise and commercial vehicle taxes legally restricted for street and alley improvements.
Nutrition Fund	Accounts for revenues and expenditures of various nutrition grants restricted or committed to health and welfare purposes.
911 Fund	Accounts for E-911 revenues legally restricted for E-911 services.
Cemetery Care Fund	Accounts for 12.5% of all cemetery revenues that are legally restricted for cemetery use.
ODOC Grant Fund	Accounts for revenues and expenditures of a State Department of Commerce Grant restricted for tourism per the grant agreement.

Capital Project Funds

Capital project funds are used to account for and report financial resources restricted, committed, or assigned for capital outlays, including the acquisition or construction of specific capital facilities or other capital items. The reporting entity includes the following capital project fund that is reported as a major fund:

Capital Improvement Fund	Accounts for contributions and specific revenues and transfers from other City funds, as dictated by the City Council, and expenditures for various capital outlays and projects as the City Council may designate.
--------------------------	---

Proprietary Funds

Enterprise Fund

Enterprise funds are used to account for business-like activities provided to the general public. These activities are financed primarily by user charges, and the measurement of financial activity focuses on net income measurement similar to the private sector. The reporting entity includes the following enterprise fund that is reported as a major fund:

<i>Fund</i>	<i>Brief Description</i>
PWA Fund	Accounts for the activities of the PWA public trust, a blended component unit, in providing water, wastewater, and sanitation services to the public.

1.C. MEASUREMENT FOCUS AND BASIS OF ACCOUNTING

Measurement focus is a term used to describe what transactions or events are recorded within the various financial statements. Basis of accounting refers to when and how transactions or events are recorded, regardless of the measurement focus applied.

MEASUREMENT FOCUS

In the government-wide Statement of Net Position and Statement of Activities, both governmental and business-like activities are presented using the economic resources measurement focus, within the limitations of the modified cash basis of accounting, as subsequently defined in item (b).

In the fund financial statements, the current financial resources measurement focus or the economic resources measurement focus, as applied to the modified cash basis of accounting, is used as appropriate:

- a. All governmental funds utilize a current financial resources measurement focus within the limitations of the modified cash basis of accounting. Only current financial assets and liabilities are generally included on their balance sheets. Their operating statements present sources and uses of available spendable financial resources during a given period. These funds use fund balance as their measure of available spendable financial resources at the end of the period.
- b. The proprietary fund utilizes an economic resources measurement focus within the limitations of the modified cash basis of accounting. The accounting objectives of this measurement focus are the determination of operating income, changes in net position (or cost recovery), net financial position, and cash flows. All assets, deferred outflows of resources, liabilities, and deferred inflows of resources (whether current or noncurrent or financial or nonfinancial) associated

with their activities are generally reported within the limitations of the modified cash basis of accounting.

BASIS OF ACCOUNTING

The financial statements are presented in accordance with a modified cash basis of accounting, which is a basis of accounting other than GAAP as established by GASB. This basis of accounting involves modifications to the cash basis of accounting to report in the statements of net position or balance sheets cash transactions or events that provide a benefit or result in an obligation that covers a period greater than the period in which the cash transaction or event occurred. Such reported balances include investments, interfund receivables and payables, capital assets and related depreciation, and short-term and long-term liabilities arising from cash transactions or events.

This modified cash basis of accounting differs from GAAP primarily because certain assets and their related revenues (such as accounts receivable and revenue for billed or provided services not yet collected and other accrued revenue and receivables) and certain liabilities and their related expenses or expenditures (such as accounts payable and expenses for goods or services received but not yet paid and other accrued expenses and liabilities) are not recorded in these financial statements. In addition, other economic assets, deferred outflows of resources, liabilities, and deferred inflows of resources that do not arise from a cash transaction or event are not reported, and the measurement of reported assets and liabilities does not involve adjustment to fair value.

If the City utilized accounting principles generally accepted in the United States of America, the fund financial statements for governmental funds would use the modified accrual basis of accounting, and the fund financial statements for proprietary fund types would use the accrual basis of accounting. All government-wide financial statements would be presented in accordance with the accrual basis of accounting.

1.D. FINANCIAL POSITION

CASH AND CASH EQUIVALENTS

For the purpose of financial reporting, cash and cash equivalents includes all demand and savings accounts and certificates of deposit or short-term investments with an original maturity of three months or less. Trust account investments in open-ended mutual fund shares are also considered cash equivalents.

INVESTMENTS

Investments classified in the financial statements consist entirely of certificates of deposit acquired with cash whose original maturity term exceeds three months. Investments are carried at cost, which approximates fair value.

DUE FROM OTHER FUNDS OR GOVERNMENTS

Receivables and payables to other funds or governments arising from cash transactions or events are recorded in the financial statements as a modification to the cash basis of accounting.

CAPITAL ASSETS

The City's modified cash basis of accounting reports capital assets resulting from cash transactions or events and reports depreciation, when appropriate. The accounting treatment over property, plant, and equipment (capital assets) depends on whether the assets are used in governmental fund operations or proprietary fund and similar discretely presented component unit operations and whether they are reported in the government-wide or fund financial statements.

Government-Wide Statements

In the government-wide financial statements, capital assets arising from cash transactions or events are accounted for as assets in the Statement of Net Position. All capital assets are valued at historical cost or estimated historical cost if actual is unavailable. Estimated historical cost was used to value the majority of the assets acquired prior to July 1, 20XX. Prior to July 1, 20XX, governmental funds' infrastructure assets were not capitalized. Infrastructure assets acquired since July 1, 20XX, are recorded at cost.

Depreciation of all exhaustible capital assets arising from cash transactions or events is recorded as an allocated expense in the Statement of Activities, with accumulated depreciation reflected in the Statement of Net Position. Depreciation is provided over the assets' estimated useful lives using the straight-line method of depreciation. A capitalization threshold of \$500 is used to report capital assets. The range of estimated useful lives by type of asset is as follows:

Buildings	40–50 years
Improvements other than buildings	10–25 years
Machinery, furniture, and equipment	3–20 years
Utility property and improvements	10–50 years
Infrastructure	25–50 years

Fund Financial Statements

In the fund financial statements, capital assets arising from cash transactions or events acquired for use in governmental fund operations are accounted for as capital outlay expenditures of the governmental fund upon acquisition. Capital assets acquired for use in proprietary fund operations are accounted for the same as in the government-wide statements.

LONG-TERM DEBT

All long-term bonds, notes, and other debt arising from cash transactions or events to be repaid from governmental and business-type resources are reported as liabilities in the government-wide statements.

Long-term debt arising from cash transactions or events of governmental funds is not reported as liabilities in the fund financial statements. The debt proceeds are reported as other financing sources, and payment of principal and interest is reported as expenditures. The accounting for proprietary funds is the same in the fund financial statements as the treatment in the government-wide statements.

NET POSITION/FUND BALANCE CLASSIFICATIONS

Government-Wide Statements

Net Position is classified and displayed in three components:

1. *Net investment in capital assets.* Consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvements of those assets and adjusted for any deferred inflows and outflows of resources attributable to capital assets and related debt.
2. *Restricted.* Consists of restricted assets reduced by liabilities and deferred inflows of resources related to those assets, with restriction constraints placed on the use either by external groups, such as creditors, grantors, contributors, or laws and regulations of other governments, or law through constitutional provisions or enabling legislation.
3. *Unrestricted.* Net amount of assets, deferred outflows of resources, liabilities, and deferred inflows of resources that are not included in the determination of net investment in capital assets or the restricted component of net position.

It is the City's policy to first use restricted net resources prior to the use of unrestricted net resources when an expense is incurred for purposes for which both restricted and unrestricted net resources are available.

Fund Financial Statements

Governmental Funds

The difference among assets, deferred outflows, liabilities, and deferred inflows of governmental funds is reported as fund balance and classified as nonspendable, restricted,

committed, assigned, and unassigned based on the respective level of constraint. These constraints are defined as follows:

Nonspendable. Amounts that cannot be spent because they either are not in spendable form or are legally or contractually required to be maintained intact.

Restricted. Amounts constrained regarding use from restrictions externally imposed by creditors, grantors, contributors, or laws or regulations of other governments or by restrictions imposed by law through constitutional provisions or enabling legislation.

Committed. Amounts constrained regarding use for specific purposes pursuant to requirements imposed by formal action of the City's highest level of decision-making authority. (In the case of the City of Example, commitments are evidenced by adoption of an ordinance by the City Council.)

Assigned. Amounts constrained by the City's intent to be used for specific purposes but that are neither restricted nor committed. (In the case of the City of Example, assignments are evidenced either by resolution of the City Council or by the City Manager in written form as approved by vote of the City Council pursuant to City policy.)

Unassigned. The residual classification of the General Fund for spendable amounts that have not been restricted, committed, or assigned to specific purposes.

It is the City's policy to first use restricted fund balances prior to the use of unrestricted fund balances when an expenditure is incurred for purposes for which both restricted and unrestricted fund balances are available. It is also City policy to use committed fund balances before assigned fund balances and assigned fund balances before unassigned amounts when an expenditure is incurred for purposes for which amounts in those classifications are available to be used.

The City has no formal minimum fund balance policies or any formal stabilization arrangements in place.

Proprietary Funds

The difference among assets, deferred outflows of resources, liabilities, and deferred inflows of resources of proprietary funds is reported as net position and classified in the same manner as the government-wide financial statements, as previously described.

1.E. REVENUES, EXPENDITURES, AND EXPENSES

PROGRAM REVENUES

In the Statement of Activities, modified cash basis revenues that are derived directly from each activity or from parties outside the City's taxpayers are reported as program revenues. The City has the following program revenues in each activity:

General Government	Licenses and permits.
Public Safety	Fine revenue and E-911 revenue; operating and capital grants include State Department of Agriculture and U.S. Department of Justice.
Cemetery	Grave opening/closing fees and lot sales.
Streets and Public Works	Commercial vehicle and gasoline excise tax shared by the State; operating grants include a storm damage grant from the Federal Emergency Management Agency.
Health and Welfare	Operating grant for nutrition program.
Culture and Recreation	Rental income, recreation fees, concession sales, and specific donations.

All other governmental revenues are reported as general revenues. All taxes are classified as general revenue even if restricted for a specific purpose.

OPERATING REVENUE AND EXPENSES

Operating revenues and expenses for proprietary funds and the similar discretely presented component unit result from providing services and producing and delivering goods or services. They also include all revenues and expenses not related to capital and related financing, noncapital financing, or investing activities.

1.F. INTERNAL AND INTERFUND BALANCES AND ACTIVITIES

In the process of aggregating the financial information for the government-wide Statement of Net Position and Statement of Activities, some amounts reported as interfund activity and balances in the fund financial statements have been eliminated or reclassified.

FUND FINANCIAL STATEMENTS

Interfund activity resulting from cash transactions or events, if any, within and among the governmental and proprietary fund categories is reported as follows in the fund financial statements:

- a. *Interfund loans.* Amounts provided with a requirement for repayment are reported as interfund receivables and payables.
- b. *Interfund services.* Sales or purchases of goods and services between funds are reported as revenues and expenditures or expenses.

- c. *Interfund reimbursements.* Repayments from funds responsible for certain expenditures or expenses to the funds that initially paid for them are not reported as reimbursements but as adjustments to expenditures or expenses in the respective funds.
- d. *Interfund transfers.* Flow of assets from one fund to another when repayment is not expected and reported as transfers in and out.

GOVERNMENT-WIDE FINANCIAL STATEMENTS

Interfund activity and balances resulting from cash transaction or events, if any, are eliminated or reclassified in the government-wide financial statements as follows:

- a. *Internal balances.* Amounts reported in the fund financial statements as interfund receivables and payables are eliminated in the “Governmental” and “Business-Type Activities” columns of the Statement of Net Position, except for the net residual amounts due between governmental and business-type activities, which are reported as Internal Balances.
- b. *Internal activities.* Amounts reported as interfund transfers in the fund financial statements are eliminated in the government-wide Statement of Activities, except for the net amount of transfers between governmental and business-type activities, which are reported as Transfers—Internal Activities. The effects of interfund services between funds, if any, are not eliminated in the Statement of Activities.
- c. *Primary government and component unit activity and balances.* Resource flows between the primary government (the City and PWA) and the discretely-presented component unit (the AA) are reported as if they were external transactions and are classified separately from internal balances and activities within the primary government.

1.G. USE OF ESTIMATES

The preparation of financial statements in accordance with the modified cash basis of accounting used by the City requires management to make estimates and assumptions that affect certain reported amounts and disclosures (such as estimated useful lives in determining depreciation expense); accordingly, actual results could differ from those estimates.

NOTE 2. STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY

By its nature as a local government unit, the City and its component units are subject to various federal, state, and local laws and contractual regulations. The following instances of noncompliance are considered material to the financial statements.

2.A. UNINSURED AND UNCOLLATERALIZED DEPOSITS

In accordance with State law, all uninsured deposits of municipal funds in financial institutions must be secured with acceptable collateral. Acceptable collateral includes certain U.S. Government or Government Agency securities, certain State or political subdivision debt obligations, surety bonds, or certain letters of credit. At June 30, 20X3, \$57,217 of the City's uninsured deposits were not collateralized. In July 20X3, the City obtained additional collateral to secure the uninsured deposits.

2.B. BUDGETARY NONCOMPLIANCE

For the year ended June 30, 20X3, expenditures exceeded appropriations at the legal level of control in individual funds as follows:

<i>Fund</i>	<i>Department</i>	<i>Object Category</i>	<i>Expenditures Exceeding Appropriations</i>
General Fund	N/A	Transfers out	\$93,976
Nutrition Fund	Nutrition Program	Personal services	4,634
Nutrition Fund	Nutrition Program	Materials and supplies	1,866
Nutrition Fund	Nutrition Program	Other services and charges	6,514

NOTE 3. DETAIL NOTES—TRANSACTION CLASSES AND ACCOUNTS

The following notes present detail information to support the amounts reported in the basic financial statements for its various assets, liabilities, equity, revenues, and expenditures or expenses.

3.A. CASH AND INVESTMENTS

CUSTODIAL CREDIT RISK—DEPOSITS

Primary Government Deposits

Total City bank deposits of \$1,082,539 of the primary government were insured or collateralized, except for \$57,215 of deposits at one financial institution that were uninsured and uncollateralized and, therefore, subject to custodial credit risk. Total carrying value of the deposits was \$1,082,739.

Component Unit Deposits

Total bank deposits of \$21,352 of the discretely presented component unit were fully insured with Federal Deposit Insurance Corporation insurance. Total carrying value of the deposits was \$21,352.

CUSTODIAL CREDIT RISK—INVESTMENTS

Investments are limited by State law to the following:

- a. Direct obligations of the U.S. Government and its agencies and instrumentalities to which the full faith and credit of the U.S. Government is pledged or obligations to the payment of which the full faith and credit of the State is pledged.
- b. Certificates of deposit or savings accounts that are either insured or secured with acceptable collateral with in-state financial institutions and fully insured certificates of deposit or savings accounts in out-of-state financial institutions.
- c. With certain limitation, negotiable certificates of deposit, prime bankers' acceptances, prime commercial paper, and repurchase agreements with certain limitations.
- d. County, municipal, or school district tax-supported debt obligations; bond or revenue anticipation notes; money judgments; or bond or revenue anticipation notes of public trusts whose beneficiary is a county, municipality, or school district.
- e. Notes or bonds secured by mortgage or trust deed insured by the Federal Housing Administrator and debentures issued by the Federal Housing Administrator and in obligations of the National Mortgage Association.
- f. Money market funds regulated by the Securities and Exchange Commission and in which investments consist of the investments mentioned in (a)–(d).

During the year ended June 30, 20X3, the City's investments consisted solely of open-ended money-market mutual funds in a financial institution's trust department relating to debt trust accounts and certificates of deposit whose original maturity term exceeds 3 months. At June 30, 20X3, the carrying value and fair value of the money-market mutual fund investments totaled \$89,763, and the carrying value and fair value of the certificates of deposit totaled \$183,275. For purposes of the Statement of Net Position and Statement of Cash Flows, the money-market mutual fund investments are classified as cash and cash equivalents. For purposes of custodial credit risk, the certificates of deposit are included in the preceding deposits' risk analysis, but the money-market mutual funds are not classified regarding custodial credit risk because they are not evidenced by specific investment securities.

3.B. RESTRICTED ASSETS

The amounts reported as restricted assets comprise amounts held by the PWA for utility deposits (refunded upon termination of service or applied to final bill) of \$31,214 and the amount of mutual funds held in trustee accounts on behalf of the promissory note trust accounts in the amount of \$89,763.

3.C. CAPITAL ASSETS

Capital asset activity resulting from modified cash basis transactions or events for the fiscal year ended June 30, 20X3, was as follows:

	<i>Balance at July 1, 20X2</i>	<i>Additions</i>	<i>Deductions</i>	<i>Balance at June 30, 20X3</i>
Governmental activities:				
Capital assets not being depreciated:				
Land	\$ 46,500	\$ —	\$ —	\$ 46,500
Construction-in-progress	216,191	—	44,050	172,141
Total capital assets not being depreciated	262,691	—	44,050	218,641
Other capital assets:				
Buildings	487,570	17,000	—	504,570
Other improvements	156,308	10,000	—	166,308
Machinery and equipment	768,540	282,930	1,450	1,050,020
Infrastructure	—	78,386	—	78,386
Total other capital assets at historical cost	1,412,418	388,316	1,450	1,799,284
Less accumulated depreciation for:				
Buildings	336,901	10,605	—	347,506
Other improvements	58,466	9,382	—	67,848
Machinery and equipment	517,608	72,692	1,450	588,850
Infrastructure	—	8,637	—	8,637
Total accumulated depreciation	912,975	101,316	1,450	1,012,841
Other capital assets, net	499,443	287,000	—	786,443
Governmental activities capital assets, net	\$ 762,134	\$ 287,000	\$ 44,050	\$ 1,005,084
Business-type activities:				
Capital assets not being depreciated:				
Land	\$ 70,450	\$ —	\$ —	\$ 70,450
Construction-in-progress	283,548	25,000	—	308,548
Total capital assets not being depreciated	353,998	25,000	—	378,998

(continued)

	<i>Balance at July 1, 20X2</i>	<i>Additions</i>	<i>Deductions</i>	<i>Balance at June 30, 20X3</i>
Other capital assets:				
Buildings	483,012	—	—	483,012
Machinery and equipment	155,960	34,855	2,174	188,641
Utility property and improvements	3,863,037	12,402	—	3,875,439
Total other capital assets at historical cost	4,502,009	47,257	2,174	4,547,092
Less accumulated depreciation for:				
Buildings	196,817	9,762	—	206,579
Machinery and equipment	115,771	12,810	266	128,315
Utility property and improvements	2,295,678	134,385	—	2,430,063
Total accumulated depreciation	2,608,266	156,957	266	2,764,957
Other capital assets, net	1,893,743	(109,700)	1,908	1,782,135
Business-type activities capital assets, net	\$2,247,741	(\$ 84,700)	\$ 1,908	\$2,161,133
Component unit:				
Capital assets not being depreciated:				
Land	\$ 14,000	\$ —	\$ —	\$ 14,000
Other capital assets:				
Buildings	13,499	—	—	13,499
Improvements	396,466	—	—	396,466
Machinery and equipment	1,300	—	—	1,300
Infrastructure	—	—	—	—
Total other capital assets at historical cost	411,265	—	—	411,265
Less accumulated depreciation for:				
Buildings	9,524	270	—	9,794
Improvements	353,941	4,288	—	358,229
Machinery and equipment	1,300	—	—	1,300
Infrastructure	—	—	—	—
Total accumulated depreciation	364,765	4,558	—	369,323
Other capital assets, net	46,500	(4,558)	—	41,942
Component unit capital assets, net	\$ 60,500	(\$ 4,558)	—	\$ 55,942

Depreciation expense was charged to functions as follows in the Statement of Activities:

Primary Government:

Governmental Activities:

General Government	\$ 11,516
Public Safety	51,357
Streets and Public Works	25,283
Health and Welfare	5,161
Culture and Recreation	7,999
Total depreciation expense for governmental activities	<u><u>\$101,316</u></u>

Business-Type Activities:

Water	\$ 97,153
Sewer	45,864
Sanitation	13,940
Total depreciation expense for business-type activities	<u><u>\$156,957</u></u>
Component Unit Depreciation Expense	<u><u>\$ 4,558</u></u>

3.D. LONG-TERM DEBT

The reporting entity's long-term bonds, notes, and other debt arising from cash transactions or events is segregated between the amounts to be repaid from governmental activities and amounts to be repaid from business-type activities.

GOVERNMENTAL ACTIVITIES

As of June 30, 20X3, the long-term debt arising from cash transactions or events, payable from governmental fund resources, consisted of the following:

Capital Note Obligations:

\$75,249 capital note with Ford Motor Credit for 3 police cars, payable in annual installments of \$26,183, including principal and interest at 4.45%; final payment due October 2, 20X3.	\$ 49,066
\$161,983 capital note with Information Leasing Corporation for fire truck and equipment, payable in annual installments of \$28,228, including principal and interest at 5.109%; final payment due October 22, 20X8.	<u>161,983</u>
Total Capital Note Obligations	<u><u>\$211,049</u></u>

BUSINESS-TYPE ACTIVITIES

As of June 30, 20X3, the long-term debt arising from cash transactions or events, payable from proprietary fund resources, consisted of the following:

Notes Payable:

Note payable to State Bank, payable in one installment of \$232,063 on July 10, 20X3, with interest at 5.250%	\$232,063
Note payable to Water Resources Board, payable in semiannual installments of \$1,500–\$26,000, with interest at 4.622%; final payment due August 15, 20XX	551,400
1999 Note payable to State Bank, payable in one installment of \$150,000 on July 10, 20X3, with interest at 5.250%	150,000
Total Notes Payable	<u><u>\$933,463</u></u>

Refundable Deposits:

Refundable deposits reported as a liability within the Statement of Net Assets comprise the following:	
Utility Deposits—Refundable	<u><u>\$ 31,214</u></u>

CHANGES IN LONG-TERM DEBT

The following is a summary of changes in long-term debt arising from cash transactions or events for the year ended June 30, 20X3:

Type of Debt	Balance July 1, 20X2	Additions	Reductions	Balance June 30, 20X3	Amount Due Within One Year
Governmental Activities:					
Capital Note Obligations	\$ —	\$237,232	\$26,183	\$211,049	\$ 43,755
Business-Type Activities:					
Notes Payable	\$942,863	\$ —	\$ 9,400	\$933,463	\$392,263
Refundable Deposits	29,450	8,971	7,207	31,214	—
Total Business-Type Activities	<u><u>\$972,313</u></u>	<u><u>\$ 8,971</u></u>	<u><u>\$16,607</u></u>	<u><u>\$964,677</u></u>	<u><u>\$392,263</u></u>

DEBT SERVICE REQUIREMENTS TO MATURITY

The annual debt service requirements to maturity, including principal and interest, for long-term debt, except for refundable deposits, as of June 30, 20X3, are as follows:

<i>Year Ended June 30,</i>	<i>Capital Debt Obligations</i>		<i>Notes Payable</i>	
	<i>Principal</i>	<i>Interest</i>	<i>Principal</i>	<i>Interest</i>
20X4	\$ 43,861	\$10,550	\$412,001	\$ 25,485
20X5	44,191	10,220	10,563	19,015
20X6	23,507	4,721	12,384	23,985
20X7	23,870	4,358	13,524	23,182
20X8	24,417	3,811	14,803	22,393
20X9–13	51,203	5,253	68,616	70,548
2014–18	—	—	85,531	62,214
2019–23	—	—	94,514	55,844
2024–28	—	—	100,522	40,439
2029–32	—	—	121,005	30,668
Total	<u>\$211,049</u>	<u>\$38,913</u>	<u>\$933,463</u>	<u>\$373,773</u>

3.E. INTERFUND TRANSFERS AND BALANCES

INTERFUND TRANSFERS

Transfers between funds of the primary government and between the primary government and discretely presented component unit arising from cash transactions or events for the year ended June 30, 20X3, were as follows:

	<i>Transfers In</i>	<i>Transfers Out</i>
Major Funds:		
General Fund:		
Park and Recreation Fund	\$ —	\$ 12,000
Nutrition Fund	—	3,000
Capital Improvement Fund	—	169,331
City of Example PWA	338,663	434,645
City of Example Airport Authority— Component Unit	—	6,000
Total General Fund	<u>338,663</u>	<u>624,976</u>
Capital Project Fund:		
Capital Improvement Fund:		
General Fund	169,331	—

(continued)

	<i>Transfers In</i>	<i>Transfers Out</i>
Enterprise Fund:		
City of Example PWA:		
General Fund	434,645	338,663
Non-Major Funds:		
Special Revenue Funds:		
Park and Recreation Fund:		
General Fund	12,000	—
Nutrition Fund:		
General Fund	3,000	—
Total Special Revenue Funds	15,000	—
Component Unit:		
City of Example Airport Authority:		
General Fund	6,000	—
Grand Totals	\$963,639	\$963,639

The City transfers one cent of its 2½ cent sales tax to the PWA Enterprise Fund for debt retirement, as required by the sales tax agreement in the note indenture. Any remaining sales tax monies left after debt payments are made are required to be transferred back to the General Fund for operations. In addition, the City is required to transfer an additional ½ cent sales tax to the PWA Enterprise Fund for financing the extension, enlargement, and improvement of the sanitary sewer system and the payment of principal and interest on indebtedness incurred for said purpose. The City also transferred an amount equivalent to ½ cent sales tax to the Capital Improvement Fund for a period of 12 months. This ½ cent sales tax transfer to the Capital Improvement Fund is based upon administrative authority to assist in the funding of capital improvements.

The other transfers reflected in the preceding schedule are used to move restricted resources collected by the General Fund to the funds authorized to spend the resources.

INTERFUND BALANCES

At June 30, 20X3, the General Fund owed the E-911 Special Revenue Fund \$2,185 related to E-911 restricted revenue received in the General Fund and not yet transferred to the E-911 Fund.

3F. FUND BALANCES

Fund balances of the City's governmental funds at June 30, 20X3, are classified as follows regarding level of constraint:

	<i>General Fund</i>	<i>Capital Improvement Fund</i>	<i>Other Governmental Funds</i>
Fund Balances:			
Restricted for:			
Streets and street lighting	\$ —	\$ —	\$ 1,644
Emergency services	—	—	24,074
Cemetery care	—	—	24,662
Tourism	—	—	193
Committed for:			
Culture and recreation	—	—	13,988
Assigned for:			
Capital asset replacement	—	330,219	—
Health and welfare	—	—	402
Unassigned	211,047	—	—
Total Fund Balances	<u>\$211,047</u>	<u>\$330,219</u>	<u>\$64,963</u>

NOTE 4. OTHER NOTES

4.A. EMPLOYEE PENSION AND OTHER BENEFIT PLANS

FIREFIGHTER'S PENSION AND RETIREMENT SYSTEMS

The City of Example, as the employer, participates in the statewide cost-sharing multiemployer defined benefit plan on behalf of the volunteer firefighters. The system is funded by contributions from participants, employers, insurance premium taxes, and state appropriations, as necessary.

Eligibility Factors, Contribution Methods, and Benefit Provisions

	<i>Firefighter's Pension and Retirement System</i>
Obtaining separately issued financial statements	Firefighters Pension and Retirement 4545 Any Street Example City, Any State
Eligibility to participate	All full-time or voluntary firefighters of a participating municipality and hired before age 45.
Authority establishing contribution obligations and benefits	State Statute
Employee's contribution rate	N/A

Firefighter's Pension and Retirement System

(continued)

City's contribution rate	\$60 per volunteer
State obligation	State appropriation to fund the unfunded actuarial accrued liability
Period required to vest	Ten years
Eligibility and benefits for distribution (full time)	Twenty years credited service—2.5% of final average salary multiplied by the years of credited service, with a maximum of 30 years considered; if vested at or after age 50 or after 10 but before 20 years of credited service, with reduced benefits.
Eligibility and benefits for distribution (volunteer)	Twenty years credited service equal to \$5.46 per month per year of service, with a maximum of 30 years considered.
Deferred retirement option	Yes, 20 years credited with continued service for a maximum of 30 or more years.
Provisions for:	
Cost of living adjustments (normal retirement)	Yes, if vested by 5/XX
Death (duty, nonduty, or postretirement)	Yes
Disability (duty or nonduty)	Yes
Cost of living allowances	Yes

Contributions

Contributions required by State Statute and made for each of the past three fiscal years are as follows:

20X1	\$1,200
20X2	\$1,080
20X3	\$1,080

These contributions represent 100 percent of the required contribution in each fiscal year.

4.B. RISK MANAGEMENT

The City is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors and omissions; injuries to employees; employees' health and life; and natural disasters.

The City manages these various risks of loss as follows:

<i>Type of Loss</i>	<i>Method Managed</i>	<i>Risk of Loss Retained</i>
Torts, errors, and omissions	Purchased commercial insurance	None
Workers compensation, health, and life	Purchased commercial insurance	None
Physical property loss and natural disasters	Purchased commercial insurance	None

Management believes such coverage is sufficient to preclude any significant uninsured losses to the City. Settled claims have not exceeded this insurance coverage in any of the past three fiscal years.

4.C. COMMITMENTS AND CONTINGENCIES

COMMITMENTS

Landfill Closure

The City closed a landfill site on September 1, 19XX, in accordance with State and Federal laws. This closure requires the Authority to place a final cover on its landfill site and to perform certain maintenance and monitoring functions at the site for eight years after closure. During fiscal year 20X3, the City used Community Development Block Grant funds to finance the closure costs of the landfill. Although postclosure care costs will be paid after the date the landfill stops accepting waste, the Authority estimates the remaining postclosure care costs to be \$55,000 at June 30, 20X3, based upon 2 remaining years of monitoring. This amount is based upon what it would cost to perform all postclosure care in 20X3. Actual costs may be higher due to inflation, changes in technology, or changes in regulations. Due to the City's use of the modified cash basis of accounting, this liability is not recorded in the financial statements.

EPA Consent Order

In July 20X2, the PWA was placed under an administrative order on the wastewater facility by the Environmental Protection Agency (EPA). Many areas were found to be deficient by the EPA, including records and reports, operation and maintenance, and laboratory practices and procedures. An administrative fine was assessed on the Wastewater Treatment Facility in the amount of \$10,000. However, an agreement was made whereby the City would pay a \$5,000 fine and work with the EPA in establishing a Supplemental Environmental Project. These conditions were met as of June 30, 20X3.

The preliminary engineering report states that the facility will need to be completely rebuilt. The estimate of capital needs related to this project is approximately \$4,525,000. The City has applied for various grants and loans, including those available through Rural Development in order to provide funding for this project. Preliminary engineering work related to this project is underway.

CONTINGENCIES

Grant Program Involvement

In the normal course of operations, the City participates in various Federal or State grant or loan programs from year to year. The grant or loan programs are often subject to additional audits by agents of the granting or loaning agency, the purpose of which is to ensure compliance with the specific conditions of the grant or loan. Any liability of reimbursement that may arise as a result of these audits cannot be reasonably determined at this time, although it is believed the amount, if any, would not be material.

Litigation

The City is a party to various legal proceedings that normally occur in the course of governmental operations. As a result of the City's use of the modified cash basis of accounting, the financial statements do not include accrual or provisions for loss contingencies that may result from these proceedings. State statutes provide for the levy of an ad valorem tax over a three-year period by a City "Sinking Fund" for the payment of any court-assessed judgment rendered against the City. Although the outcome of the previously noted proceedings cannot be predicted due to the insurance coverage maintained by the City and the State statute relating to judgments, the City believes that any settlement or judgment not covered by insurance would not have a material adverse effect on the financial condition of the City.

Illustration A-8

(VOLUNTARY SUPPLEMENTARY INFORMATION)
CITY OF EXAMPLE, ANY STATE
BUDGETARY COMPARISON SCHEDULE—
MODIFIED CASH BASIS—GENERAL FUND
FOR THE YEAR ENDED JUNE 30, 20X3

	<i>Budgeted Amounts</i>			<i>Variance With Final Budget Positive (Negative)</i>
	<i>Original</i>	<i>Final</i>	<i>Actual Amounts</i>	
Beginning Budgetary Fund Balance:	\$ 156,663	\$ 156,663	\$ 156,663	\$ —
Resource (Inflows):				
Taxes:				
Sales tax	630,000	750,500	773,308	22,808
Franchise tax	70,000	70,000	66,619	(3,381)
Total Taxes	700,000	820,500	839,927	19,427
Intergovernmental:				
Alcoholic beverage tax	45,000	45,000	42,500	(2,500)
Grant revenue	2,000	13,523	32,825	19,302
PILOT—Housing Authority	2,500	2,500	—	(2,500)
Total Intergovernmental	49,500	61,023	75,325	14,302
Fines and Forfeitures:				
Court fines	17,500	17,500	12,365	(5,135)
Dog pound	500	500	331	(169)
Total Fines and Forfeitures	18,000	18,000	12,696	(5,304)
Licenses and Permits	2,500	2,500	5,400	2,900
Investment Income	8,000	8,000	6,424	(1,576)
Miscellaneous:				
Miscellaneous	11,200	11,200	6,055	(5,145)
Rental income	1,000	1,000	1,400	400
Gas royalties	38,000	38,000	24,914	(13,086)
Total Miscellaneous	50,200	50,200	32,369	(17,831)
Other Financing Sources:				
Transfers from other funds	260,000	260,000	338,663	78,663
Total Other Financing Sources	260,000	260,000	338,663	78,663
Amounts available for appropriation	1,244,863	1,376,886	1,467,467	90,581

(continued)

		<i>Budgeted Amounts</i>		<i>Variance With Final Budget Positive (Negative)</i>
		<i>Original</i>	<i>Final</i>	
Charges to Appropriations (Outflows):				
Managerial:				
Personal services		27,073	27,340	26,165 1,175
Materials and supplies		3,500	173	26 147
Other services and charges		—	2,500	162 2,338
Total Managerial		30,573	30,013	26,353 3,660
Judge:				
Personal services		3,600	3,600	3,600 —
City Clerk:				
Personal services		29,451	29,656	29,614 42
Materials and supplies		2,500	2,295	1,637 656
Other services and charges		1,000	1,000	110 890
Total City Clerk		32,951	32,951	31,361 1,590
Attorney:				
Personal services		7,200	7,200	7,200 —
General Government:				
Personal services		6,519	6,519	6,461 58
Materials and supplies		5,000	3,468	3,369 119
Other services and charges		130,438	135,406	112,499 22,907
Total General Government		141,957	145,413	122,329 23,084
Police:				
Personal services		167,312	188,291	182,416 5,875
Materials and supplies		13,500	10,960	10,364 596
Other services and charges		13,500	17,261	15,874 1,387
Capital outlay		—	2,651	2,651 —
Debt service		—	183	183 —
Total Police		214,312	219,346	211,488 7,858
Fire:				
Personal services		2,000	2,000	1,080 920
Materials and supplies		11,000	5,876	5,876 —
Other services and charges		29,000	28,565	27,550 1,015
Capital outlay		—	10,235	10,235 —
Total Fire		42,000	46,676	44,741 1,935

<i>Budgeted Amounts</i>				<i>Variance With Final Budget Positive (Negative)</i>
<i>Original</i>	<i>Final</i>	<i>Actual Amounts</i>		
Cemetery:				
Other services and charges	8,500	8,500	8,500	—
Street:				
Personal services	90,079	88,964	86,766	2,198
Materials and supplies	8,000	6,699	6,395	304
Other services and charges	22,000	24,416	23,494	922
Total Street	120,079	120,079	116,655	3,424
Senior Citizens:				
Personal services	17,866	17,811	16,318	1,493
Materials and supplies	1,000	613	165	448
Other services and charges	15,264	17,952	4,953	12,999
Capital outlay	—	1,549	1,549	—
Total Senior Citizens	34,130	37,925	22,985	14,940
Library:				
Other services and charges	5,000	5,000	5,000	—
Civil Defense:				
Other services and charges	8,448	8,448	8,448	—
Animal Control:				
Personal services	8,715	18,742	17,037	1,705
Materials and supplies	5,000	4,131	2,905	1,226
Other services and charges	2,000	2,331	2,331	—
Capital outlay	—	511	511	—
Total Animal Control	25,715	25,715	22,784	2,931
Other Financing Uses:				
Transfers to other funds	440,735	525,000	618,976	(93,976)
Transfers to component units	6,000	6,000	6,000	—
Total Other Financing Uses	446,735	531,000	624,976	(93,976)
Total Charges to Appropriations	1,121,200	1,221,866	1,256,420	(34,554)
Ending Budgetary Fund Balance	\$ 123,663	\$ 155,020	\$ 211,047	\$ 56,027

Illustration 8-A—Notes

CITY OF EXAMPLE, ANY STATE NOTES TO BUDGETARY COMPARISON SCHEDULE JUNE 30, 20X3

Budget Law

The City prepares its annual operating budget under the provisions of the Municipal Budget Act (the Budget Act). In accordance with those provisions, the following process is used to adopt the annual budget:

- a. Prior to June 1, the Mayor submits to the City Council a proposed operating budget for the fiscal year commencing the following July 1.
- b. Public hearings are conducted to obtain citizen comments. At least one public hearing must be held no later than 15 days prior to July 1.
- c. Subsequent to the public hearings but no later than seven days prior to July 1, the budget is adopted by resolution of the City Council.
- d. The adopted budget is filed with the Office of State Auditor and Inspector.

The legal level of control at which expenditures may not legally exceed appropriations is the object category level by department within a fund. The Budget Act recognizes the following object categories as the minimum legal level of control by department within a fund:

- Personal service
- Materials and supplies
- Other services and charges
- Capital outlay
- Debt service
- Interfund transfers

All transfers of appropriations between departments and supplemental appropriations require City Council approval. The Mayor may transfer appropriations between object categories within a department without City Council approval. Supplemental appropriations must also be filed with the Office of State Auditor and Inspector.

Basis of Accounting

The budget is prepared in accordance with the same modified cash basis of accounting as applied to the governmental funds in the basic financial statements. Revenues and expenditures are reported when they result from cash transactions or events.

Illustration A-9

(VOLUNTARY SUPPLEMENTARY INFORMATION)
CITY OF EXAMPLE, ANY STATE
COMBINING BALANCE SHEET—MODIFIED CASH BASIS
NON-MAJOR GOVERNMENTAL FUNDS
JUNE 30, 20X3

	SPECIAL REVENUE FUNDS					<i>Total Non-major Governmental Funds</i>
	<i>Park and Recreation</i>	<i>Street and Alley</i>	<i>Nutrition Fund</i>	<i>E-911 Fund</i>	<i>Cemetery Care Fund</i>	
Assets						
Cash and cash equivalents	\$ 13,940	\$ 1,644	\$ 402	\$21,889	\$18,301	\$193
Investments	—	—	—	—	6,361	6,361
Due from General Fund	—	—	—	2,185	—	2,185
Due from other governments	48	—	—	—	—	48
Total Assets	\$13,988	\$1,644	\$402	\$24,074	\$24,662	\$64,963
Fund Balances						
Restricted for:						
Streets and street lighting	\$ —	\$ 1,644	\$ —	\$ —	\$ —	\$ —
Emergency services	—	—	—	24,074	—	24,074
Cemetery care	—	—	—	—	24,662	24,662
Tourism	—	—	—	—	—	193
Committed for:						
Culture and recreation	13,988	—	—	—	—	13,988
Assigned for:						
Health and welfare	—	—	402	—	—	402
Total Fund Balances	\$13,988	\$1,644	\$402	\$24,074	\$24,662	\$193
						\$64,963

Illustration A-10

(VOLUNTARY SUPPLEMENTARY INFORMATION)
CITY OF EXAMPLE, ANY STATE
COMBINING STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCE—MODIFIED CASH BASIS
NON-MAJOR GOVERNMENTAL FUNDS
FOR THE YEAR ENDED JUNE 30, 20X3

	<i>SPECIAL REVENUE FUNDS</i>						<i>Total</i>
	<i>Park and Recreation</i>	<i>Street and Alley</i>	<i>Nutrition Fund</i>	<i>E-911 Fund</i>	<i>Cemetery Care Fund</i>	<i>ODOC Grant Fund</i>	<i>Non-major Governmental Funds</i>
Revenues:							
Taxes	\$ —	\$ —	\$ —	\$ 27,194	\$ —	\$ —	\$ 27,194
Intergovernmental	—	27,521	74,810	—	—	—	102,331
Charges for services	9,744	—	—	29,512	3,895	—	43,151
Investment income	306	—	—	654	609	5	1,574
Miscellaneous	2,500	—	—	—	—	—	2,500
Total Revenues	12,550	27,521	74,810	57,360	4,504	5	176,750
Expenditures:							
Current:							
E-911	—	—	—	91,285	—	—	91,285
Streets	—	31,765	—	—	—	—	31,765
Park and recreation	25,461	—	—	—	—	—	25,461
Nutrition program	—	—	80,498	—	—	—	80,498
General government	—	—	—	—	—	90	90
Total Expenditures	25,461	31,765	80,498	91,285	—	90	229,099

	<i>SPECIAL REVENUE FUNDS</i>						<i>Total</i>
	<i>Park and Recreation</i>	<i>Street and Alley</i>	<i>Nutrition Fund</i>	<i>E-911 Fund</i>	<i>Cemetery Care Fund</i>	<i>ODOC Grant Fund</i>	<i>Non-major Governmental Funds</i>
Excess (deficiency) of revenues over expenditures	(12,911)	(4,244)	(5,688)	(33,925)	4,504	(85)	(52,349)
Other Financing Sources (Uses):							
Transfers in	12,000	—	3,000	—	—	—	15,000
Total Other Financing Sources (Uses)	12,000	—	3,000	—	—	—	15,000
Net change in fund balances	(911)	(4,244)	(2,688)	(33,925)	4,504	(85)	(37,349)
Fund balances—Beginning	14,899	5,888	3,090	57,999	20,158	278	102,312
Fund balances—Ending	<u><u>\$ 13,988</u></u>	<u><u>\$ 1,644</u></u>	<u><u>\$ 402</u></u>	<u><u>\$ 24,074</u></u>	<u><u>\$ 24,662</u></u>	<u><u>\$ 193</u></u>	<u><u>\$ 64,963</u></u>

Illustration A-11

(VOLUNTARY SUPPLEMENTARY INFORMATION)

CITY OF EXAMPLE, ANY STATE

**BUDGETARY COMPARISON SCHEDULE—MODIFIED CASH BASIS
BUDGETED NON-MAJOR GOVERNMENTAL FUNDS
FOR THE YEAR ENDED JUNE 30, 20XX**

PARK AND RECREATION		SPECIAL REVENUE FUNDS		STREET AND ALLEY	
Budgeted Amounts		Budgeted Amounts		Budgeted Amounts	
		Original	Final	Actual	Variance With Final Budget— Positive (Negative)
Beginning Budgetary Fund Balance		\$14,899	\$14,899	\$14,899	\$ —
Resources (Inflows):					
Taxes	—	—	—	—	—
Intergovernmental	—	—	—	33,000	33,000
Charges for services	8,765	8,765	9,744	978	—
Investment income	—	—	306	306	—
Miscellaneous	3,235	3,235	2,500	(735)	—
Transfers in	12,000	12,000	12,000	—	—
Amounts available for appropriation	38,899	38,899	39,449	550	38,888
					33,409
					(5,479)

SPECIAL REVENUE FUNDS						
PARK AND RECREATION			STREET AND ALLEY			
Budgeted Amounts		Budgeted Amounts		Variance With Final Budget—Positive (Negative)		
Original	Final	Actual Amounts	Original	Final	Actual Amounts	Variance With Final Budget—Positive (Negative)
Charges to appropriations (Outflows):						
E-911:						
Personal services	—	—	—	—	—	—
Materials and supplies	—	—	—	—	—	—
Other services and charges	—	—	—	—	—	—
Capital outlay	—	—	—	—	—	—
Total E-911	—	—	—	—	—	—
Cemetery:						
Other services and charges	—	—	—	—	—	—
Street:						
Materials and supplies	—	—	—	—	33,000	33,000
Parks and Recreation:						
Personal services	9,590	8,218	7,888	—	—	—
Materials and supplies	6,500	10,266	9,850	—	—	—
Other services and charges	7,910	10,496	7,723	—	—	—
Capital outlay	—	—	—	—	—	—
Total Park and Recreation	24,000	29,000	35,359	—	—	—

(continued)

		SPECIAL REVENUE FUNDS			STREET AND ALLEY		
		PARK AND RECREATION			BUDGETED AMOUNTS		
		BUDGETED AMOUNTS			VARIANCE WITH FINAL BUDGET—		
		Original	Final	Actual Amounts	Positive Variance With Final Budget—	Actual Positive Amounts	Variance With Final Budget—
				Original Amounts (Negative)	Positive Variance With Final Budget—	Final Amounts	Positive Amounts (Negative)
Nutrition Program:							
Personal services		—	—	—	—	—	—
Materials and supplies		—	—	—	—	—	—
Other services and charges		—	—	—	—	—	—
Total Nutrition Program		—	—	—	—	—	—
Total Charges to Appropriations		24,000	29,000	25,461	3,539	33,000	31,765
Ending Budgetary Fund Balance		\$14,899	\$ 9,899	\$13,988	\$4,089	\$ 5,888	\$ 1,644
							\$ (4,244)

		SPECIAL REVENUE FUNDS			E-911 FUND	
		NUTRITION FUND		E-911 FUND		
		Budgeted Amounts		Budgeted Amounts		
		Original	Final	Actual	Final	Actual
				Amounts	Original	Amounts
					Variance With Final Budget— Positive (Negative)	Variance With Final Budget— Positive (Negative)
Beginning Budgetary Fund Balance		\$ 3,090	\$ 3,090	\$ 3,090	\$—	\$57,999
Resources (Inflows):						
Taxes		—	—	—	—	32,601
Intergovernmental	64,484	64,484	74,810	—	29,512	29,512
Charges for services	—	—	—	—	—	—
Investment income	—	—	—	—	—	654
Miscellaneous	—	—	—	—	—	—
Transfers in	3,000	3,000	3,000	—	34,000	34,000
Amounts available for appropriation	70,574	70,574	80,900	10,326	154,112	115,359
Charges to appropriations (Outflows):						
E-911:						
Personal services	—	—	—	—	85,113	85,113
Materials and supplies	—	—	—	—	2,400	1,938
Other services and charges	—	—	—	—	8,600	9,062
Capital outlay	—	—	—	—	—	—
Total E-911	—	—	—	—	96,113	96,113
Cemetery:						
Other services and charges	—	—	—	—	—	—
Street:						
Materials and supplies	—	—	—	—	—	—

(continued)

SPECIAL REVENUE FUNDS						
NUTRITION FUND			E-911 FUND			
Budgeted Amounts		Budgeted Amounts				
			<i>Variance With Final Budget— Positive (Negative)</i>	<i>Original Final Amounts</i>	<i>Final Original Amounts</i>	<i>Variance With Final Budget— Positive (Negative)</i>
Parks and Recreation:						
Personal services	—	—	—	—	—	—
Materials and supplies	—	—	—	—	—	—
Other services and charges	—	—	—	—	—	—
Capital outlay	—	—	—	—	—	—
Total Park and Recreation	—	—	—	—	—	—
Nutrition Program:						
Personal services	36,569	36,569	41,203	(4,634)	—	—
Materials and supplies	27,915	27,915	29,781	(1,866)	—	—
Other services and charges	3,000	3,000	9,514	(8,514)	—	—
Total Nutrition Program	67,484	67,484	80,498	(13,014)	—	—
Total Charges to Appropriations	67,484	67,484	80,498	(13,014)	96,113	91,285
Ending Budgetary Fund Balance	\$ 3,090	\$ 3,090	\$ 402	\$ (2,688)	\$ 57,999	\$ 24,074
						\$ (33,925)

SPECIAL REVENUE FUNDS
NUTRITION FUND

	<i>Budgeted Amounts</i>	<i>Original</i>	<i>Final</i>	<i>Actual Amounts</i>	<i>Variance With Final Budget—Positive (Negative)</i>
Beginning Budgetary Fund Balance					
Resources (Inflows):		\$20,158	\$20,158	\$20,158	\$ —
Taxes		—	—	—	—
Intergovernmental		—	—	—	—
Charges for services		—	—	3,895	3,895
Investment income		—	—	609	609
Miscellaneous		—	—	—	—
Transfers in		—	—	—	—
Amounts available for appropriation		20,158	20,158	24,662	4,504
Charges to appropriations (Outflows):					
E-911:					
Personal services		—	—	—	—
Materials and supplies		—	—	—	—
Other services and charges		—	—	—	—
Capital outlay		—	—	—	—
Total E-911		—	—	—	—
Cemetery:					
Other services and charges		5,000	5,000	—	5,000
Street:		—	—	—	—
Materials and supplies		—	—	—	—

(continued)

SPECIAL REVENUE FUNDS
NUTRITION FUND

	<i>Budgeted Amounts</i>		<i>Variance With Final Budget—Positive (Negative)</i>
	<i>Original</i>	<i>Final</i>	
Parks and Recreation:			
Personal services	—	—	—
Materials and supplies	—	—	—
Other services and charges	—	—	—
Capital outlay	—	—	—
Total Park and Recreation	—	—	—
Nutrition Program:			
Personal services	—	—	—
Materials and supplies	—	—	—
Other services and charges	—	—	—
Total Nutrition Program	—	—	—
Total Charges to Appropriations	5,000	5,000	5,000
Ending Budgetary Fund Balance	\$15,158	\$15,158	\$24,662
			\$9,504

Illustration B — Illustrated Cash Basis Financial Statements of a School District

Illustrated Entity—School District

These illustrative financial statements provide an example of selected financial statements of a hypothetical school district, including a statement of net position, statement of activities, and fund financial statements for governmental and fiduciary funds. Note that the example school district has no enterprise funds, internal service funds, or business-type activities. Also note that the school lunch or food services program is accounted for as a governmental fund and reported as governmental activities in the government-wide statements. (Food service activities are also sometimes accounted for in enterprise funds and reported as business-type activities in the government-wide statements.)

These financial statements are illustrative only and should not be considered authoritative. The notes to the financial statements are not illustrated; thus, this set of financial statements is not intended to and does not present complete financial statements as may be required.

These financial statements have been prepared in accordance with the basis of cash receipts and disbursement (the pure cash basis of accounting). The pure cash basis of accounting recognizes cash and cash equivalents and changes in cash and cash equivalents resulting from cash receipts and disbursements.

The financial statement components illustrated in this example include the following:

Statement of Net Position—Cash Basis B-1

Statement of Activities—Cash Basis B-2

Statement of Cash Basis Assets and Fund Balances and Cash Receipts, Disbursements, and Changes in Cash Basis Fund Balances—Governmental Funds B-3

Statement of Cash Receipts, Disbursements, and Changes in Cash Basis Net Position—Fiduciary Funds B-4

Statement of Activities and Net Position—Cash Basis B-5

Illustration B-1

EXAMPLE SCHOOL DISTRICT
STATEMENT OF NET POSITION—CASH BASIS
AUGUST 31, 20XX

<i>Governmental Activities</i>	
ASSETS	
Cash	\$ 7,899,797
Cash equivalents	<u>49,548,147</u>
TOTAL ASSETS	<u><u>\$57,447,984</u></u>
NET POSITION	
Restricted for:	
Special building program	\$14,777,292
School lunch program	1,206,130
Debt service	12,506,837
Unrestricted	<u>28,957,725</u>
TOTAL NET POSITION	<u><u>\$57,447,984</u></u>

Illustration B-2

EXAMPLE SCHOOL DISTRICT STATEMENT OF ACTIVITIES—CASH BASIS FOR THE YEAR ENDED AUGUST 31, 20XX

	<i>Program Cash Receipts</i>			<i>Net (Disbursements) Receipts and Changes in Net Position</i>
	<i>Cash Disbursements</i>	<i>Charges for Services</i>	<i>Operating Grants and Contributions</i>	
Governmental activities:				
Instructional services	\$ (79,916,640)	\$ 314,166	\$ 10,576,556	\$ (65,025,918)
Support services	(27,631,856)	—	1,214,171	(26,417,685)
Food services	(5,490,622)	4,828,270	674,840	12,488
Building maintenance and improvements	(19,437,234)	—	—	(19,437,234)
Principal and interest on indebtedness	(14,828,360)	—	—	(14,828,360)
Other	(724,752)	—	—	(724,752)
Net program (disbursements) receipts	<u>\$ (148,029,464)</u>	<u>\$ 5,142,436</u>	<u>\$ 12,465,567</u>	<u>(130,421,461)</u>
General receipts:				
Local receipts				82,467,582
County receipts				830,704
State receipts				44,306,496
Federal receipts				521,234
Investment income				1,123,104
Other				1,626,397
Total general receipts				<u>130,875,499</u>
Increase in net position				454,038
Net position—Beginning of year				<u>56,993,946</u>
Net position—End of year				<u>\$ 57,447,984</u>

Author's Note: In this example, school lunch activities are reported as governmental activities. However, a school lunch program may also be reported as business-type activities because the activities are funded, in part, by fees charged for the lunch services.

Illustration B-3

EXAMPLE SCHOOL DISTRICT
STATEMENT OF CASH BASIS ASSETS AND FUND BALANCES AND CASH RECEIPTS, DISBURSEMENTS, AND
CHANGES IN CASH BASIS FUND BALANCES—GOVERNMENTAL FUNDS
AS OF AND FOR THE YEAR ENDED AUGUST 31, 20XX

	<i>General Fund</i>	<i>Special Building Fund</i>	<i>School Lunch Fund</i>	<i>Employee Benefit Fund</i>	<i>Debt Service Fund</i>	<i>Other Governmental Funds</i>	<i>Total Governmental Funds</i>
Receipts							
Local receipts	\$ 84,108,451	\$ 5,089,603	\$ 18,635	\$ —	\$ 14,266,290	\$ 187,665	\$ 83,650,644
County receipts	830,704	—	—	—	—	—	830,704
State receipts	52,599,640	48,121	23,223	—	145,947	—	52,816,941
Federal receipts	3,818,881	8,060	651,617	—	—	—	4,476,358
Sales of lunches	—	—	4,809,635	—	—	—	4,809,635
Investment income	223,492	685,248	15,583	32,055	166,746	—	1,123,104
Nonrevenue receipts	144,402	431,714	—	9,601,236	200,000	615,726	10,993,168
Total Receipts	\$121,723,370	\$ 6,246,746	\$5,518,673	\$9,633,381	\$14,778,993	\$803,391	\$158,700,554
Disbursements							
Instructional services	\$ 77,881,429	\$ —	\$ —	\$ —	\$ —	\$ —	\$77,881,429
Support services	44,020,067	—	—	—	—	—	44,020,087
Other salaries and benefits	—	—	2,538,746	—	—	—	2,538,746
Supplies and materials	—	—	431,539	—	—	—	431,539
Purchased services	—	961,932	—	8,275,230	—	—	9,425,372
Food	—	—	2,407,851	—	—	188,210	2,407,651
Capital outlay	—	1,149,846	112,686	—	—	—	1,791,839
Building and site acquisition and improvement	—	4,809,584	—	—	—	529,307	4,859,833
Other	—	81,680	—	—	—	50,249	61,660
Redemption of principal	—	—	—	—	8,155,000	—	8,155,000
Debt service interest	—	—	—	—	6,879,372	—	6,879,372
Total Disbursements	\$121,901,518	\$6,983,022	\$5,490,622	\$8,275,230	\$15,034,372	\$ 767,766	\$158,452,528

	<i>General Fund</i>	<i>Building Fund</i>	<i>Special Building Fund</i>	<i>School Lunch Fund</i>	<i>Employee Benefit Fund</i>	<i>Debt Service Fund</i>	<i>Other Governmental Funds</i>	<i>Total Governmental Funds</i>
Excess (Deficiency) of Receipts Over Disbursements	(178,146)	(740,276)		28,051	1,358,151	(49,367)	35,625	454,038
Other Financing Sources (Uses)								
Proceeds from refunding bonds					21,536,525		21,536,525	
Payment to bond refunding escrow agent					(21,330,513)		(21,330,513)	
Total Other Financing Sources (Uses)					206,012		206,012	
Excess (Deficiency) of Receipts and Other Financing Sources Over Disbursements and Other Financing Sources	(178,146)	(740,276)		28,051	1,358,151	(49,367)	35,625	454,038
Cash Basis Fund Balance—Beginning of year	25,475,314	15,517,568	1,178,079	1,387,495	12,556,204		879,286	56,993,946
Cash Basis Fund Balance—End of year	\$25,297,168	\$14,777,292	\$1,206,130	\$ 2,745,646	\$12,506,837		\$914,911	\$ 57,447,984
Cash Basis Assets—								
End of year								
Cash	\$ 7,302,683	\$ —	\$ 592,904	\$ —	\$ —		\$ 4,210	\$ 7,899,797
Cash equivalents	17,994,485	14,777,292	613,226	2,745,646	12,506,837		910,701	49,548,187
	\$25,297,168	\$14,777,292	\$1,206,130	\$ 2,745,646	\$12,506,837		\$914,911	\$ 57,447,984

(continued)

	<i>General Fund</i>	<i>Special Building Fund</i>	<i>School Lunch Fund</i>	<i>Employee Benefit Fund</i>	<i>Debt Service Fund</i>	<i>Other Governmental Funds</i>	<i>Total Governmental Funds</i>
Cash Basis Fund Balances—							
End of year							
Fund Balances:							
Restricted for:							
Building improvements	\$ —	\$14,777,292	\$ —	\$ —	\$ —	\$ —	\$ 14,777,292
School lunches	—	—	1,206,130	—	—	—	1,206,130
Debt service reserve	—	—	—	—	500,000	—	500,000
Committed for:							
Education programs	—	—	—	—	—	4,210	4,210
Assigned for:							
Employee benefits	—	—	—	2,745,646	—	—	2,745,646
Capital asset replacement	—	—	—	—	—	910,701	910,701
Debt service	—	—	—	—	12,006,837	—	12,006,837
Unassigned	25,297,168	—	—	—	—	—	25,297,168
Total Fund Balances	\$25,297,168	\$14,797,292	\$1,206,130	\$ 2,745,646	\$12,506,837	\$ 4,210	\$ 57,447,984

Illustration B-4

EXAMPLE SCHOOL DISTRICT
STATEMENT OF CASH RECEIPTS, DISBURSEMENTS, AND CHANGES IN
CASH BASIS NET POSITION—FIDUCIARY FUNDS
AS OF AND FOR THE YEAR ENDED AUGUST 31, 20XX

<i>Activities' Fund</i>	<i>Beginning Net Position</i>	<i>Receipts</i>	<i>Disbursements</i>	<i>Ending Net Position</i>
Administrative Office	\$ 302,634	\$ 250,118	\$ 333,635	\$ 219,118
High Schools:				
North	549,336	966,755	1,014,537	501,554
South	378,954	853,328	850,086	382,196
West	276,297	1,065,342	1,039,340	302,299
Middle Schools:				
Central	90,044	126,024	136,956	79,112
North	63,730	109,085	120,282	52,533
South	3,121	49,838	41,952	11,077
East	96,728	119,994	144,455	72,267
West	150,404	187,240	184,026	153,618
East Central	64,942	194,971	198,412	61,501
Elementary Schools:				
A	12,030	30,519	30,763	11,786
B	24,518	47,534	53,514	18,538
C	1,987	15,248	12,887	4,348
D	5,913	46,886	44,090	8,709
E	12,139	23,962	29,583	6,516
F	14,935	25,891	22,535	18,291
G	12,247	30,973	31,723	11,497
H	8,342	11,405	12,128	7,619
I	15,095	19,024	19,471	14,648
J	16,208	17,912	20,393	13,727
K	11,782	12,050	16,210	7,622
L	7,672	20,989	22,515	6,146
M	9,177	21,149	19,641	10,685
N	7,555	59,174	57,770	8,959
O	5,841	34,395	32,430	7,806

(continued)

<i>Activities' Fund</i>	<i>Beginning Net Position</i>	<i>Receipts</i>	<i>Disbursements</i>	<i>Ending Net Position</i>
P	18,939	47,621	45,018	21,742
Q	5,069	24,107	21,761	7,415
R	25,413	30,667	32,154	23,926
S	9,007	26,424	23,263	12,168
T	8,594	33,623	35,438	6,779
U	12,054	25,334	23,173	14,215
V	11,120	33,805	28,489	16,526
Summer School	2,050	3,866	120	5,796
Learning Center	93	11,930	10,501	1,522
Skills Factory	49	—	—	49
Program Sales	249	721	—	970
Life Skills	1,060	—	594	466
Total Activities Fund	\$2,235,418	\$4,578,105	\$4,709,845	\$2,103,678

Student Fee Fund

All Schools	
Net Position	
Cash	\$1,383,761
Cash equivalents	813,333
Total Net Position—	
Cash Basis Held in Trust	\$2,197,094

Illustration B-5

EXAMPLE SCHOOL DISTRICT
STATEMENT OF ACTIVITIES AND NET POSITION—CASH BASIS
AS OF AND FOR THE YEAR ENDED AUGUST 31, 20XX

	<i>Program Cash Receipts</i>			<i>Net (Disbursements) Receipts and Changes in Net Position</i>
	<i>Cash Disbursements</i>	<i>Charges for Services</i>	<i>Operating Grants and Contributions</i>	
Governmental activities				
Instructional services	\$ (79,916,640)	\$ 314,166	\$ 10,576,566	\$ (69,025,918)
Support services	(27,631,856)	—	1,214,171	(26,417,685)
Food services	(5,490,622)	4,828,270	674,840	12,468
Building maintenance and improvements	(19,437,234)	—	—	(19,437,234)
Principal and interest on indebtedness	(14,628,360)	—	—	(14,828,360)
Other	(724,752)	—	—	(724,752)
Net program (disbursements) receipts	<u>\$ (148,029,464)</u>	<u>\$ 5,142,436</u>	<u>\$ 12,465,567</u>	<u>(130,421,461)</u>
General receipts:				
Local receipts				82,467,562
County receipts				830,704
State receipts				44,306,498
Federal receipts				521,234
Investment earnings				1,123,104
Other				1,626,397
Total general receipts				<u>130,875,499</u>
Increase in net position				<u>454,038</u>
Net position—Beginning of year				<u>56,993,946</u>
Net position—End of year				<u>\$ 57,447,984</u>
ASSETS				
Cash				\$ 7,899,797
Cash equivalents				49,548,187
TOTAL ASSETS				<u>\$ 57,447,984</u>
NET POSITION				
Restricted				
Special building				\$ 14,777,292
School lunch program				1,206,130
Debt service				12,506,837
Unrestricted				28,957,725
TOTAL NET POSITION				<u>\$ 57,447,984</u>

Illustration C — Illustrated Regulatory Basis Financial Statements of a County Government

Illustrated Entity—County Government

These illustrative financial statements provide an example of selected financial statements prepared to comply with certain regulatory requirements. The example financial statements are those of a hypothetical county government and include a summary of cash receipts, expenditures, and unencumbered cash and a summary of expenditures—actual and budget.

These financial statements are illustrative only and should not be considered authoritative. Any other regulatory requirements for presentation and disclosure, such as notes to the financial statements, and any other regulatory required information are not illustrated; thus, this set of financial statements is not intended to and does not present complete financial statements as may be required to meet any specific regulations.

These financial statements have been prepared in accordance with the basis of accounting and presentation that meets hypothetical requirements of a state regulatory agency as applied to a county government (regulatory basis of accounting). This example regulatory basis framework requires only summary financial information by individual fund and fund type and recognizes cash and cash equivalents and the changes therein resulting from cash receipts and regulatory basis expenditures. In this regulatory basis example, expenditures are recognized when encumbrances or accounts payable are incurred.

The financial statement components illustrated in this example include the following:

Summary of Cash Receipts, Expenditures, and Unencumbered Cash—
Regulatory Basis C-1

Summary of Expenditures—Regulatory Basis (Actual and Budget) C-2

Illustration C-1

EXAMPLE COUNTY, ANY STATE
SUMMARY OF CASH RECEIPTS, EXPENDITURES, AND UNENCUMBERED CASH—REGULATORY BASIS
FOR THE YEAR ENDED DECEMBER 31, 20XX

	<i>Add:</i>				
	<i>Beginning Unencumbered Cash Balance</i>	<i>Cash Receipts</i>	<i>Expenditures</i>	<i>Unencumbered Cash Balance</i>	<i>Outstanding Encumbrances and Accounts Payable</i>
General Operating Fund	\$112,565	\$246,405	\$246,637	\$112,333	\$ 458
Special Revenue Funds:					\$112,791
Special Highway Fund	40,748	20,697	3,018	58,427	—
Special Park and Recreation Fund	1,590	—	1,590	—	58,427
Total Special Revenue Funds	42,338	20,697	4,608	58,427	—
Debt Service Fund:					58,427
Bond and Interest Fund	—	99,272	89,170	10,102	—
Capital Project Fund:					10,102
Capital Improvement Fund	171,273	128,726	130,478	169,521	42,266
					211,787
Enterprise Funds:					
Utilities Fund	299,770	391,442	407,638	283,574	15,000
Airport Fund	30,710	29,819	21,931	38,958	208
Emergency Services Fund	106,842	69,082	53,306	122,618	148
Total Enterprise Funds	437,322	490,343	482,875	444,790	15,356
Agency Funds:					460,146
Recreation Committee Fund	117	600	535	182	—
Property Tax Fund	—	7,209	7,209	—	—
Total Agency Funds	117	7,809	7,744	182	—
Total Reporting Entity	\$763,615	\$993,252	\$961,512	\$795,355	\$58,080
Composition of Cash:					
Certificate of Deposit—Example State Bank					\$120,000
Checking Account—Example State Bank					733,211
Checking Account—Example Federal Bank					182
Petty Cash—County Clerk					42
Total Reporting Entity					\$853,435

Illustration C-2

EXAMPLE COUNTY, ANY STATE
SUMMARY OF EXPENDITURES—REGULATORY BASIS (ACTUAL AND BUDGET)
(BUDGETED FUNDS ONLY)
FOR THE YEAR ENDED DECEMBER 31, 20XX

	<i>Certified Budget</i>	<i>Qualifying Budget Adjustments</i>	<i>Total Budget for Comparison</i>	<i>Expenditures Chargeable to Current Year</i>	<i>Variance—Favorable (Unfavorable)</i>
General Operating Fund	\$ 304,691	\$10,000	\$ 314,691	\$246,637	\$ 68,054
Special Revenue Funds:					
Special Highway Fund	51,884	—	51,884	3,018	48,866
Special Park and Recreation Fund	1,590	—	1,590	1,590	—
Total Special Revenue Funds	53,474	—	53,474	4,608	48,866
Debt Service Fund:					
Bond and Interest Fund	99,755	—	99,755	89,170	10,585
Capital Project Fund:					
Capital Improvement Fund	410,438	—	410,438	130,478	279,960
Enterprise Funds:					
Utilities Fund	625,155	—	625,155	407,638	217,517
Airport Fund	41,142	—	41,142	21,931	19,211
Emergency Services Fund	203,255	—	203,255	53,306	149,949
Total Enterprise Funds	869,552	—	869,552	482,875	386,677
Total Reporting Entity	\$1,737,910	\$10,000	\$1,747,910	\$953,768	\$794,142

Illustration D — Illustrated Modified Cash Basis Financial Statements of a Single-Program Governmental Activity

Illustrated Entity—Single-Program Government (Governmental Activity)

These illustrative financial statements provide an example of selected financial statements of a hypothetical single-program government with multiple governmental funds and engaged in only governmental activities (an example emergency services district). The example financial statements present an alternative method of combining the government-wide statement of net position and statement of activities with the fund financial statements. This presentation is an acceptable alternative to presenting separate government-wide and fund statements.

This presentation is illustrative only and should not be considered authoritative. The notes to the financial statements are not illustrated; thus, this set of financial statements is not intended to and does not present complete financial statements as may be required.

These financial statements have been prepared in accordance with a modified cash basis of accounting that recognizes certain assets, deferred outflows of resources, liabilities, deferred inflows of resources, revenues, and expenditures or expenses when they arise from cash transactions or events, including the reporting of depreciation expense and accumulated depreciation on capital assets in government-wide financial statements. Therefore, the financial statements do not include receivables or payables resulting from accruals or any other financial statement elements unless they result from cash transactions or events.

The financial statement components illustrated in this example include the following:

Statement of Net Position and Governmental Funds Balance Sheet—Modified Cash Basis D-1

Statement of Activities and Governmental Funds Revenues, Expenditures, and Changes in Fund Balances—Modified Cash Basis (Alternative Format 1) D-2

Statement of Activities and Governmental Funds Revenues, Expenditures, and Changes in Fund Balances—Modified Cash Basis (Alternative Format 2) D-3

Illustration D-1

EXAMPLE COUNTY EMERGENCY SERVICES DISTRICT
STATEMENT OF NET POSITION AND GOVERNMENTAL FUNDS BALANCE SHEET—MODIFIED CASH BASIS
JUNE 30, 20XX

	<i>General Fund</i>	<i>Other Funds</i>	<i>Total</i>	<i>Adjustments (Note X)*</i>	<i>Statement of Net Position</i>
Assets					
Cash and cash equivalents	\$5,163,743	\$321,074	\$5,484,817	\$ —	\$ 5,484,817
Internal receivables	—	15,550	15,550	(15,550)	—
Land	—	—	—	298,554	298,554
Other capital assets, net of accumulated depreciation	—	—	—	4,975,266	4,975,266
Total assets	5,163,743	336,624	5,500,367	5,258,270	10,758,637
Liabilities					
Payroll withholdings payable	123,485	—	123,485	—	123,485
Internal payables	15,550	—	15,550	(15,550)	—
Long-term liabilities:					
Due within one year	—	—	—	397,850	397,850
Due after one year	—	—	—	3,214,085	3,214,085
Total liabilities	139,035	—	139,035	3,596,385	3,735,420

Fund Balances/Net Position	General Fund	Other Funds	Total	Adjustments	Statement of
				(Note X)*	Net Position
Fund balances					
Restricted	—	206,622	206,622	(206,622)	—
Committed	—	130,002	130,002	(130,002)	—
Assigned	—	—	—	—	—
Unassigned	5,024,708	—	5,024,708	—	—
Total fund balances	5,024,708	336,624	5,361,332	(5,024,708)	—
Total liabilities and fund balances	\$5,024,708	\$336,624	\$5,361,332	(5,361,332)	—
Net position:					
Net investment in capital assets				1,661,885	1,661,885
Restricted for debt service				206,622	206,622
Unrestricted				5,759,140	5,759,140
Total net position				\$ 7,267,647	\$ 7,267,647

* Note X would provide the details for the main components of the adjustments.

Illustration D-2

**EXAMPLE COUNTY EMERGENCY SERVICES DISTRICT
STATEMENT OF ACTIVITIES AND GOVERNMENTAL FUNDS REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCES—MODIFIED CASH BASIS
FOR THE YEAR ENDED JUNE 30, 20XX**

	<i>General Fund</i>	<i>Other Funds</i>	<i>Total</i>	<i>Adjustments (Note Y)*</i>	<i>Statement of Activities</i>
Expenditures/expenses:					
Emergency service—Operations	\$9,346,789	\$245,084	\$ 9,591,873	\$ 373,982	\$ 9,965,855
Capital outlay	123,000	221,100	344,100	(344,100)	—
Debt service:					
Principal	12,367	345,000	357,367	(357,367)	—
Interest	2,328	103,759	106,087	—	106,087
Total expenditures/expenses	<u>9,484,484</u>	<u>914,943</u>	<u>10,399,427</u>	<u>(327,485)</u>	<u>10,071,942</u>
Program revenues:					
Charges for services	283,905	—	283,905	—	283,905
Net program expense					9,788,037
General revenues:					
Property taxes	9,520,751	—	9,520,751	—	9,520,751
Investment income	528,038	63,205	591,243	—	591,243
Miscellaneous	123,029	—	123,029	—	123,029
Transfers—Internal activities	(450,000)	450,000	—	—	—
Total general revenues and transfers	<u>9,721,818</u>	<u>513,205</u>	<u>10,235,023</u>	<u>—</u>	<u>10,235,023</u>
Excess of revenues and transfers in over expenditures and transfers out	521,239	(401,738)	119,501	(119,501)	—
Change in net position	—	—	—	446,986	446,986
Fund balance/net position:					
Beginning of the year	<u>4,503,469</u>	<u>738,362</u>	<u>5,241,831</u>	<u>1,938,830</u>	<u>7,180,661</u>
End of the year	<u>\$5,024,708</u>	<u>\$336,624</u>	<u>\$ 5,361,332</u>	<u>\$2,266,315</u>	<u>\$ 7,627,647</u>

* Note Y would provide the details for the main components of the adjustments.

This alternative presentation is focused more on the statement of activities' format.

Illustration D-3

**EXAMPLE COUNTY EMERGENCY SERVICES DISTRICT
STATEMENT OF ACTIVITIES AND GOVERNMENTAL FUNDS REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCES—MODIFIED CASH BASIS
FOR THE YEAR ENDED JUNE 30, 20XX**

	<i>General Fund</i>	<i>Other Funds</i>	<i>Total</i>	<i>Adjustments (Note V)*</i>	<i>Statement of Activities</i>
Revenues:					
Property taxes	\$ 9,520,751	\$ —	\$ 9,520,751	\$ —	\$ 9,520,751
Investment income	528,038	63,205	591,243	—	591,243
Charges for services	283,905	—	263,905	—	283,905
Miscellaneous	123,029	—	123,029	—	123,029
Total revenues	10,455,723	63,205	10,518,928	—	10,518,928
Expenditures/expenses:					
Emergency services					
Current					
Personal services	8,527,864	—	8,527,864	—	8,527,864
Materials and services	818,925	245,084	1,064,009	—	1,064,009
Depreciation	—	—	—	373,982	373,982
Capital outlay	123,000	221,100	344,100	(344,100)	—
Debt service:					
Principal	12,367	345,000	357,367	(357,367)	—
Interest	2,328	103,759	106,087	—	106,087
Total expenditures/expenses	9,484,484	914,943	10,399,427	327,485	10,071,942

(continued)

	<i>General Fund</i>	<i>Other Funds</i>	<i>Total</i>	<i>Adjustments (Note Y)*</i>	<i>Statement of Activities</i>
Excess (deficiency) of revenues over expenditures	971,239	(851,738)	119,501	(327,485)	446,986
Other financing sources/uses:					
Transfers—Internal activities	(450,000)	450,000	—	—	—
Excess (deficiency) of revenues and transfers in over expenditures and transfers out	521,239	(401,738)	119,501	(119,501)	—
Change in net position	—	—	—	446,986	446,986
Fund balances/net position:					
Beginning of the year	4,503,469	738,362	5,241,831	1,938,830	7,180,661
End of the year	<u><u>\$ 5,024,708</u></u>	<u><u>\$ 336,624</u></u>	<u><u>\$ 5,361,332</u></u>	<u><u>\$ 2,266,315</u></u>	<u><u>\$ 7,627,647</u></u>

* Note Y would provide the details for the main components of the adjustments.

This alternative presentation is focused more on the fund statements' format.

Illustration E — Illustrated Modified Cash Basis Financial Statements of a Single-Program Business-Type Activity

Illustrated Entity—Single-Program Government (Business-Type Activity)

These illustrative financial statements provide an example of selected financial statements of a hypothetical single-program government with only one fund and engaged in only business-type activities (a solid waste authority of a state government). The financial statements include a statement of net position; a statement of revenues, expenses, and changes in net position; and a statement of cash flows.

These financial statements are illustrative only and should not be considered authoritative. The notes to the financial statements are not illustrated; thus, this set of financial statements is not intended to and does not present complete financial statements as may be required.

These financial statements have been prepared in accordance with a modified cash basis of accounting that recognizes certain assets, deferred outflows of resources, liabilities, deferred inflows of resources, revenues, and expenditures or expenses when they arise from cash transactions or events, including the reporting of depreciation expense and accumulated depreciation on capital assets in government-wide financial statements. Therefore, the financial statements do not include receivables or payables resulting from accruals or any other financial statement elements unless they result from cash transactions or events.

The financial statement components illustrated in this example include the following:

Statement of Net Position—Modified Cash Basis E-1

Statement of Revenues, Expenses, and Changes in Net Position—
Modified Cash Basis E-2

Statement of Cash Flows—Modified Cash Basis E-3

Illustration E-1

**EXAMPLE STATE SOLID WASTE AUTHORITY
(A COMPONENT UNIT OF STATE OF EXAMPLE)
STATEMENT OF NET POSITION—MODIFIED CASH BASIS
DECEMBER 31, 20XX**

Assets

Current assets:

Cash and cash equivalents	\$ 2,450
Investments	<u>673,290</u>
Total current assets	<u>675,740</u>

Noncurrent assets:

Restricted cash and cash equivalents	335,000
--------------------------------------	---------

Capital assets:

Land	513,298
Buildings and equipment	6,728,340
Less accumulated depreciation	<u>(1,839,774)</u>
Total noncurrent assets	<u>5,401,864</u>
Total assets	<u>6,412,604</u>

Liabilities

Current liabilities:

Due to State General Fund	153,200
---------------------------	---------

Noncurrent liabilities:

Revenue bonds payable	<u>4,222,870</u>
Total liabilities	<u>4,376,070</u>

Net Position

Net investment in capital assets	1,178,994
Restricted for debt service	335,000
Unrestricted	522,540
Total net position	<u>\$ 2,036,534</u>

Illustration E-2

**EXAMPLE STATE SOLID WASTE AUTHORITY
(A COMPONENT UNIT OF STATE OF EXAMPLE)
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN
NET POSITION—MODIFIED CASH BASIS
FOR THE YEAR ENDED DECEMBER 31, 20XX**

Operating Revenues	
Charges for services	\$2,854,789
Miscellaneous	7,988
Total operating revenues	<u>2,862,777</u>
Operating Expenses	
Salaries and wages	1,137,654
Employee benefits	102,753
Materials and supplies	79,028
Contractual services	25,391
Maintenance and repairs	390,912
Utilities	17,780
Administrative and general	492,804
Miscellaneous	19,225
Depreciation	<u>236,883</u>
Total operating expenses	<u>2,502,430</u>
Operating income	<u>360,347</u>
Nonoperating Revenues (Expenses)	
Investment income	210,241
Interest expense	<u>(189,288)</u>
Total nonoperating revenues	<u>20,953</u>
Change in net position	<u>381,300</u>
Net position—Beginning of the year	<u>1,655,234</u>
Net position—End of the year	<u>\$2,036,534</u>

Illustration E-3

**EXAMPLE STATE SOLID WASTE AUTHORITY
(A COMPONENT UNIT OF STATE OF EXAMPLE)
STATEMENT OF CASH FLOWS—MODIFIED CASH BASIS
FOR THE YEAR ENDED DECEMBER 31, 20XX**

Cash Flows From Operating Activities:

Cash received from customers	\$ 2,854,789
Cash paid to employees	(1,240,407)
Cash paid to suppliers	(1,025,140)
Other receipts	7,988
Net cash provided by operations	<u>597,230</u>

Cash Flows From Noncapital Financing Activities:

Loans from the State General Fund	<u>153,200</u>
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Cash Flows From Capital and Related Financing Activities:

Acquisition of capital assets	(337,826)
Payment of principal on long-term debt	(475,000)
Payment of interest on long-term debt	(189,288)
Net cash used in capital and related financing activities	<u>(1,002,114)</u>

Cash Flows From Investing Activities:

Purchase of investments	(150,000)
Proceeds from sale and maturities of investments	275,000
Investment income received	210,241
Net cash provided by investing activities	<u>335,241</u>
Net increase in cash and cash equivalents	83,557
Beginning cash and cash equivalents	253,893
Ending cash and cash equivalents	<u>\$ 337,450</u>

Reconciliation of Operating Income to Net Cash Provided by Operating Activities:

Operating income	\$ 360,347
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation	236,883
Net cash provided by operating activities	<u>\$ 597,230</u>

Appendix C

Example Auditor Reports on Special Purpose Financial Statements of State and Local Governments

This appendix contains a table that provides an overview of auditor reporting requirements for special purpose frameworks and illustrated example auditor reports on special purpose financial statements with a variety of different types of opinions. The overview table provides a summary of the auditor reporting requirements with regard to opinions to be rendered, a description of the purpose of the special purpose financial statements, emphasis-of-matter paragraphs, and other-matter paragraph regarding restricted use.

These following example auditor reports illustrate the major points of discussion from chapter 4, “Auditor Reporting on Special Purpose Financial Statements of State and Local Governments,” of this practice aid:

<i>Illustration</i>	<i>Type of Special Report Opinion</i>	<i>Basis of Accounting</i>
1	Unmodified Opinions on the Basic Financial Statements	Cash Basis or Modified Cash Basis
2	Unmodified Opinions on the Basic Financial Statements Accompanied by Supplementary and Other Information	Cash Basis or Modified Cash Basis
3	Unmodified Opinion on Regulatory Basis	Regulatory Basis
4	Adverse Opinion About GAAP and Unmodified Opinion on Regulatory Basis	Regulatory Basis
5	Includes a Qualified Opinion on the Discretely Presented Component Unit’s Opinion Unit Because of the Inability to Obtain Sufficient Appropriate Audit Evidence Related to an Unaudited Component Unit and Includes Unmodified Opinions on All Other Opinion Units	Cash Basis or Modified Cash Basis
6	Adverse Opinion Regarding an Omitted Material Major Enterprise Fund, a Qualified Opinion on Business-Type Activities Because of a Material Misstatement Related to the Omitted Fund, and an Unmodified Opinion on All Other Opinion Units	Cash Basis

(continued)

Illustration	Type of Special Report Opinion	Basis of Accounting
7	Adverse Opinion on Governmental Activities Because of the Omission of Certain Material General Infrastructure Assets and Unmodified Opinions on All Other Opinion Units	Modified Cash Basis
8	Adverse Opinion on the Financial Statements as a Whole Because of the Omission of Government-Wide Financial Statements	Cash Basis or Modified Cash Basis
9	Includes a Disclaimer of Opinion on the Discretely Presented Component Unit's Opinion Unit Because One (But Not All) Discretely Presented Component Units Are Not Audited and Includes Unmodified Opinions on All Other Opinion Units	Cash Basis or Modified Cash Basis
10	Adverse Opinion on Discretely Presented Component Unit Because the Component Unit Is Presented in Accordance With a GAAP Basis and Includes Unmodified Opinions on All Other Opinion Units	Cash Basis or Modified Cash Basis

Overview of Auditor Reporting Requirements for Special Purpose Frameworks Applicable to State and Local Governments

	<i>Cash Basis or Modified Cash Basis</i>	<i>Regulatory Basis Restricted Use</i>	<i>Regulatory Basis General Use</i>
Opinion(s)	Opinion(s) on special purpose framework	Opinion(s) on special purpose framework	Dual opinion on special purpose framework and U.S. generally accepted accounting principles
Description of purpose for which special purpose financial statements are prepared	No	Yes	Yes
Emphasis-of-matter paragraph alerting readers to preparation in accordance with a special purpose framework	Yes	Yes	No
Other-matter paragraph restricting the use of the auditor's report	No	Yes	No
Illustrated examples	1, 2, 5, 6, 7, 8, 9, and 10	3	4

Illustration 1—Auditor’s Report on Cash Basis or Modified Cash Basis Financial Statements (Unmodified Opinions on the Basic Financial Statements)

Illustration assumptions:

- ▶ Financial statements are of a general purpose government and have been prepared by management in accordance with the cash basis or modified basis of accounting. Management has a choice of financial reporting frameworks.
- ▶ Auditor’s opinions on all opinion units are unmodified. Auditor is not engaged to render an opinion on effectiveness of internal control.
- ▶ Financial statements are not accompanied by any supplementary or other information.

Independent Auditor’s Report

[Appropriate Addressee]

Report on Financial Statements

We have audited the accompanying cash basis [*or modified cash basis, if applicable*] financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and aggregate remaining fund information of the City of Example, Any State, as of and for the year ended June 30, 20XX, and the related notes to the financial statements, which collectively comprise the City’s basic financial statements as listed in the table of contents.

Management’s Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the cash basis [*or modified cash basis, if applicable*] of accounting described in Note X; this includes determining that the cash basis [*or modified cash basis, if applicable*] of accounting is an acceptable basis for the preparation of the financial statements in the circumstances. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. [*If the audit was performed in accordance with Government Auditing Standards, reference to such standards should be added here.*] Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the City's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used, and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective cash basis [*or modified cash basis, if applicable*] financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Example, Any State, as of June 30, 20XX; the respective changes in cash basis [*or modified cash basis, if applicable*] financial position; and, where applicable, cash flows thereof for the year then ended in accordance with the cash basis [*or modified cash basis, if applicable*] of accounting described in Note X.

Basis of Accounting

We draw attention to Note X of the financial statements, which describes the basis of accounting. The financial statements are prepared in accordance with the cash basis [*or modified cash basis, if applicable*] of accounting, which is a basis of accounting other than

accounting principles generally accepted in the United States of America. Our opinions are not modified with respect to this matter.

Report on Other Legal and Regulatory Requirements

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities, if any. For example, if the audit is performed in accordance with Government Auditing Standards, wording would be added here that links this report with the related Report on Internal Control over Financial Reporting and on Compliance and Other Matters. Guidance for such reporting is provided in the AICPA Audit Guide Government Auditing Standards and Single Audits.]

[Auditor's Signature]

[Auditor's City and State]

[Date of Auditor's Report]

Illustration 2—Auditor's Report on Cash Basis or Modified Cash Basis Financial Statements (Unmodified Opinions on the Basic Financial Statements Accompanied by Supplementary and Other Information)

Illustration assumptions:

- ▶ Financial statements are of a general purpose government and have been prepared by management in accordance with the cash basis or modified cash basis of accounting. Management has a choice of financial reporting frameworks.
- ▶ Auditor's opinions on all opinion units are unmodified. Auditor is not engaged to render an opinion on effectiveness of internal control.
- ▶ Financial statements are accompanied by management's discussion and analysis, introductory information, and statistical tables that are to be reported on as other information in accordance with AU-C section 720, *Other Information in Documents Containing Audited Financial Statements* (AICPA, *Professional Standards*), and also accompanied by budgetary comparison schedules and combining and individual fund statements to be reported on as supplementary information in accordance with AU-C section 725, *Supplementary Information in Relation to the Financial Statements as a Whole* (AICPA, *Professional Standards*), and such supplementary information is fairly stated in relation to the financial statements as a whole.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Financial Statements

We have audited the accompanying cash basis [*or modified cash basis, if applicable*] financial statements of the governmental activities, the business-type activities, aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Example, Any State, as of and for the year ended June 30, 20XX, and the related notes to the financial statements, which collectively comprise the City's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the cash basis [*or modified cash basis, if applicable*] of accounting described in Note X; this includes determining that the cash basis [*or modified cash basis, if applicable*] of accounting is an acceptable basis for the preparation of the financial statements in the circumstances. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. [*If the audit was performed in accordance with Government Auditing Standards, reference to such standards should be added here.*] Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the City's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we express no such opinion. An audit also includes evaluat-

ing the appropriateness of accounting policies used, and the reasonableness of significant accounting estimates made, by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective cash basis [*or modified cash basis, if applicable*] financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and aggregate remaining fund information of the City of Example, Any State, as of June 30, 20XX; the respective changes in cash basis [*or modified cash basis, if applicable*] financial position; and, when applicable, cash flows thereof for the year then ended in accordance with the cash basis [*or modified cash basis, if applicable*] of accounting described in Note X.

Other Matters

Supplementary and Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements as a whole that collectively comprise the City of Example's basic financial statements. The [*identify accompanying supplementary information, such as budgetary comparison information and combining and individual non-major fund financial statements, and other information, such as management's discussion and analysis, introductory information, and statistical or trend schedules*] are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The budgetary comparison information presented on pages [*insert applicable page numbers*] and combining and individual fund financial statements presented on pages [*insert applicable page numbers*] is the responsibility of management and was derived from, and relates directly to, the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the budgetary comparison information and combining and individual fund financial statements is fairly stated in all

material respects in relation to the basic financial statements as a whole on the basis of accounting described in Note X.

Management's discussion and analysis on pages [insert applicable page numbers], the introductory information on pages [insert applicable page numbers], and the statistical and trend schedules presented on pages [insert applicable page numbers] have not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Basis of Accounting

We draw attention to Note X of the financial statements that describes the basis of accounting. The financial statements are prepared in accordance with the cash basis [*or modified cash basis, if applicable*] of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our opinions are not modified with respect to this matter.

Report on Other Legal and Regulatory Requirements

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities, if any. For example, if the audit is performed in accordance with Government Auditing Standards, wording would be added here that links this report with the related Report on Internal Control over Financial Reporting and on Compliance and Other Matters. Guidance for such reporting is provided in the AICPA Audit Guide Government Auditing Standards and Single Audits.]

[Auditor's Signature]

[Auditor's City and State]

[Date of Auditor's Report]

Illustration 3—Auditor's Report on Regulatory Basis Financial Statements Not Intended for General Use (Unmodified Opinion on Regulatory Basis)

Illustration assumptions:

- Financial statements are of a special purpose government and have been prepared by management in accordance with a regulatory basis of accounting prescribed by state statutes applicable to the government entity. The regulatory basis financial statements, together with the auditor's report, are intended for filing only with a state regulatory agency to whose jurisdiction the entity is subject, and the

statements are not intended for general use. Because of the regulatory requirements, management does not have a choice of financial reporting frameworks.

- Auditor's opinion is unmodified. Auditor is not engaged to render an opinion on the effectiveness of internal control.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Financial Statements

We have audited the accompanying statement of net position—regulatory basis of ABC Government Authority as of December 31, 20XX, and the related statement of revenues, expenses, and changes in net position—regulatory basis and statement of cash flows—regulatory basis for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the financial reporting provisions of Section Y of Regulation Z of Any State Statutes, as described in Note X. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. *[If the audit was performed in accordance with Government Auditing Standards, reference to such standards should be added here.]* Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the

circumstances but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used, and the reasonableness of significant accounting estimates made, by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the regulatory basis net position of ABC Government Authority as of December 31, 20XX, and the regulatory basis revenues, expenses, and changes in net position and regulatory basis cash flows thereof for the year then ended in accordance with the financial reporting provisions of Section Y of Regulation Z of Any State Statutes described in Note X.

Basis of Accounting

We draw attention to Note X of the financial statements that describes the basis of accounting. The financial statements are prepared by ABC Government Authority on the basis of the financial reporting provisions of Section Y of Regulation Z of Any State Statutes, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Restriction on Use

Our report is intended solely for the information and use of ABC Government Authority and Any State and is not intended to be and should not be used by anyone other than these specified parties.

Report on Other Legal or Regulatory Requirements

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities, if any. For example, if the audit is performed in accordance with Government Auditing Standards, wording would be added here that links this report with the related Report on Internal Control over Financial Reporting and on

Compliance and Other Matters. *Guidance for such reporting is provided in the AICPA Audit Guide Government Auditing Standards and Single Audits.]*

[*Auditor's Signature*]

[*Auditor's City and State*]

[*Date of Auditor's Report*]

Illustration 4—Auditor's Report on Regulatory Basis Financial Statements Intended for General Use (Adverse Opinion on GAAP and Unmodified Opinion on Regulatory Basis)

Illustration assumptions:

- ▶ Financial statements are of a special purpose government and have been prepared by management in accordance with a regulatory basis of accounting prescribed by state statutes applicable to the government entity. The regulatory basis financial statements, together with the auditor's report, are intended for general use. Because of the regulatory requirements, management does not have a choice of financial reporting frameworks. The variances between the regulatory basis of accounting and GAAP are not reasonably determinable and are presumed to be material.
- ▶ Auditor's opinion on GAAP is adverse, and the opinion on the regulatory basis is unmodified. Auditor is not engaged to render an opinion on the effectiveness of internal control.

Independent Auditor's Report

[*Appropriate Addressee*]

Report on the Financial Statements

We have audited the accompanying statement of net position—regulatory basis of ABC Government Authority as of December 31, 20XX, and the related statement of revenues, expenses, and changes in net position—regulatory basis and statement of cash flows—regulatory basis for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the financial reporting provisions of Section Y of Regulation Z of Any State Statutes, as described in Note X. Management is also responsible for

the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. [*If the audit was performed in accordance with Government Auditing Standards, reference to such standards should be added here.*] Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used, and the reasonableness of significant accounting estimates made, by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles

As described in Note X to the financial statements, the financial statements are prepared by ABC Government Authority on the basis of the financial reporting provisions of Section Y of Regulation Z of Any State Statutes, which is a basis of accounting other than accounting principles generally accepted in the United States of America, to meet the requirements of [*identify to the applicable entity*].

The effects on the financial statements of the variances between the regulatory basis of accounting described in Note X and accounting principles generally accepted in the United States of America, although not reasonably determinable, are presumed to be material.

Adverse Opinion on U.S. Generally Accepted Accounting Principles

In our opinion, because of the significance of the matter discussed in the “Basis for Adverse Opinion on U.S. Generally Accepted Accounting Principles” paragraph, the financial statements referred to above do not present fairly, in accordance with accounting principles generally accepted in the United States of America, the financial position of ABC Government Authority as of December 31, 20XX, or the changes in net position and cash flows thereof for the year then ended.

Unmodified Opinion on Regulatory Basis of Accounting

In our opinion, the financial statements referred to above present fairly, in all material respects, the regulatory basis net position of ABC Government Authority as of December 31, 20XX, and the regulatory basis changes in net position and regulatory basis cash flows thereof for the year then ended in accordance with the financial reporting provisions of Section Y of Regulation Z of Any State Statutes described in Note X.

Report on Other Legal or Regulatory Requirements

[Form and content of this section of the auditor’s report will vary depending on the nature of the auditor’s other reporting responsibilities, if any. For example, if the audit is performed in accordance with Government Auditing Standards, wording would be added here that links this report with the related Report on Internal Control over Financial Reporting and on Compliance and Other Matters. Guidance for such reporting is provided in the AICPA Audit Guide Government Auditing Standards and Single Audits.]

[Auditor’s Signature]

[Auditor’s City and State]

[Date of Auditor’s Report]

Note: No restricted-use paragraph is required because of the expression of an adverse opinion on GAAP.

Illustration 5—Auditor’s Report on Cash Basis or Modified Cash Basis Financial Statements (Includes a Qualified Opinion on the Discretely Presented Component Unit’s Opinion Unit Because of the Inability to Obtain Sufficient Appropriate Audit Evidence Related to an Unaudited Component Unit and Includes Unmodified Opinions on All Other Opinion Units)

Illustration assumptions:

- ▶ Financial statements are of a general purpose government and have been prepared by management in accordance with the cash basis or modified cash basis of accounting. Management has a choice of financial reporting frameworks.
- ▶ Auditor’s opinions on all opinion units are unmodified, except for the opinion on the financial statements of the discretely presented component units, which is qualified because of an unaudited component unit that is deemed to be material to the discretely presented component unit opinion unit. Auditor is unable to determine whether any adjustments are needed to the amounts reported for the component unit. Auditor is not engaged to render an opinion on the effectiveness of internal control.
- ▶ Financial statements are not accompanied by any supplementary or other information.

Independent Auditor’s Report

[Appropriate Addressee]

Report on the Financial Statements

We have audited the accompanying cash basis [*or modified cash basis, if applicable*] financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Example, Any State, as of and for the year ended June 30, 20XX, and the related notes to the financial statements, which collectively comprise the City’s basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the cash basis [*or modified cash basis, if applicable*] of accounting described in Note X. This includes determining that the cash basis [*or modified cash basis, if applicable*] of accounting is an acceptable basis for the preparation of the financial statements in the circumstances. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. [*If the audit was performed in accordance with Government Auditing Standards, reference to such standards should be added here.*] Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the City's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used, and the reasonableness of significant accounting estimates made, by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Summary of Opinions

<i>Opinion Unit</i>	<i>Type of Opinion</i>
Governmental Activities	Unmodified
Business-Type Activities	Unmodified
Aggregate Discretely Presented Component Units	Qualified
Governmental Fund X	Unmodified
Governmental Fund Y	Unmodified
Governmental Fund Z	Unmodified
Enterprise Fund A	Unmodified
Enterprise Fund B	Unmodified
Aggregate Remaining Fund Information	Unmodified

Basis for Qualified Opinion on the Aggregate Discretely Presented Component Units

The financial statements of Example Component Unit (ECU) have not been audited, and we were not engaged to audit the ECU financial statements as part of our audit of the City's basic financial statements. ECU's financial activities are included in the City's basic financial statements as a discretely presented component unit and represent XX percent and XX percent of the cash and cash equivalents and cash receipts, respectively, of the City's aggregate discretely presented component units.

Qualified Opinion

In our opinion, except for the possible effects of the matter described in the "Basis for Qualified Opinion on the Aggregate Discretely Presented Component Units" paragraph, the cash basis [*or modified cash basis, if applicable*] financial statements referred to above present fairly, in all material respects, the cash basis [*or modified cash basis, if applicable*] financial position of the aggregate discretely presented component units for City of Example, Any State, as of June 30, 20XX, and the changes in cash basis [*or modified cash basis, if applicable*] financial position thereof for the year then ended in accordance with the cash basis [*or modified cash basis, if applicable*] of accounting described in Note X.

Unmodified Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective cash basis [*or modified cash basis, if applicable*] financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Example, Any State, as of June 30, 20XX, and the respective changes in cash basis [*or modified cash basis, if applicable*]

financial position and, when applicable, cash flows thereof for the year then ended in accordance with the cash basis [*or modified cash basis, if applicable*] of accounting described in Note X.

Basis of Accounting

We draw attention to Note X of the financial statements that describes the basis of accounting. The financial statements are prepared in accordance with the cash basis [*or modified cash basis, if applicable*] of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our opinions are not modified with respect to this matter.

Report on Other Legal or Regulatory Requirements

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities, if any. For example, if the audit is performed in accordance with Government Auditing Standards, wording would be added here that links this report with the related Report on Internal Control over Financial Reporting and on Compliance and Other Matters. Guidance for such reporting is provided in the AICPA Audit Guide Government Auditing Standards and Single Audits.]

[Auditor's Signature]

[Auditor's City and State]

[Date of Auditor's Report]

Illustration 6—Auditor's Report on Cash Basis Financial Statements (Adverse Opinion Regarding an Omitted Material Major Enterprise Fund, a Qualified Opinion on Business-Type Activities Because of a Material Misstatement Related to the Omitted Fund, and an Unmodified Opinion on All Other Opinion Units)

Illustration assumptions:

- Financial statements are of a general purpose government and have been prepared by management in accordance with the cash basis of accounting. Management has a choice of financial reporting frameworks. Management has elected to exclude the financial statements of a material enterprise fund that, if included, would be reported as a major fund, and related financial information would be included in the amounts reported for business-type activities.

- Auditor's opinions on all opinion units are unmodified, except for the expression of an adverse opinion on the omitted major fund and a qualified opinion on the business-type activities' opinion unit. The amount by which this special purpose framework departure would affect the cash basis amounts reported for the business-type activities and the omitted major fund is not reasonably determinable. Auditor is not engaged to render an opinion on the effectiveness of internal control.
- Financial statements are not accompanied by any supplementary or other information.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Financial Statements

We have audited the accompanying cash basis financial statements of the governmental activities, the business-type activities, aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Example, Any State, as of and for the year ended June 30, 20XX, and the related notes to the financial statements, which collectively comprise the City's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the cash basis of accounting described in Note X; this includes determining that the cash basis of accounting is an acceptable basis for the preparation of the financial statements in the circumstances. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. *[If the audit was performed in accordance with Government Auditing Standards, reference to such standards should be added here.]* Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the City's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used, and the reasonableness of significant accounting estimates made, by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Summary of Opinions

<i>Opinion Unit</i>	<i>Type of Opinion</i>
Governmental Activities	Unmodified
Business-Type Activities	Qualified
Aggregate Discretely Presented Component Units	Unmodified
Governmental Fund X	Adverse
Governmental Fund Y	Unmodified
Governmental Fund Z	Unmodified
Enterprise Fund A	Unmodified
Enterprise Fund B	Unmodified
Aggregate Remaining Fund Information	Unmodified

Basis for Adverse Opinion on [indicate the omitted fund] and Qualified Opinion on Business-Type Activities

Management has not included the [indicate the omitted fund] in the City's financial statements. Accounting principles applicable to the City's cash basis of accounting require the [indicate the omitted fund] to be presented as a major enterprise fund and financial information about the [indicate the omitted fund] to be part of the business-type activities, thus increasing the activities' cash and cash equivalents, cash receipts, and disbursements and changing its net position. The amount by which this departure would affect the cash and cash equivalents, net position, and cash receipts and disbursements of the business-type activities and the omitted major fund has not been determined.

Adverse Opinion

In our opinion, because of the significance of the matter discussed in the “Basis for Adverse Opinion on [*indicate the omitted fund*] and Qualified Opinion on Business-Type Activities’ paragraph, the financial statements referred to above do not present fairly, the cash basis financial position of the [*indicate the omitted fund*] of the City of Example, Any State, as of June 30, 20XX, or the changes in cash basis financial position thereof for the year then ended, in accordance with the cash basis of accounting described in Note X.

Qualified Opinion

In our opinion, except for the matter described in the “Basis for Adverse Opinion on [*indicate the omitted fund*] and Qualified Opinion on Business-Type Activities’ paragraph, the financial statements referred to above present fairly, in all material respects, the cash basis financial position of the business-type activities of the City of Example, Any State, as of June 30, 20XX, and the changes in cash basis financial position thereof for the year then ended, in accordance with the cash basis of accounting described in Note X.

Unmodified Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective cash basis financial position of the governmental activities, aggregate discretely presented component units, [*indicate the presented major funds not affected by the previously described adverse and qualified opinions*], and the aggregate remaining fund information of the City of Example, Any State, as of June 30, 20XX, and the respective changes in cash basis financial position thereof for the year then ended, in accordance with the cash basis of accounting described in Note X.

Basis of Accounting

We draw attention to Note X of the financial statements that describes the basis of accounting. The financial statements are prepared in accordance with the cash basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our opinions are not modified with respect to this matter.

Report on Other Legal and Regulatory Requirements

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities, if any. For example, if the audit is performed in accordance with Government Auditing Standards, wording would be added here that links this report with the related Report on Internal Control over Financial Reporting and on Compliance and Other Matters. Guidance for such reporting is provided in the AICPA Audit Guide Government Auditing Standards and Single Audits.]

[Auditor's Signature]

[Auditor's City and State]

[Date of Auditor's Report]

Illustration 7—Auditor's Report on Modified Cash Basis Financial Statements (Adverse Opinion on Governmental Activities Because of the Omission of Certain Material General Infrastructure Assets and Unmodified Opinions on All Other Opinion Units)

Illustration assumptions:

- ▶ Financial statements are of a general purpose government and have been prepared by management in accordance with a modified cash basis of accounting. Management has a choice of financial reporting frameworks.
- ▶ Auditor's opinions on all opinion units are unmodified, except for the opinion on the governmental activities' opinion unit business-type activities opinion unit that is adverse, in the auditor's judgment, because although the City's cash basis of accounting has been modified to include capital assets and related accumulated depreciation and depreciation expense, management has not recorded certain general infrastructure assets and related depreciation on those assets in the governmental activities' financial statements. The amounts by which this departure would affect the modified cash basis assets and expenses of the governmental activities have not been determined. Auditor is not engaged to render an opinion on the effectiveness of internal control.
- ▶ Financial statements are not accompanied by any supplementary or other information.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Financial Statements

We have audited the accompanying modified cash basis financial statements of governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and aggregate remaining fund information of the City of Example, Any State, as of and for the year ended June 30, 20XX, and the related notes to the financial statements, which collectively comprise the City's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the cash basis of accounting described in Note X. This includes determining that the modified cash basis of accounting is an acceptable basis for the preparation of the financial statements in the circumstances. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. [*If the audit was performed in accordance with Government Auditing Standards, reference to such standards should be added here.*] Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the City's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used, and the reasonableness of significant

accounting estimates made, by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Summary of Opinions

<i>Opinion Unit</i>	<i>Type of Opinion</i>
Governmental Activities	Adverse
Business-Type Activities	Unmodified
Aggregate Discretely Presented Component Units	Unmodified
Governmental Fund X	Unmodified
Governmental Fund Y	Unmodified
Governmental Fund Z	Unmodified
Enterprise Fund A	Unmodified
Enterprise Fund B	Unmodified
Aggregate Remaining Fund Information	Unmodified

Basis for Adverse Opinion on Governmental Activities

As discussed in Note X to the financial statements, although the City's cash basis of accounting has been modified to include capital assets and related accumulated depreciation and depreciation expense, management has not recorded certain general infrastructure assets in governmental activities and, accordingly, has not recorded depreciation expense on those assets. Accounting principles applicable to the City's modified cash basis of accounting require that those general infrastructure assets resulting from cash transactions be capitalized and depreciated, which would increase the modified cash basis assets, net position, and expenses of the governmental activities. The amount by which this departure would affect the modified cash basis assets and expenses of the governmental activities has not been determined.

Adverse Opinion

In our opinion, because of the significance of the matter discussed in the "Basis for Adverse Opinion on Governmental Activities" paragraph, the financial statements referred to above do not present fairly, the modified cash basis financial position of the governmental activities of the City of Example, Any State, as of June 30, 20XX, and the changes in modified cash basis financial position thereof for the year then ended, in accordance with the modified cash basis of accounting described in Note X.

Unmodified Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective modified cash basis financial position of the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the City of Example, Any State, as of June 30, 20XX, and the respective changes in modified cash basis financial position and, where applicable, cash flows thereof for the year then ended in accordance with the modified cash basis of accounting described in Note X.

Basis of Accounting

We draw attention to Note X of the financial statements that describes the basis of accounting. The financial statements are prepared in accordance with the modified cash basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our opinions are not modified with respect to this matter.

Report on Other Legal and Regulatory Requirements

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities, if any. For example, if the audit is performed in accordance with Government Auditing Standards, wording would be added here that links this report with the related Report on Internal Control over Financial Reporting and on Compliance and Other Matters. Guidance for such reporting is provided in the AICPA Audit Guide Government Auditing Standards and Single Audits.]

[Auditor's Signature]

[Auditor's City and State]

[Date of Auditor's Report]

Illustration 8—Auditor's Report on Cash Basis or Modified Cash Basis Financial Statements (Adverse Opinion on the Financial Statements as a Whole Because of the Omission of Government-Wide Financial Statements)

Illustration assumptions:

- Financial statements are a complete set of financial statements of a general purpose government and have been prepared by management in accordance with the cash basis or modified basis of accounting. Management has a choice of financial reporting frameworks.

- ▶ Auditor's report expresses an adverse opinion on the statements as a whole because of the omission of the government-wide financial statements. Auditor is not engaged to render an opinion on the effectiveness of internal control.
- ▶ Financial statements are not accompanied by any supplementary or other information.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Financial Statements

We have audited the accompanying cash basis [*or modified cash basis, if applicable*] financial statements of each major fund and the aggregate remaining fund information of the City of Example, Any State, as of and for the year ended June 30, 20XX, and the related notes to the financial statements, which collectively comprise a portion of the City's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the cash basis [*or modified cash basis, if applicable*] of accounting described in Note X; this includes determining that the cash basis [*or modified cash basis, if applicable*] of accounting is an acceptable basis for the preparation of the financial statements in the circumstances. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. [*If the audit was performed in accordance with Government Auditing Standards, reference to such standards should be added here.*] Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's

judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the City's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used, and the reasonableness of significant accounting estimates made, by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our adverse audit opinion.

Basis for Adverse Opinion on the Financial Statements as a Whole

Management has not presented government-wide financial statements to display the cash basis [*or modified cash basis, if applicable*] financial position and changes in cash basis [*or modified cash basis, if applicable*] financial position of its governmental activities, business-type activities, and discretely presented component units. Accounting principles applicable to the cash basis [*or modified cash basis, if applicable*] of accounting require the presentation of government-wide financial statements. The amounts that would be reported in government-wide financial statements resulting from cash basis [*or modified cash basis, if applicable*] transactions or events for the City of Example, Any State's governmental activities, business-type activities, and discretely presented component units have not been determined.

Adverse Opinion

In our opinion, because of the significance of the matter discussed in the "Basis for Adverse Opinion" paragraph, the financial statements referred to above do not present fairly, the cash basis [*or modified cash basis, if applicable*] financial position of the City of Example, Any State, as of June 30, 20XX, or the changes in its cash basis [*or modified cash basis, if applicable*] financial position or, where applicable, its cash flows for the year then ended, in conformity with the cash basis [*or modified cash basis, if applicable*] of accounting described in Note X.

Basis of Accounting

We draw attention to Note X of the financial statements that describes the basis of accounting. The financial statements are prepared in accordance with the cash basis [*or modified cash basis, if applicable*] of accounting, which is a basis of accounting other than

accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Report on Other Legal and Regulatory Requirements

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities, if any. For example, if the audit is performed in accordance with Government Auditing Standards, wording would be added here that links this report with the related Report on Internal Control over Financial Reporting and on Compliance and Other Matters. Guidance for such reporting is provided in the AICPA Audit Guide Government Auditing Standards and Single Audits.]

[Auditor's Signature]

[Auditor's City and State]

[Date of Auditor's Report]

Illustration 9—Auditor's Report on Cash Basis or Modified Cash Basis Financial Statements (Includes a Disclaimer of Opinion on the Discretely Presented Component Unit's Opinion Unit Because One (But Not All) Discretely Presented Component Units Are Not Audited and Includes Unmodified Opinions on All Other Opinion Units)

Illustration assumptions:

- ▶ Financial statements are of a general purpose government and have been prepared by management in accordance with the cash or modified cash basis of accounting. Management has a choice of financial reporting frameworks.
- ▶ Auditor's opinions on all opinion units are unmodified, except for the financial statements of the discretely presented component units on which the auditor expresses a disclaimer of opinion because one, but not all, of the discretely presented component units were not audited. Auditor is unable to determine whether any adjustments are needed to the amounts reported for this component unit. Auditor is not engaged to render an opinion on the effectiveness of internal control.
- ▶ Financial statements are not accompanied by any supplementary or other information.

Independent Auditor's Report

[Appropriate Addressee]

Report on the Financial Statements

We have audited the accompanying cash basis [*or modified cash basis, if applicable*] financial statements of the governmental activities, the business-type activities, each major fund, and aggregate remaining fund information of the City of Example, Any State, as of and for the year ended June 30, 20XX, and the related notes to the financial statements. We were also engaged to audit the cash basis [*or modified cash basis, if applicable*] financial statements of the aggregate discretely presented component units. These financial statements collectively comprise the City's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the cash basis [*or modified cash basis, if applicable*] of accounting described in Note X. This includes determining that the cash basis [*or modified cash basis, if applicable*] of accounting is an acceptable basis for the preparation of the financial statements in the circumstances. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. [*If the audit was performed in accordance with Government Auditing Standards, reference to such standards should be added here.*] Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. Because of the matter described in the "Basis for Disclaimer of Opinion" paragraph, however, we were unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the aggregate discretely presented component units.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial

statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the City's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used, and the reasonableness of significant accounting estimates made, by management, as well as evaluating the overall presentation of the financial statements.

Except for the matter described in the "Basis for Disclaimer of Opinion" paragraph, we believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Summary of Opinions

<i>Opinion Unit</i>	<i>Type of Opinion</i>
Governmental Activities	Unmodified
Business-Type Activities	Unmodified
Aggregate Discretely Presented Component Units	Disclaimer
Governmental Fund X	Unmodified
Governmental Fund Y	Unmodified
Governmental Fund Z	Unmodified
Enterprise Fund A	Unmodified
Enterprise Fund B	Unmodified
Aggregate Remaining Fund Information	Unmodified

Basis for Disclaimer of Opinion on the Aggregate Discretely Presented Component Units

The financial statements of Example Component Unit (ECU) have not been audited, and we were not engaged to audit the ECU financial statements as part of our audit of the City's basic financial statements. ECU's financial activities are included in the City's basic financial statements as a discretely presented component unit and represent XX percent and XX percent of cash and cash equivalents and cash receipts, respectively, of the City's aggregate discretely presented component units.

Disclaimer of Opinion

Because of the significance of the matter described in the "Basis for Disclaimer of Opinion on the Aggregate Discretely Presented Component Units" paragraph, we have not been

able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the basic financial statements of the aggregate discretely presented component units of the City of Example, Any State. Accordingly, we do not express an opinion on these financial statements.

Unmodified Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective cash basis [*or modified cash basis, if applicable*] financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Example, Any State, as of June 30, 20XX, and the respective changes in cash basis [*or modified cash basis, if applicable*] financial position and, where applicable, cash flows thereof for the year then ended in accordance with the cash basis [*or modified cash basis, if applicable*] of accounting described in Note X.

Basis of Accounting

We draw attention to Note X of the financial statements that describes the basis of accounting. The financial statements are prepared in accordance with the cash basis [*or modified cash basis, if applicable*] of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our opinions are not modified with respect to this matter.

Report on Other Legal and Regulatory Requirements

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities, if any. For example, if the audit is performed in accordance with Government Auditing Standards, wording would be added here that links this report with the related Report on Internal Control over Financial Reporting and on Compliance and Other Matters. Guidance for such reporting is provided in the AICPA Audit Guide Government Auditing Standards and Single Audits.]

[Auditor's Signature]

[Auditor's City and State]

[Date of Auditor's Report]

Illustration 10—Auditor’s Report on Cash Basis or Modified Cash Basis Financial Statements (Includes an Adverse Opinion on the Aggregate Discretely Presented Component Units Because a Component Unit Is Presented in Accordance With GAAP and Includes Unmodified Opinions on All Other Opinion Units Presented Fairly in Accordance With Cash Basis or Modified Cash Basis)

Illustration assumptions:

- ▶ Financial statements are of a general purpose government and have been prepared by management in accordance with the cash or modified cash basis of accounting, except for the discretely presented component unit (there is only one discretely presented component unit presented) whose financial statements are presented in accordance with GAAP.
- ▶ Auditor’s opinions on all opinion units are unmodified, except for the financial statements of the aggregate discretely presented component units on which the auditor expresses an adverse opinion because of the material differences between GAAP and the cash basis or modified cash basis. Auditor is not engaged to render an opinion on the effectiveness of internal control.
- ▶ Financial statements are not accompanied by any supplementary or other information.

Independent Auditor’s Report

[Appropriate Addressee]

Report on the Financial Statements

We have audited the accompanying cash basis [*or modified cash basis, if applicable*] financial statements of the governmental activities, the business-type activities, aggregate discretely presented component units, each major fund, and aggregate remaining fund information of the City of Example, Any State, as of and for the year ended June 30, 20XX, and the related notes to the financial statements. These financial statements collectively comprise the City’s basic financial statements as listed in the table of contents.

Management’s Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the bases of accounting described in Note X. This includes determining that the bases of accounting described in Note X are acceptable for the preparation of the financial statements in the circumstances. Management is also responsible for

the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. [*If the audit was performed in accordance with Government Auditing Standards, reference to such standards should be added here.*] Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the City's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the City's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used, and the reasonableness of significant accounting estimates made, by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Summary of Opinions

<i>Opinion Unit</i>	<i>Type of Opinion</i>
Governmental Activities	Unmodified
Business-Type Activities	Unmodified
Aggregate Discretely Presented Component Units	Adverse
Governmental Fund X	Unmodified
Governmental Fund Y	Unmodified
Governmental Fund Z	Unmodified
Enterprise Fund A	Unmodified
Enterprise Fund B	Unmodified
Aggregate Remaining Fund Information	Unmodified

Basis for Adverse Opinion on the Discretely Presented Component Unit

As further discussed in Note X, the financial statements of Example Component Unit (ECU), the discretely presented component unit, are prepared and presented in accordance with accounting principles generally accepted in the United States of America. These accounting principles differ from the accounting principles applied in the preparation of the financial statements of the governmental activities, the business-type activities, each major fund, and aggregate remaining fund information that are prepared and presented in accordance with a modified cash basis of accounting.

Adverse Opinion

In our opinion, because of the significance of the matter discussed in the “Basis for Adverse Opinion on the Discretely Presented Component Unit” paragraph, the financial statements referred to above do not present fairly, the cash basis [*or modified cash basis, if applicable*] financial position of the discretely presented component unit of the City of Example, Any State, as of June 30, 20XX, and the changes in cash basis [*or modified cash basis, if applicable*] financial position thereof for the year then ended, in accordance with the cash basis [*or modified cash basis, if applicable*] of accounting described in Note X.

Unmodified Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective cash basis [*or modified cash basis, if applicable*] financial position of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the City of Example, Any State, as of June 30, 20XX, and the respective changes in cash basis [*or modified cash basis, if applicable*] financial position and, where applicable, cash flows thereof for the year then ended in accordance with the cash basis [*or modified cash basis, if applicable*] of accounting described in Note X.

Basis of Accounting

We draw attention to Note X of the financial statements that describes the basis of accounting. Except for the financial statements of the ECU discretely presented component unit, the financial statements are prepared in accordance with the cash basis [*or modified cash basis, if applicable*] of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Except for the aggregate discretely presented component units, our opinions are not modified with respect to this matter.

Report on Other Legal and Regulatory Requirements

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities, if any. For example, if the audit is performed in accordance with Government Auditing Standards, wording would be added here that links this report with the related Report on Internal Control over Financial Reporting and on Compliance and Other Matters. Guidance for such reporting is provided in the AICPA Audit Guide Government Auditing Standards and Single Audits.]

[Auditor's Signature]

[Auditor's City and State]

[Date of Auditor's Report]

Appendix D

Glossary

applicable financial reporting framework. The financial reporting framework adopted by management and, when appropriate, those charged with governance in the preparation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements or that is required by law or regulation.

AU-C. Reference identifier of clarified and recodified AICPA *Professional Standards* sections indicating auditing standards generally accepted in the United States of America (GAAS).

basic financial statements. The primary financial statements of a state or local government intended to be a complete set of financial statements that includes, to the extent applicable, the government-wide statement of net position and statement of activities; fund financial statements for governmental, proprietary, and fiduciary funds; and notes to the financial statements.

cash basis. Also referred to as a pure cash basis, the cash basis of accounting is a special purpose financial reporting framework that is commonly referred to as a comprehensive basis of accounting other than accounting principles generally accepted in the United States of America (GAAP) that measures and reports cash and cash equivalents and the changes therein resulting from cash receipt and disbursement transactions and events.

complete set of financial statements. A set of financial statements intended to present both financial position and changes in financial position of the entity, the form and content of which are determined by the applicable financial reporting framework.

FASB. The Financial Accounting Standards Board, which has primary responsibility for establishing GAAP for all entities other than the federal government and state and local governments.

financial reporting framework. A set of criteria used to determine measurement, recognition, presentation, and disclosure of all material items appearing in the financial statements; for example, U.S. GAAP, International Financial Reporting Standards

promulgated by the International Accounting Standards Board or a special purpose framework.

GAAP. Generally accepted accounting principles as promulgated by the Governmental Accounting Standards Board, FASB, the Federal Accounting Standards Advisory Board, and the International Accounting Standards Board.

GASB. The Governmental Accounting Standards Board, which has the primary responsibility for establishing GAAP for state and local governments in the United States of America.

general purpose financial statements. Financial statements prepared in accordance with a general purpose framework.

general purpose framework. A financial reporting framework that consists of accounting principles recognized as GAAP.

MD&A. Management's discussion and analysis (MD&A) is a component of required supplementary information (RSI) of the state and local government GAAP reporting model. MD&A is an introduction to the basic financial statements and an analytical overview of the government's financial activities. In special purpose financial statements, MD&A is considered other information (OI) accompanying basic financial statements rather than RSI.

modified cash basis. A special purpose financial reporting framework that is considered a comprehensive basis of accounting other than GAAP that uses the cash basis of accounting, with modifications to cash receipt and disbursement transactions that have substantial support, such as recording depreciation on capital assets arising from cash transactions or events.

OCBOA. Other comprehensive basis of accounting. Term commonly used to describe the cash, tax, and regulatory bases of accounting and other bases of accounting having substantial support. See **special purpose framework**.

opinion units. Separate materiality determinations for purposes of planning, performing, evaluating the results of, and reporting on the audit of a government's basic financial statements for each opinion unit. Generally, the opinion units in a government's basic financial statements are (as applicable) the governmental activities; the business-type activities; the aggregate discretely presented component units; each major governmental and enterprise fund; and the aggregate remaining fund

information (non-major governmental and enterprise funds, the internal service fund type, and the fiduciary fund types).

OI. Financial and nonfinancial information (other than the financial statements and auditor's report thereon) that is included in a document containing audited financial statements and the auditor's report thereon, excluding RSI.

regulatory basis. A special purpose financial reporting framework that is considered a comprehensive basis of accounting other than GAAP that an entity uses to comply with the accounting or financial reporting provisions of a regulatory agency to whose jurisdiction the entity is subject. An example would be the cash basis of accounting amended for reporting encumbrances as expenditures and liabilities that is required to be used for school district financial statements to be filed with a state department of education.

RSI. Information required by GAAP standard setters (such as GASB) to accompany the basic financial statements in state and local government financial reports prepared in accordance with GAAP. In special purpose financial statements, RSI is not applicable, but such information (such as MD&A and budgetary comparison information) is considered voluntary information that may accompany basic financial statements, and for auditor reporting purposes, it is considered supplementary information (SI) or OI accompanying basic financial statements.

SI. Information presented outside the basic financial statements, excluding RSI, that is not considered necessary for the financial statements to be fairly presented in accordance with the applicable financial reporting framework. Such information may be presented in a document containing the audited financial statements or separate from the financial statements. SI includes additional details or explanations of items in, or related to, the basic financial statements, combining information, historical summaries of items extracted from the basic financial statements, statistical data, and other material, some of which may be from sources outside the accounting system or entity. For the purposes of this practice aid, SI is considered information that is optionally included in a state and local government's financial report to supplement the basic financial statements and that is derived from, and directly relates to, the underlying accounting and other records used to prepare the basic financial statements, such as combining statements and schedules for non-major funds, for which the auditor is engaged to report on the information's fair presentation in relation to the financial statements as a whole.

special purpose financial statements. Financial statements prepared in accordance with a special purpose framework.

special purpose framework. A financial reporting framework, other than GAAP, that an entity uses and includes the following bases of accounting:

- a. **Cash basis.** A basis of accounting that the entity uses to record cash receipts and disbursements and modifications of the cash basis having substantial support (for example, recording depreciation on fixed assets).
- b. **Tax basis.** A basis of accounting that the entity uses to file its tax return for the period covered by the financial statements.
- c. **Regulatory basis.** A basis of accounting that the entity uses to comply with the requirements or financial reporting provisions of a regulatory agency to whose jurisdiction the entity is subject (for example, a basis of accounting that insurance companies use pursuant to the accounting practices prescribed or permitted by a state insurance commission).
- d. **Contractual basis.** A basis of accounting that the entity uses to comply with an agreement between the entity and one or more third parties other than the auditor.
- e. **Other basis.** A basis of accounting that uses a definite set of logical, reasonable criteria that is applied to all material items appearing in financial statements.

About the Author

Michael A. (Mike) Crawford, CPA, is chairman of Crawford & Associates, P.C., in Oklahoma City, OK, a firm dedicated exclusively to the practice area of state and local governments. Mike is a past president of the Oklahoma Society of CPAs (OSCPA), an inductee into the Oklahoma Accounting Hall of Fame, and past vice-chairman of the Governmental Accounting Standards Advisory Council. He has chaired or participated in a number of committees and task forces for the AICPA, the OSCPAs, and the Governmental Accounting Standards Board, including chairing an AICPA Special Purpose Framework Task Force.

Mike has provided more than three decades of accounting and consulting assistance to governments in preparing and reviewing annual financial statements, both in accordance with accounting principles generally accepted in the United States of America and special purpose frameworks. In addition, he is recognized both nationally and internationally as a frequent lecturer at many governmental accounting and auditing conferences. He has also authored a number of professional guides, practice aids, and articles on topics of governmental accounting, auditing, and professional ethics.

