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To: Officials of Local Governments and Certified Public Accountants

From: T. Vance Holloman, Director
Fiscal Management Section

Subject: Governmental Accounting Standards Board Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions* and Statement No. 36, *Recipient Reporting for Certain Shared Nonexchange Revenues*

The Governmental Accounting Standards Board (*GASB*) has issued Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions* and Statement No. 36, an amendment to No. 33, *Recipient Reporting for Certain Shared Nonexchange Revenues*. These two statements offer guidance for state and local governments on accounting for and financial reporting of nonexchange transactions. In the past, the standards used in accounting and financial reporting of these transactions varied between governments. The goal of these Statements is to create consistency and comparability between the financial statements of units of governments. These Statements also try to create symmetry in accruing transaction between provider and recipient governments.

Capital Contributions to Proprietary Funds

One of the most pervasive changes resulting from GASB 33 relates to the treatment of contributed capital. As a result of Statement 33, contributions to proprietary funds, except transfers, are now to be recognized as assets and revenues and not contributed capital. Governments should not restate contributed capital arising from periods prior to issuance of Statement 33. No retroactive reporting is required so contributed capital will remain as part of the fund equity section until the implementation of Statement 34 (paragraph 98), when retained earnings and contributed capital will no longer be shown separately but will be combined into total net assets. Governments may continue to use the add back option of reducing existing contributed capital by depreciation expense on assets contributed by outside sources (other governments and developers) prior to Statement 33 implementation. This option from NCGA Statement 2 will be eliminated upon implementation of GASB Statement 34.

Nonexchange Transactions

Nonexchange transactions are defined as external transactions involving financial or capital resources in which a government gives or receives value <u>without</u> directly receiving or giving equal value. These Statements do not apply to internal events, such as operating transfers, residual equity transfers, or other interfund activities. These statements do not apply to Food Stamps and on-behalf payments for fringe benefits and salaries, which are addressed in GASB Statement 24, *Accounting and Financial Reporting for Certain Grants and Other Financial Assistance*.

Although most nonexchange transactions involve current financial resources and take place in governmental fund types, these Statements provide guidance for asset, cash or receivables, and revenue recognition under both the modified accrual basis of accounting and the full accrual basis of accounting. This is necessary for the preparation of government-wide full accrual financial statements under GASB Statement 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments* (refer to LGC memoranda #928 and #934). The requirements of GASB Statement 33 are effective for financial statements for periods beginning after June 15, 2000 (fiscal years ending June 30, 2001, for most North Carolina governmental units).

The staff of the Local Government Commission has reviewed the potential revenue sources that are available to local governments and public authorities. We have categorized the nonexchange transactions according to the guidance issued by the GASB in Statements 33 and 36 and in conjunction with the staff of the North Carolina Office of State Controller. There may be nonexchange transactions that are unique to a local government that have not been covered by this Memorandum. The guiding principles presented in this Memorandum should be followed in accounting for and reporting on those transactions. Members of our staff are available to help in applying these Statements to those transactions.

GASB examined the principal characteristics of different kinds of nonexchange transactions and grouped them into the following categories based on shared characteristics:

1) Derived tax revenues transactions,
2) Imposed nonexchange revenues transactions,
3) Government-mandated nonexchange transactions,
4) Voluntary nonexchange transactions.

Since asset and revenue recognition criteria are the same for government mandated and voluntary nonexchange transactions, they will be treated as a single category in this Memorandum. In determining which category a nonexchange transaction should be classified, governmental units should analyze the substance of the transaction and not its label. A transaction may indicate its substance and, therefore, the class of transaction by its label. However, in substance, the label such as "tax" or "grant" may have different characteristics than the name implies. In addition, labels commonly used for exchange and exchange-like transactions, such as "fees" and "charges," sometimes are applied to nonexchange transactions, so that these labels do not always indicate that an exchange has occurred.

Time Requirements and Purpose Restrictions
GASB has established two stipulations that apply to each category of transaction, time requirements and purpose restrictions. Time requirements specify the period when resources

are required to be used or when use may begin. For example, a provider may stipulate that the provided funding is to be used during a specified fiscal year or specified number of years, or cannot be disbursed until after a certain date or event occurs. Time requirements affect the timing of recognition of the nonexchange transaction. The effect on the timing is different depending on whether the transaction is classified as an imposed nonexchange revenue or a government-mandated/voluntary nonexchange transaction. Generally, derived tax revenues do not have time requirements. Laws, regulations, contracts, or grant agreements may specify the particular period when the resources are required to be used or when use may begin.

Purpose restrictions specify the purpose or purposes for which the resources are required to be used. Purpose restrictions are occasionally placed on the use of resources by laws, regulations, contracts, or grant agreements. The provider may specify that its funds may only be used for road and street repair. Purpose restrictions do not affect the timing of recognition of transactions. Recipients should report the nonexchange revenue with purpose restrictions as a restriction of their assets, equity, or fund balance, as appropriate.

Derived Tax Revenues
Derived tax revenues are taxes imposed by governments on an exchange transaction, such as retail sales transactions or payment of wages to employees for their services. The principal characteristics of these types of transactions are that the assessing government imposes a "tax" on the entity that acquires the income, goods or services (provider); and the government's assessment is based on an exchange transaction.

Asset recognition should take place for derived tax revenues in the period when the exchange transaction upon which the tax is levied occurs, or when the resources are received, whichever occurs first. Revenue is recognized, net of any estimated refunds and estimated uncollectible amounts, when the underlying transaction has occurred and the amount can be measured. If any of the resources are received in advance, then deferred revenue is recognized (liability) until the period of exchange. When applying modified accrual accounting, the resources also should be measurable and available. In order to recognize revenues from the above criteria, estimates will often be used to make the appropriate accrual at year-end.

Imposed Nonexchange Revenues
Imposed nonexchange revenues are from assessments by governments on nongovernmental entities other than assessments on exchange transactions. The principal characteristic is that the assessing government (recipient) imposes the assessment on an act committed or omitted by the nongovernmental entity (provider) and that the transaction is not an exchange transaction. An act committed could be acquiring property or subscribing to a telephone service. An act omitted would result in a fine, penalty, or forfeiture. Imposed transactions have both timing requirements and purpose restrictions.

Assets should be recognized from imposed nonexchange transactions in the period that an enforceable legal claim arises on the asset or when the resources are received, whichever is first. In that case, deferred revenue may be reported if resources have been received but not yet recognized as revenue. Revenues should be recognized at the same time as assets unless the enabling legislation has time requirements. Revenues should be recognized net of estimated refunds and estimated uncollectible amounts. If there have been time requirements imposed, then revenues should be recognized in the period when the resources are required to be used or when use is first permitted.

Receivables from assets should be recognized for property taxes when an enforceable legal claim arises. Although taxes are levied in a budget ordinance that is usually adopted prior to the beginning of the fiscal year, an enforceable legal claim does not arise until the fiscal year for which the tax is levied. Therefore a receivable should be recorded at the time the tax bills are sent out and would not be recognized as of the June 30th preceding that fiscal year. Revenues should be recognized in the period for which the taxes are levied. Deferred revenues would be recognized for any receipts prior to the fiscal year for which the taxes are levied. Deferred revenue would also be recognized for any past due taxes that are not measurable and available at the report date under the modified accrual basis of accounting.

Government-Mandated and Voluntary Nonexchange Transactions

Government-mandated nonexchange transactions occur when one government provides resources to another government, and the provider requires that the recipient use them for a specific purpose(s) established in the enabling legislation. The government may be a pass through recipient by distributing the resources from the provider to a nongovernmental entity.

Voluntary nonexchange transactions arise from legislative or contractual agreements other than exchanges and are between two or more parties. One party may be a nongovernmental entity, including an individual. The principal characteristics are that they are not imposed on the provider or the recipient <u>and</u> the fulfillment of eligibility requirements is essential for a transaction to occur, other than the provision of cash or other assets in advance. The providing government may impose purpose restrictions and eligibility requirements. If the requirements are not met by the recipient, then all or a portion of the resources provided may be required to be paid back to the provider.

Eligibility Requirements

Eligibility requirements are applicable to government-mandated and voluntary nonexchange transactions. The eligibility requirements are conditions established by the provider or enabling legislation. These conditions must be met before a transaction can occur. They consist of one or more of the following:

1. <u>Required characteristics of recipients</u>. The provider of the resources specifies that the recipient and secondary recipient, if any, must have specific characteristics.

2. <u>Time requirements</u>. The provider specifically states the period when resources are to be used (sold, disburse, consumed), when use of the resources is first permitted or when the resources are to remain intact. Enabling legislation or the appropriation process may dictate time requirements.

3. <u>Reimbursements</u>. These are expenditure driven. The provider reimburses the recipient once an allowable cost, determined by the provider under a predetermined

agreement, has been incurred. Similarly, a matching requirement may be set as a condition of eligibility.

4. Contingencies. The provider's offer of a resource is contingent upon a specified action by the recipient that has occurred. For example a grant or donation requires a recipient to raise a specific amount from third parties or dedicate its own resources and has to comply with those requirements before it can recognize revenues. Contingency requirements only apply to voluntary nonexchange transactions.

Recognition Requirements of Government-Mandated and Voluntary Nonexchange Transactions

Recipient governments should recognize assets when all the applicable eligibility requirements are met, including time requirements, or when resources are first received, whichever comes first. The providers should recognize a liability, or decrease in assets, and expenses. When resources are received before eligibility or time requirements are met, deferred revenues should be recorded by the recipients and advances by the provider.

Revenues should be recognized by the recipient government, net of estimated collectible amounts, when all applicable requirements are satisfied. When applying modified accrual accounting, the resources also should be available. Recognition of revenues by the recipient and expenses by the provider should not be delayed because routine administrative requirements (such as filing for claims for allowable cost or the filing of progress reports to the provider) have not been completed.

In some government-mandated or voluntary nonexchange transactions, a provider may distribute assets, such as cash, with the stipulation that the resources cannot be sold, distributed, or consumed until after a specified time requirement or event has taken place. The provider does allow the recipient to receive benefits from the resources, such as interest income. The benefits received from this type of transaction should be recognized as revenue if all the eligibility requirements have been met. As long as the provider's purpose restrictions or time requirements remain in effect, assets associated with these resources should be restricted. If however, an award or grant was received for administrative or practical reasons before the period that the provider specifies the resources can be used, any benefit is considered incidental and not for its primary purpose. Deferred revenue should be recognized in this case.

If the provider does not establish time requirements in a government-mandated or voluntary nonexchange transaction and there are no other eligibility requirements, recipients should recognize a receivable and a revenue and the provider should recognize a liability and an expense for the entire amount in the period when all of the eligibility requirements are met. When the provider is a government, the applicable period for both the provider and the recipient is the first day of the provider's fiscal year; and the entire award should be recognized at that time.

Subsequent Contravention of Eligibility Requirements or Purpose Restrictions

After a government recognizes a government-mandated or voluntary nonexchange transaction, it may become apparent that it may not receive the resources or it must pay back part or all of the awards that it received. This may be the result of the eligibility requirements no longer being met or of the recipient not complying with the purpose restriction within the specified time limit. If it is probable that the resources will not be provided or a payback will be required, the recipient should recognize a decrease in assets or an increase in liabilities and a reduction of revenues for the amount that the provider is expected to cancel or reclaim. The provider should recognize a decrease in liabilities or increase in assets and a reduction of expense or increase in revenues for the amount expected. If a payback occurs in a fiscal year subsequent to the original transaction, an expense would be recognized by the receiving government and a revenue would be recognized by the provider government.

Nonexchange Revenues Administered or Collected by Another Government

In some cases, a government collects derived tax revenues or imposed nonexchange revenues on behalf of the recipient government that imposed the revenue source. This is the case with the state that administers and collects one percent local option sales tax and the two supplemental one half percent sales and use taxes in conjunction with the state sales tax. The state subsequently remits the collection of receipts to the local government. The local government should recognize a receivable and a revenue at June 30 for the August 15th payment. Even though the November 15th payment may contain some sales tax revenues from transactions occurring prior to June 30th, this amount is not determinable and should be insignificant. Therefore, the Office of State Controller has informed us that the state will not recognize a liability for the amounts that are included in the November 15th distribution at June 30th. Therefore local governments should not accrue any portion of the November 15th sales and use tax distribution.

Recipient Reporting for Certain Shared Nonexchange Revenues-Statement No. 36

A government may distribute to another government its share of a derived tax revenue or an imposed nonexchange revenue. These shared revenues can be allocated through a continuing appropriation. Continuing appropriation is defined in Statement 36 as an appropriation that, once established, is automatically renewed without further legislative action, period after period, until altered or revoked. Under continuing appropriations, eligibility requirements are considered to have been met as each sales transaction occurs. Statement 36 states that in situations involving shared revenues with a continuing appropriation, both the provider and the recipient should treat the resources as a voluntary or government-mandated nonexchange transaction, as appropriate. Both the recipient and the provider should account for the shared revenues symmetrically regardless of the basis of accounting used.

Shared revenue sources for local governments in North Carolina that are considered continuing appropriations are the piped natural gas tax, the scraped tire disposal tax, the white goods disposal tax, and the unauthorized substance tax. Therefore governmental units should recognize receivables and revenues at June 30th for August 15th and September 15th payments, or any unauthorized substance tax payments received after year-end related to events occurring prior to year-end. Under the modified accrual basis of accounting, revenues received within 60 days of year-end would be recognized. If received more than 60 days after year-end, deferred revenue would be recognized. Payments received more than 60 days beyond year end are not considered to be available to pay year-end liabilities. Because the Powell Bill allocation must be annually appropriated, it should not be accrued at June 30th.

Reimbursements and Local Revenues

Division of Mental Health, Developmental Disabilities, and Substance Abuse Service, State and Federal Awards. Resources are distributed to local Area Programs through the Unit Cost Reimbursement System (UCR) for certain programs and on a reimbursement basis (non-UCR) for other programs. The UCR (referred to as Pioneer) System allocates monthly allotments to certain programs in which a settlement period follows to adjust to actual cost after the year-end, usually after the financial statements are issued. Payments are received during the month for that month's services. Since the eligibility requirements have been met, based on the nature of MHDDSAS programs, payments received during the month are earned by month's end and there would be no year-end accrual of revenues. Unless material, paybacks or payments received as the result of the year-end settlement would be recognized in the following fiscal year.

For non-UCR funding, a revenue for the expected reimbursement should be recognized as revenue when allowable costs are incurred. This would require a year-end accrual to record a receivable for the reimbursement due to the area program in the following month.

Social Services and Public Health Programs: Since these programs are reimbursement programs, a revenue for the expected reimbursement should be recognized when allowable costs are incurred. This would require a year-end accrual to record a receivable for the reimbursement due the following month. Any settlement due or to be paid after year-end that can be estimated should also be accrued and possibly deferred if the availability criteria is not met.

County Appropriations to Public Schools:
Most counties distribute funds to school systems either through periodic lump sum payments during the fiscal year or on a reimbursement basis. Lump sum payments are intended to finance the operations of a particular fiscal year, are budgeted by the county and the school in a particular fiscal year, and should be recognized during that fiscal year. Any payments not received by the fiscal year end should be accrued as a receivable or payable and revenue or expense. A receivable or payable would not be recognized if both parties agree the payments will not be made. School systems should recognize reimbursements as revenues when allowable costs are incurred. This would require year-end accruals to record a receivable for the reimbursements due the following month.

Reimbursements for Intangibles, Inventories, Food Stamps, and Homestead Property Exemption:
These are voluntary nonexchange transactions that would be recognized as revenue by the local government based upon the State budget's authorization to make the payment in a particular period. An exception would occur if the State delayed payment but ultimately made the payment under the authority that existed for the prior period. This was the case with the delayed inventory tax reimbursement that was scheduled for April 30th but not distributed

until July 2001. In that case, locals should accrue revenue at year-end. See Memorandum # 947 for further discussion.

Year End Adjustments

Prior period adjustments and adjusting entries may be needed by local governments to comply with this statement. In particular, units that have not accrued the August 15th sales tax distribution in the past may need to record a prior period adjustment. Although the differences between the August 15, 2000 and August 15, 2001 distributions may be small, units will need to reflect the August 15, 2001 distribution on the June 30, 2001 balance sheet. Units should not recognize five quarters of sales tax revenues in the 2000-01 fiscal year in order to record this accrual. The need for a prior period adjustment for this or another revenue source would be subject to materiality considerations.

The need for prior period adjustments for other revenue sources should be evaluated. All units should look closely at special revenue funds established to account for expenditure driven grants and determine if equity balances in those funds are appropriate.

If you have any questions about this memorandum, please contact Jim Burke at 919-807-2383 or Samantha Cox at 919-807-2394.