

PROPRIETARY FUND FINANCIAL STATEMENTS

Under GASB Statement No. 34, governments will continue to report two types of proprietary funds (i.e., enterprise and internal service funds). Both types of proprietary funds will be reported, as they are today, using the economic resources measurement focus and the accrual basis of accounting. These are the same measurement focus and basis of accounting as will be applied in the preparation of the government-wide financial statements.

Under GASB Statement No. 34, the use of an enterprise fund normally is restricted to activities “for which a fee is charged to external users for goods or services.” Enterprise funds must be established whenever any of the following criteria are met:

Debt backed solely by fees and charges. If debt has been issued that is backed solely by fees and charges, then an enterprise fund must be used to account for the activity. This “sole backing” criterion would encompass debt that is secured, in part, by a portion of the debt proceeds themselves (i.e., “reserve funds”), but not debt that is also secondarily secured by the full faith and credit of the government.

Legal requirement to recover cost. An enterprise fund must be used if the cost of providing services for an activity (including capital costs such as depreciation or debt service) must legally be recovered through fees or charges.

Policy decision to recover cost. The use of an enterprise fund is necessary if it is the government’s policy to establish fees or charges for an activity that are designed to recover the cost of providing services (including capital costs such as depreciation or debt service).

Under GASB Statement No. 34, the focus of the basic financial statements will shift from fund types to individual major funds. In other words, a separate column for each individual major enterprise fund will be presented in the proprietary fund financial statements. Internal service funds, though, will always be presented in the aggregate in the fund financial statements.

Major individual enterprise funds will be those that meet the following criteria:

An individual fund that reports at least 10 percent of any of the following:

- a. total enterprise fund assets, or
- total enterprise fund liabilities, or
- total enterprise fund revenues, or
- total enterprise fund expenses, and

at least 5 percent of any of the following:

- total assets for governmental and enterprise funds, or
- total liabilities for governmental and enterprise funds, or
- total revenues for governmental and enterprise funds, or
- total expenditures/expenses for governmental and enterprise funds.

Nonmajor funds may be reported singly, or combined into a “nonmajor governmental funds” column, and a “nonmajor proprietary funds” column. If an entity on has a few proprietary funds, each fund may be presented in its own column.

Traditionally, proprietary funds, like private-sector businesses, have taken a “capital maintenance” approach to preparing their financial statements. This approach carefully distinguished the portion of net position provided by “investors” (i.e., “contributed capital”), from the portion of net position generated from operations (i.e., retained earnings”). Under the new reporting model, however, proprietary fund financial statements will focus on limitations on the use of assets rather than on their source. Accordingly, proprietary fund financial statements will

no longer distinguish between contributed capital and retained earnings. Proprietary fund net position will, instead, be classified as net investment in capital assets, as restricted, and as unrestricted.

For Proprietary Funds, the required financial statements are:

The Statement of Net Position

The Statement of Revenues, Expenses and Changes in Net Position; and,

The Statement of Cash Flows

PROPRIETARY FUNDS STATEMENT OF NET POSITION

Under the new reporting model, proprietary funds will focus on net position rather than on the degree to which they have preserved capital. The current balance sheet format will be retained. Additionally, a “classified” presentation of assets and liabilities in the statement of position (balance sheet) is now required.

PROPRIETARY FUNDS STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION

The key features of the proprietary fund operating statement are as follows:

Each major enterprise fund will be presented in its own column, with a total column for all enterprise funds.

Internal service funds will be aggregated in a single column, presenting all internal service funds separately from enterprise funds to underscore the connection between the enterprise funds and the business-type activities reported in the government-wide financial statements.

Contributions of capital will be reported as a separate line item in the statement of activities following “non-operating revenues (expenses).”

PROPRIETARY FUNDS STATEMENT OF CASH FLOWS

Major individual enterprise funds will be presented in separate columns on this statement, too, with all internal service funds aggregated into a single column. A total column for all enterprise funds must be included. Proprietary funds are currently required to present a statement of cash flows. GASB Statement No. 9, allows governments to use either the direct method or the indirect method to report cash flows from operating activities, but recommends the direct method. The direct method presents information on individual types of cash flows (e.g., “receipts from customers,” “payments to suppliers,” “payments to employees”), whereas the indirect method simply furnishes a reconciliation of the differences that exist between “cash flows from operating activities” and “operating income.” GASB Statement No. 34 amends GASB Statement No. 9 to require the use of the direct method in all cases, with the appropriate reconciliation prepared using the indirect method. When the direct method is used, certain operating cash flows must be reported as separate line items.

The principal advantage of the direct method is that it shows operating cash receipts and payments. That is, it is more consistent with the objective of a statement of cash flows—to provide information about cash receipts and cash payments—than the indirect method, which does not report operating cash receipts and payments. Supporters of the direct method contend that knowledge of the specific sources of operating cash receipts and the purposes for which operating cash payments were made in past periods is useful in estimating future operating cash flows. Furthermore, information about the amounts of major classes of

operating cash receipts and payments is more useful than information only about the arithmetic sum (the net cash flow from operating activities)

Under the new governmental financial reporting model, governments will continue to report two types of proprietary funds; enterprise funds and internal service funds.

The main purpose of the statement of cash flows is to provide relevant information about the cash received and cash disbursed by a proprietary fund during the fiscal year.

Corollary purposes are to aid the reader in:

- Assessing the fund's ability to generate positive net cash flows.

- Assessing the fund's ability to meet its obligations, its ability to support Governmental Funds' operations, and its need for future financing.

- Assessing the reasons for differences between net income and the associated cash receipts and disbursements.

- Assessing the effects on a fund's financial position of both its cash and non-cash investing and financing transactions during a period.

Cash not only includes cash on hand and demand deposits, and short-term time deposits (passbook savings), but also includes savings certificates and highly liquid investments with terms to maturity of three months (90 to 92 days) or less when acquired. However, a security reaching its final three months to maturity, but which was acquired more than three months before maturity does not get reclassified as a cash equivalent.

Restricted cash balances, usually classified as non-current assets, are included in the cash and cash equivalents definition regardless of the restrictions on their use.

The notes to the financial statements should include a definition of cash and cash equivalents applied to the statement of cash flows.

Preparation:

In the preparation of the statement of cash flows, GASB requires four cash flow categories:

- Cash flows from operating activities

- Cash flows from noncapital financing activities

- Cash flows from capital and related financing activities

- Cash flows from investing activities

Operating activities: The proprietary fund cash flows from operating activities classification generally incorporates only the cash effects of transactions and events that enter into operating income rather than net income. Consequently, the cash effects associated with nonoperating revenues and expenses such as interest revenue and interest expense are not included in cash flows from operating activities. The GASB Codification states that: Operating activities generally result from providing services and producing and delivering goods, and include all transactions and other events that are not defined as capital and related financing, noncapital financing, or investing activities....

Noncapital financing activities and Capital and related financing activities: Noncapital financing activities and capital and related financing activities are distinguished by whether the cash flow is clearly attributable to the financing of capital assets (i.e., fixed assets) acquisition, construction, or improvement. Cash flows from issuing (or repaying) debt, interest payments, interfund transfers from other funds, and certain other transactions will be classified as capital and related financing activities if clearly attributable to capital asset financing. Otherwise, they are classified as noncapital financing activities. For example, cash received from issuing bonds that are clearly issued for the explicit purpose of financing construction of a fixed asset is

reported as cash flows from capital and related financing activities. Cash payments of interest or principal on those bonds also will be classified as capital and related financing activities. The cash effects of issuing or servicing all other debt issuances (not clearly attributable to capital asset financing) would be noncapital financing activities.

Investing activities: Investing activities include (a) making and collecting most loans, (b) making or disposing of investments in debt or equity instruments, and (c) the related interest and dividends received.

The table below summarizes the common classifications of the typical cash flows of proprietary funds. This table is not intended to be comprehensive. Many transactions and situations are beyond the scope of this summary.

Cash Flow Classification Summary

Cash Flows from Operating Activities

Cash received from sales of goods and services
Cash paid for materials used in providing services or manufacturing goods for resale
Cash paid to suppliers for other goods or services
Cash paid to employees for services
Cash received or paid resulting from quasi-external transactions *
Cash received from other funds for reimbursement of operating transactions
Cash payments for taxes
Cash received or paid from grants for specific activities that are part of grantor governments' operating activities
Other cash flows that are not properly reported in the other classifications

* Quasi-external Transactions – transactions that would be treated as revenues or expenses if they involved organizations external to the governmental unit. Examples would be services provided by a department financed from one fund to a department financed from another fund. These services should be accounted for as revenues or expenses as appropriate in the funds involved.

Cash Flows from Noncapital Financing Activities

Cash received from (or paid to repay) borrowing not clearly attributable to capital assets
Cash paid for interest on those borrowings
Cash received from operating grants not included in operating activities
Cash paid for grants or subsidies to other governments that are not included in operating activities
Cash paid for transfers out and for interfund reimbursements not included in operating activities
Cash received from transfers not clearly made for capital asset purposes

Cash Flows from Capital and Related Financing Activities

Cash received from (or paid to repay) borrowings clearly attributable to capital assets
Cash paid for interest on those borrowings
Cash received from capital grants
Cash paid or received from acquisition or disposal of capital assets
Cash received from transfers from other funds for the specific purpose of financing capital assets
Cash received from special assessments or taxes levied to finance capital assets

Cash Flows from Investing Activities

Cash paid or received for the acquisition or disposal of investments in debt or equity securities
Cash paid or received from loans made to others
Cash received from interest and dividends

NONCASH INVESTING, CAPITAL, AND RELATED FINANCING ACTIVITIES

Information about all investing, capital, and financing activities of a governmental enterprise during a period that affect recognized assets or liabilities but do not result in cash receipts or cash payments in the period should be reported. This information, should be presented on the same page as the statement of cash flows. Examples of noncash transactions are acquiring assets by assuming directly related liabilities, obtaining an asset by entering into a capital lease; and exchanging noncash assets or liabilities for other noncash assets or liabilities.

INDIRECTLY DETERMINING DIRECT-METHOD CASH FLOWS

GASB Statement No. 9, states that under the direct method, governments should, at a minimum, separately report these classes of operating cash receipts and payments.

Cash receipts from customers

Cash receipts from quasi-external operating transactions with other funds

Other operating cash receipts, if any

Cash payments to other suppliers of goods or services

Cash payments to employees for services

Cash payments for quasi-external operating transactions with other funds, including payments in lieu of taxes

Other operating cash payments, if any

Items a, d, and e generally will account for the majority of cash flows from operating activities and, depending on the particular accounting system, may require substantial time and effort to accumulate actual amounts. As mentioned in footnote 82 to paragraph 440 in the Basis for Conclusions of Statement 34, however, acceptable approximations of these amounts may be determined indirectly.

Essentially, the accrual-basis revenues and expenses are adjusted for changes in related accounts receivable and payable. The attached calculations demonstrate how to indirectly determine the direct-method cash flows for cash receipts from customers and for cash paid to employees and suppliers.

Operating revenue is adjusted to determine “cash received from customers” by (1) adding the beginning customer accounts receivable balance to account for cash collected on prior years’ sales and (2) deducting the end-of-the-year customer accounts receivable balance to adjust for the cash not collected from this year’s sales.

Salaries and benefits expense is adjusted to determine “cash paid to employees” by (1) adding the beginning payroll-related accruals to recognize cash that was paid out this year for last year’s payroll expenses and (2) deducting the ending payroll-related accruals to account for the cash that will be paid next year for payroll expenses this year.

Total operating expenses, excluding salaries and employee benefits, and depreciation (an allocation), are adjusted to determine the “cash paid to suppliers” by adding the beginning accounts payable balance and deducting the ending accounts payable balance.

PROPRIETARY FUNDS CONCLUSION

The measurement focus and basis of accounting for proprietary funds has remained basically unchanged. Total enterprise fund amounts appearing in the fund financial statements normally will require little; if any, adjusting when carried to the government-wide financial statements.