



Governmental Accounting Standards Board
of the Financial Accounting Foundation

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Improved Clarity and Consistency at Core Of GASB Fund Balance Proposal

Fund balance—the difference between assets and liabilities in the governmental funds balance sheet—holds great appeal among governmental entities and the users of their financial statements. However, the Governmental Accounting Standards Board (GASB) has found that the usefulness of fund balance information is greatly undercut by misunderstandings regarding what messages it conveys and diversity in how governments report it.

GASB research indicates that fund balance is one of the most widely used pieces of information in state and local government financial statements. A staple of the credit reviews performed by municipal bond analysts, fund balance also is frequently used by taxpayer associations, research organizations, oversight bodies, state, county and local legislators and their staffs, and news media representatives. Financial statement users examine fund balance information to identify the available liquid resources that can be used to repay long-term debt, reduce property taxes, add new governmental programs, expand existing ones, or enhance the financial position of the government.

In its current state, however, fund balance information can also be problematic due to inconsistencies in the way governments interpret the relevant accounting and financial reporting requirements. To enhance the usefulness of fund balance information, on February 29 the GASB published an Exposure Draft of a proposed Statement, *Fund Balance Reporting and Governmental Fund Type Definitions*.

What is the GASB Proposing?

The requirements of this proposal would improve financial reporting by establishing fund balance categories and classifications that are easier to understand. The proposed Statement establishes fund balance classifications comprising a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon how it can use amounts reported in governmental fund balances.

The initial distinction that would be made in reporting fund balance information is between amounts that are considered **nonspendable**, such as fund balance associated with inventories, and those that are **spendable**, such as fund balance associated with cash. The proposed Statement also provides for four classifications within the spendable category based on the relative strength of the constraints that control how specific amounts can be spent:

- The **restricted** fund balance category includes amounts that can be spent only for the specific purposes stipulated by external resource providers (for example, grant providers), constitutionally, or through enabling legislation (that is, particularly stringent legislation that creates a new revenue source and restricts its use).
- The **limited** fund balance classification includes amounts that can be used only for the specific purposes determined by a formal action of the government's highest level of decision-making authority (for example, an ordinance passed by a city council).
- Amounts in the **assigned** fund balance classification are intended to be used by the government for specific purposes but do not meet the criteria to be classified as restricted or limited (for instance, the constraint on use is not imposed externally or by a government's highest level of decision-making authority). In governmental funds other than the general fund, assigned fund balance represents the amount that is not restricted or limited.
- **Unassigned** fund balance is the residual classification for the government's general fund and includes all spendable amounts not contained in the other classifications and, therefore, unassigned amounts are available for any purpose.

The GASB proposal also would improve the usefulness of fund balance information by clarifying certain parts of the definitions of governmental fund types that have proven to be a source of confusion. Most notably, the proposal would make clear that special revenue funds are created only to report a revenue source that is restricted or limited to a specified purpose, and that revenue source should constitute a significant portion of the resources reported in the fund.

The basic definitions of the debt service and capital projects fund types would remain unchanged. However, the definition of the debt service fund type would be edited to emphasize that governments are currently required to report debt service funds under two circumstances—when legally required to do so, or when amounts have been accumulated for the purpose of making future principal and interest payments.

The proposal would require certain related note disclosures. Governments would disclose their accounting policies that indicate the order in which they consider restricted, limited, assigned, and unassigned amounts to have been spent when an expenditure is made for a purpose for which amounts are available in multiple fund balance classifications. For example, a town may have a state grant for public safety activities (restricted), proceeds from a portion of its own property that the town council voted could only be used for public safety (limited), and general revenues available for

public safety spending; the disclosure would identify the order in which the town assumes those resources will be spent.

Governments also would be required to describe the processes through which they imposed limitations and assignments on fund balance amounts. In addition, governments would disclose the purpose for each major special revenue fund—identifying which specific revenues and other resources are authorized to be reported in each.

“Rainy-Day” Funds

Many financial report users are interested in how governments report their “rainy-day,” “stabilization,” or “contingency” amounts. The GASB proposal would treat “economic stabilization” as a specified purpose, allowing amounts constrained to economic stabilization to be reported as restricted or limited fund balance in the general fund if they meet the other criteria for those classifications. However, stabilization would be regarded as a specified purpose only if the circumstances or conditions that signal the need for stabilization are identified in sufficient detail and are not expected to occur routinely. Governments would be required to disclose key information about their stabilization arrangements, including the authority by which they were established, provisions for additions to the stabilization amount, and circumstances under which those amounts may be spent.

Some governments create stabilization-like arrangements by establishing formal minimum fund balance requirements. Because users are interested in information about those minimum fund balance requirements and how governments comply with them, the proposal would require governments to explain their minimum fund balance requirements, if they have them, in notes to the financial statements.

Incorporating Feedback

In October 2006 the GASB issued an Invitation to Comment that sought input on alternative approaches to addressing the fund balance reporting issues identified by the GASB’s research. The quality and content of the constituent responses to that document gave the GASB excellent background and reasoning that ultimately led to the solutions proposed in the Exposure Draft.

The GASB considered the respondents’ concerns that all of the alternative modifications to the fund type definitions would have led to significant changes in practice, particularly with respect to reporting special revenue funds. Based in part on that feedback, the GASB declined to alter the existing fund type definitions in ways that would impose what some would consider to be overly restrictive interpretations regarding what resources may be reported. The GASB concluded that more substantial changes to the definitions should come only after a broader reexamination of governmental fund reporting.

The respondents commented extensively on the alternative models for classifying fund balance information presented in the Invitation to Comment. The comments led the GASB to construct a new approach based on the preferred aspects of those models, focusing on (a) what information is most important to fund balance information users and (b) the nature of the resources reported in governmental funds.

The most frequently articulated need was an understanding about the availability of spendable resources. To respond to that need, the GASB concluded that fund balance information should be classified and reported in a way that allows readers to readily identify the extent to which spending constraints are imposed on the use of amounts and how binding those constraints are.

Proposed Effective Date

The requirements of the proposed Statement would be effective for financial statements for fiscal years ending June 30, 2011, or later. Fund balance reclassifications would be applied retroactively by restating fund balance for all prior periods presented. Changes to the fund balance information presented for prior years in a statistical section would not be required, although retroactive application would be encouraged.

How Can You Help the GASB Complete This Standard?

You can assist the GASB with the process of finalizing its standards on fund balance reporting by reading the Exposure Draft and providing feedback. The document is available to download free from the GASB website, www.gasb.org. (See the links below.) It is most helpful if you react to not only the aspects you disagree with, but also those that you support. In addition, it is most valuable to the GASB when respondents explain why they support or oppose a particular facet of a proposal.

You can submit comments by email (director@gasb.org) or traditional mail. The GASB also will be holding a public hearing in Kansas City, Missouri on July 14 in conjunction with the annual conference of the National Association of Counties. You can participate in person or via telephone. Additional information about responding to the proposal or participating in the hearing can be found in the front of the Exposure Draft.