June 10, 1977

The Honorable Abraham D. Beame
Mayor of the City of New York
Office of the Mayor
City Hall
New York, New York 10007

The Honorable Harrison J. Goldin
Comptroller of the City of New York
Office of the City Comptroller
Municipal Building
New York, New York 10007

Dear Mayor Beame and Comptroller Goldin:

Transmitted herewith are copies of a loose-leaf manual containing a codification of the Accounting Systems Directives promulgated by my Office for New York City. They prescribe accounting and financial reporting principles to be followed by the City.

These directives, which conform with generally accepted accounting principles, address the principal shortcomings that had tended to obscure the City's true financial situation. They were prepared in consultation with independent experts in governmental accounting and also reflect informal comments received from interested parties such as the U. S. General Accounting Office and CPA firms retained by the City and by the U. S. Treasury. In addition, consideration was given to comments by your offices on drafts of the directives.

The nine directives which were originally promulgated over the last year and a half have been consolidated into five chapters in this codified manual. The loose-leaf format will facilitate their use with any supplementary or revised material which may be issued later.

The manual will make possible the preparation of uniform and meaningful financial statements and enable independent auditors to render opinions thereon. However, the final test as to whether future New York City accounting records and financial statements will provide the type of accountability and reliability needed by taxpayers and the financial community rests largely upon the fidelity and consistency with which the principles are implemented.

Sincerely,

[Signature]
Comptroller

Attachment
c: Hon. Hugh L. Carey, Governor
Hon. Peter Goldmark, Division of the Budget
Hon. Michael Bloomingthal, Secretary of the Treasury
Hon. Elmer B. Staats, Comptroller General, GAO
Hon. Paul O'Dwyer, President, City Council
Hon. Felix Rohatyn, Chairman, MAC
July 14, 1973

The Honorable Edward I. Koch
Mayor of the City of New York
Office of the Mayor
City Hall
New York, New York 10007

The Honorable Harrison J. Goldin
Comptroller of the City of New York
Office of the City Comptroller
Municipal Building
New York, New York 10007

Dear Mayor Koch and Comptroller Goldin:

Transmitted herewith are copies of revised pages to the codification of the Accounting Systems Directives promulgated for New York City by the State Comptroller's Office which was originally furnished to your respective offices on June 10, 1977. These revisions to the accounting and financial reporting principles to be followed by the City were developed as a result of discussions with representatives of the City Comptroller's Office and the City's independent public accountants, Peat, Marwick, Mitchell & Co.

The most significant change, the use of the modified accrual basis for reporting real estate tax revenues instead of the cash basis, will permit the City to apply such revenues which are clearly measurable and available and which accrue in any fiscal year to meet the accrued liabilities of that same fiscal year. Certain other changes to the directives were made largely for clarification purposes.

These revisions to the Accounting System Directives are effective for fiscal 1979. An asterisk on the page identifies the areas of change.

Very truly yours,

Joseph L. Mahran
Deputy Comptroller

JLM:pgd
Attachment
cc: Hon. Hugh L. Carey, Governor
    Hon. Howard Miller, Budget Division
    Hon. Michael Bloomberg, Secretary of the Treasury
    Hon. Elmer B. Staats, Comptroller General, SAC
    Hon. Carol Bellamy, President, City Council
    Hon. Felix Rohatyn, Chairman, MAC
    Hon. Donald Kermerfied, Executive Director, EFCB
ACCOUNTING SYSTEMS DIRECTIVES
FOR
NEW YORK CITY

ARThUR LEVITT
State Comptroller
Office of the State Comptroller
Division of Audits and Accounts
June, 1977
INTRODUCTION

Section 36 of the General Municipal Law empowers the State Comptroller to prescribe accounting systems for municipalities. The Municipal Assistance Corporation for the City of New York (Chapter 169 of the Laws of 1975) requires that, in order for the City to receive financial assistance from the Municipal Assistance Corporation (MAC), it must adopt the State Comptroller's uniform system of accounts for municipalities, modified for the needs of New York City. Such system of accounts, as set forth in these directives, has been specifically designed to be in conformity with generally accepted accounting principles. Application of these principles requires that the City maintain separate self-balancing groups of accounts for each appropriate fund.

The MAC Act further requires the City to complete the transition to the State Comptroller's method as promptly and as reasonably practicable in order that audited financial statements may be available for the fiscal year ending June 30, 1978. The Act permits the City and MAC to formulate a mutually-acceptable method of phasing the adjustments resulting from application of the State Comptroller's accounting directives into its accounting system over a reasonable period, not to exceed ten years. The State Comptroller encourages early implementation of these accounting principles.

The accounting systems directives are codified in this document. Future opinions will be issued as needed and will be appended to this volume. This document will be updated to conform with future changes in generally accepted accounting principles.
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ACCOUNTING OPINION NO. 1 ON PARTICULAR FINANCIAL TRANSACTIONS OF NEW YORK CITY
Nature and Sources of Generally Accepted Accounting Principles

As developed for and utilized by governmental units in the implementation and administration of public policies, accounting principles have been defined as "specific fundamental tenets which, on the basis of reason, demonstrated performance, and general acceptance by public administrators, accountants and others concerned with public financial operations, are generally recognized as being essential to correct analysis of financial operations and to the proper preparation and presentation of required financial statements and reports."\(^1\)

Generally accepted accounting principles applicable to governmental units have evolved over a period of several decades. Their current status reflects not only the historical requirements of users of financial information but also the "state of the art" in public sector financial management. Visibility of these generally accepted accounting principles has been achieved through publications by interested governmental organizations and pronouncements by professional accounting bodies which over the years have prescribed such principles for governmental units to adopt and follow in the conduct of their financial operations.

\(^1\)Governmental Accounting, Auditing, and Financial Reporting, p. 3.
Among the professional bodies whose publications and pronouncements constitute generally accepted accounting principles applicable to governmental units are:

American Institute of Certified Public Accountants, Audits of State and Local Governmental Units (1973); Statement of Position 75-3 (1975); Other Relevant Pronouncements and Publications, specifically Audits of Hospitals (1972), considered applicable to the Health and Hospitals Corporation, a separate enterprise fund;

National Committee (now Council) on Governmental Accounting, Governmental Accounting, Auditing and Financial Reporting (1968); NCGA Interpretation No. 1 (1975);

Financial Accounting Standards Board, Various Relevant Pronouncements.

Each of these professional bodies may issue relevant pronouncements and publications in the future, to which governmental accounting and finance officials and independent auditors must be alert. Such pronouncements may modify presently accepted principles or establish new accounting principles in areas not yet covered in professional literature.

Generally Accepted Accounting Principles Applicable to Financial Transactions of New York City.

The MAC legislation requires the City to adopt the State Comptroller’s uniform system of accounts for municipalities, as modified for the needs of New York City. It also requires the City to complete this transition as promptly and as reasonably practicable in order that audited financial statements may be available for the fiscal year ended June 30, 1978. The ultimate objective is financial statements that present fairly the financial position and results of operations of the various funds and account groups of the City in conformity with generally
accepted accounting principles. Accordingly, the accounting principles designated herein for application to the financial transactions of the City are intended to conform to generally accepted accounting principles. They also encompass the modification of the State Uniform System of Accounts, as determined by the State Comptroller in consultation with the City Comptroller, as provided for in the MAC legislation.

Apart from the specific accounting principles having application to the City's financial transactions, as hereinafter described, certain broad accounting concepts that universally apply to business enterprises have relevance to governmental operations generally and specific application to the financial transactions of New York City. These broad concepts include objectivity, historical cost, materiality, full disclosure, consistency and conservatism.

Specific applications of generally accepted accounting principles follow. It should be noted that their specific application may vary, depending on the type of fund involved. To the extent applicable, these distinctions will be delineated throughout this Chapter.

**Fund Accounting**

The diverse nature of governmental operations and the necessity of complying with legal provisions preclude a single unified set of accounts for recording and summarizing all financial transactions of a governmental unit. Instead, the required accounts are organized on the basis of funds and account groups, each of which constitutes a separate entity. Thus, the
operations of each fund are accounted for by providing a separate set of self-balancing accounts which comprise its assets, liabilities, fund balance, revenues and expenditures. It is a basic principle that only the minimum number of funds consistent with legal and operating requirements should be established.

It is inherent in the concept of fund accounting that the financial transactions of a governmental unit not only be accounted for in "a fund" but in "the correct fund," as provided for in authoritative accounting literature applicable to State and local governmental units. For this purpose, the following types of funds are recognized and should be used in accounting for the financial operations of New York City:

Types of Funds

The General Fund to account for all financial transactions not properly accounted for in another fund; this fund will account for the costs of rendering the general services of the City, which benefit the citizenry as a whole. Generally, such activities are financed by revenues collected from the broad general public.

Special Revenue Funds to account for the proceeds of earmarked revenue sources, as required by law or administrative regulations to finance specified activities.

Debt Service Funds to account for the payment of interest and principal on long-term debt other than special assessment bonds and revenue or general obligation bonds intended to be repaid from earnings or other resources of enterprise funds.
Capital Projects Funds to account for resources used for the acquisition of major capital facilities or improvements for general City purposes (other than those in enterprise, intragovernmental service, special assessment, and certain trust funds).

Enterprise Funds to account for the financing of services (and related debt) to the general public where all or a predominant part of the costs involved are paid in the form of charges by users of such services.

Intragovernmental Service Funds to account for the financing of special activities and services performed by a designated organization unit for other organization units within the City.

Trust and Agency Funds to account for assets held by the City in a fiduciary or agency capacity for individuals, private organizations, and other governmental units.

Special Assessment Funds to account for special assessments levied to finance public improvements or services deemed to benefit the properties against which the assessments are levied.

In addition to the above funds for recording of monetary transactions, the following account groups are prescribed for use by the City:

General fixed assets to account for the cost value of fixed assets, i.e., those assets normally lasting beyond one year, which have been acquired in past years for general City purposes.
Capital Projects Funds to account for resources used for the acquisition of major capital facilities or improvements for general City purposes (other than those in enterprise, intragovernmental service, special assessment, and certain trust funds).

Enterprise Funds to account for the financing of services (and related debt) to the general public where a significant part of the revenues involve charges to users of such services.

Intragovernmental Service Funds to account for the financing of special activities and services performed by a designated organization unit for other organization units within the City.

Trust and Agency Funds to account for assets held by the City in a fiduciary or agency capacity for individuals, private organizations, and other governmental units.

Special Assessment Funds to account for special assessments levied to finance public improvements or services deemed to benefit the properties against which the assessments are levied.

In addition to the above funds for recording of monetary transactions, the following account groups are prescribed for use by the City:

General fixed assets to account for the cost value of fixed assets, i.e., those assets normally lasting beyond one year, which have been acquired in past years for general City purposes.
General long-term debt to account for the liability of general obligation bonds and other general long-term debt to be repaid from general property taxes or other designated general revenue sources to be levied or provided in future years.

**Specific Funds to be Established**

Based on an analysis as of June 30, 1975 of the financial transactions of the City, as classified in the City Comptroller's Annual Report for fiscal year 1974-75, the funds set forth below are prescribed for adoption by New York City on or before July 1, 1977. (Certain of these funds were established as of June 30, 1976 and improvements in accounting for transactions therein were effected subsequent thereto.) The types of funds or elements thereof existing on June 30, 1975 that would be incorporated into each proposed new fund are delineated under each separate fund caption, as follows:

**General Fund**

General fund, as established by Section 126 of the Charter, and consisting of taxes (other than property taxes) and certain city-imposed, non-tax revenues, certain state grants in aid, and federal revenue sharing, would be directly or ultimately accounted for in the formally established general fund. Excluded therefrom would be those revenues which are separately proposed to be accounted for in individual enterprise funds. Certain non-recurring "revenues" detailed in the annual report for the fiscal year 1974-75 would, of course, also be excluded, as follows:
New York City Stabilization Reserve Corporation
Borrowed from other City funds (characterized in
miscellaneous revenue accounts as "advance to
make up revenue shortfall")

Property tax revenues

Supplementary revenues used to finance
certain functions, such as State and Federal aid for education,
social services, health, hospitals, charitable institutions,
medicare, medicaid, poverty programs, and other purposes.
Included also in this category would be various other revenues,
as, for example, those detailed on page 34 of the 1974-75 annual
report. However, sewer rents therein would be excluded for the
reasons stated in the preceding paragraph. Also, the service
fees, interest income on mortgages and other revenues generated
by the Mitchell Lama Limited Profit Housing Program and the
Municipal Loan Program within the revenues of the Housing and
Development Administration should be excluded as these revenues
and the related expenses are proposed to be accounted for in a
separate Housing enterprise fund.

Miscellaneous revenue accounts should be
included in the proposed general fund to the extent they
constitute valid revenues of a source and nature that qualify
them as general fund revenues. Under prior accounting practice,
certain expenditures of a general fund nature have been made
from excess revenues of the current year or from amounts accumulated
in prior years in these accounts. To the extent such expenditures
qualify as true general fund expenditures, they would be made
from the new general fund once it is formally established. In
addition, any asset, liability, or fund balance items would be incorporated in the general fund at its inception. 

Special accounts, as then categorized, would be incorporated into the general fund to the extent the transactions recorded therein are of a general fund nature and purpose. Subject to analysis, these would consist of asset, liability, fund balance, revenue, and expenditure accounts or elements thereof.

Expense budget, as categorized, would be incorporated into the general fund except for those revenues and expenditures and other proprietary financial transactions designated to be accounted for in other types of funds. Major items to be excluded are:

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<th>Budget No.</th>
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<th>Function or Activity</th>
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<td>856</td>
<td>NYC Health and Hospitals Corp.</td>
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<td>Municipal Services Adm.</td>
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<td>826</td>
<td>Housing and Development Adm.</td>
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<td>&quot; Water Register</td>
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<td>&quot; Water Supply</td>
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<tr>
<td>826</td>
<td>&quot; Sewage</td>
<td>0093-000</td>
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Expenditures incurred for the payment of judgments, claims, awards, retroactive collective bargaining agreements, annual payments under long-term leases for various City facilities and vocational educational and related expense programs for which bonds were authorized and issued would be included in the general fund except for certain judgments which relate specifically to capital projects. (These types of expenditures appear in appendix B of the City Comptroller's 1974-75 annual report.)
Unexpended balances in various supplementary revenue accounts and expense budgets for prior years and the related receivable balances, as set forth in sections C-1 through C-4 in appendix C of the 1974-75 annual report, should be closed into the fund balance account of the general fund at the point of its formal inception.

Residue equity in special assessment funds, consisting of past due assessments receivable would be included in the general fund. Advances have been made by the general fund in prior years to meet scheduled bond payments that have now been completed. The proceeds from collection of the assessments receivable would otherwise have been used to repay the general fund.

Certain Restricted Revenues

There is a substantial number of restricted revenues of a general fund nature that normally might be accounted for in special revenue funds. However, all these can be appropriately accounted for on a restricted basis in the general fund. Accordingly, there appears to be no immediate need to establish any special revenue funds.

All other asset, liability or fund balance accounts or elements thereof, however currently accounted for, that properly belong in the general fund of the City.

Debt Service Funds

The payment of interest and principal installments on all general obligation bonds and other long-term debt and the
Unexpended balances in various supplementary revenue accounts and expense budgets for prior years and the related receivable balances, as set forth in sections C-1 through C-4 in appendix C of the 1974-75 annual report, should be closed into the fund balance account of the general fund at the point of its formal inception.

Residue equity in special assessment funds, consisting of past due assessments receivable would be included in the general fund. Advances have been made by the general fund in prior years to meet scheduled bond payments that have now been completed. The proceeds from collection of the assessments receivable would otherwise have been used to repay the general fund.

Certain Restricted Revenues

Because of the general fund nature of the restricted revenues currently being received by the City, all such revenues can be appropriately accounted for on a restricted basis in the general fund. Accordingly, there appears to be no need to establish any special revenues funds at the present time. However, the need to establish special revenue funds should be reassessed as other funds of this nature are received in the future.

All other asset, liability or fund balance accounts or elements thereof, however currently accounted for, that properly belong in the general fund of the City.

Debt Service Funds

The payment of interest and principal installments on all general obligation bonds and other long-term debt and the
related revenues to cover such payment should be accounted for in one or more debt service funds of the City instead of the general fund, as heretofore. The preferable method of providing a direct financing source for annual debt service is to allocate common revenues between the general and debt service funds. The alternative would be to credit all such revenues direct to the general fund and appropriate for transfer to the debt service fund an amount equal thereto in each annual budget of the general fund. However, for reasons of convenience, the City may wish to account for debt service transactions during that year within the general fund. This is acceptable provided that for financial reporting purposes, the necessary year-end adjustments and/or transfers are made to an appropriate debt service fund or funds, in order to report the City's debt service transactions in conformity with generally accepted accounting principles. At such time as debt service funds may be deemed necessary by revision of the City Charter or by other law or regulation, the minimum number of separate funds permitted under the applicable bond resolutions should be formally established. A review of the related bond resolutions would be requisite to a final decision on the number of individual debt service funds required.

With respect to the City's general obligation bonds issued for water supply and water pollution control purposes and for non-assessable sewer improvements, it would be normal practice for such bonds to be repaid out of the earnings of the water and sewer systems, commencing with the establishment of an enterprise fund to account for the operations thereof.
related revenues to cover such payments, should be accounted for in one or more debt service funds of the City instead of the general fund, as heretofore. Revenues should be reported in the fund legally entitled to their receipt, which currently is the general fund. An amount equal to that provided in each annual budget of the general fund should be transferred from the general fund to the debt service funds. However, for reasons of convenience, the City may wish to account for debt service transactions during that year within the general fund. This is acceptable provided that for financial reporting purposes, the necessary year-end adjustments and/or transfers are made to an appropriate debt service fund or funds, in order to report the City's debt service transactions in conformity with generally accepted accounting principles. At such time as debt service funds may be deemed necessary by revision of the City Charter or by other law or regulation, the minimum number of separate funds permitted under the applicable bond resolutions should be formally established. A review of the related bond resolutions and/or applicable law would be requisite to a final decision on the number of individual debt service funds required.

With respect to the City's general obligation bonds issued for water supply and water pollution control purposes and for non-assessable sewer improvements, it would be normal practice for such bonds to be repaid out of the revenues of the water and sewer systems, commencing with any establishment of an enterprise fund to account for the operations thereof.
Accordingly, interest and principal payments on these bonds would be made directly from the enterprise funds proposed later in this document to be established to account for the City's water and sewer operations.

Apart from accounting for debt service on the City's serial bonds and short-term notes which may be converted to long-term debt, as described earlier, there will be a need to continue the four presently established sinking funds, as shown in the annual report for the year ended June 30, 1975.

To the extent it is necessary to make annual contributions to such sinking funds it would be acceptable to appropriate for transfer to the respective sinking funds an amount equal to each requirement in each annual budget of the general fund.

Capital Projects Fund

All expenditures for qualified capital projects for general City purposes (other than those in enterprise, intragovernmental service, special assessment, and certain trust funds), should be accounted for in a capital projects fund. Generally, all projects included in the City's capital budget for successive fiscal years can be accounted for in a single capital projects fund.

It is recommended that as of July 1, 1977 a capital projects fund be established for all uncompleted capital projects as of that date. It is further recommended that projects approved in capital budgets for succeeding years be incorporated into the existing capital projects fund. This fund should be maintained over the life of all projects accounted for therein.
Accordingly, interest and principal payments on these bonds would be made directly from the enterprise funds which may be established to account for the City’s water and sewer operations.

Apart from accounting for debt service on the City’s serial bonds and short-term notes which may be converted to long-term debt, as described earlier, there will be a need to continue the four presently established sinking funds, as shown in the annual report for the year ended June 30, 1975.

To the extent it is necessary to make annual contributions to such sinking funds it would be necessary to appropriate for transfer to the respective sinking funds an amount equal to each requirement in each annual budget of the general fund.

**Capital Projects Fund**

All expenditures for qualified capital projects for general City purposes (other than those in enterprise, intragovernmental service, special assessment, and certain trust funds), should be accounted for in a capital projects fund.

Generally, all projects included in the City’s capital budget for successive fiscal years can be accounted for in a single capital projects fund.

It is recommended that as of July 1, 1977 a capital projects fund be established for all uncompleted capital projects as of that date. It is further recommended that projects approved in capital budgets for succeeding years be incorporated into the existing capital projects fund. This fund should be maintained over the life of all projects accounted for therein.
Management determination as to the cost value of projects to be financed, in part or in full, in each current year for the purpose of determining borrowing needs is an administrative function having no impact on the fund accounting requirements.

**Enterprise Funds**

The City's respective water and sewer operations each meet the criteria of an enterprise fund. While a separate enterprise fund for each of these operations may be established, the City has elected to plan for a single enterprise fund for their combined operations. In addition, the Health and Hospitals Corporation, which is established as a separate "political subdivision" in the authorizing statute, qualifies as an enterprise fund and should be independently accounted for in such manner. The general fund of the City should reflect only its net contribution to the Corporation and not the latter's total revenues and expenditures. Since this entity is a public benefit corporation, its financial statements would not be included with the statements of other City funds in the City Comptroller's annual report; rather, they would be separately presented with the financial statements of other public benefit corporations in such report.

Housing and Development Administration revenues now included in supplementary revenues and expenditures of that department which pertain to the operations of the Mitchell Lama Housing Program and the Municipal Loan Program would appear to meet the criteria of an enterprise fund. It is therefore recommended that a separate enterprise fund for these operations,
Management determination as to the cost value of projects to be financed, in part or in full, in each current year for the purpose of determining borrowing needs is an administrative function having no impact on the fund accounting requirements.

Enterprise Funds

It is recommended that the City's water and sewer operations be accounted for by an enterprise fund or funds. In addition, the Health and Hospitals Corporation, which is established as a separate "political subdivision" in the authorizing statute, qualifies as an enterprise fund and should be independently accounted for in such manner. The general fund of the City should reflect only its net contribution to the Corporation and not the latter's total revenues and expenditures. Since this entity is a public benefit corporation, its financial statements would not be included with the statements of other City funds in the City Comptroller's annual report; rather, they would be separately presented with the financial statements of other public benefit corporations in such report.

The Housing Enterprise Fund (HEF), included in the City Comptroller's annual report for the 1977 fiscal year, was established to account for the operations of the Mitchell Lama Housing Program and the Municipal Loan Program. Currently, a substantial portion of the HEF's mortgage loans receivable are being sold. If it is determined that the remaining operations no longer meet the criteria for an enterprise fund then the HEF should be discontinued and the transactions of these programs should be reported in with the general fund.
together with its mortgages and other receivables and related debt, be formally established as of July 1, 1977.

**Intragovernmental Service Fund**

It is recommended that an intragovernmental service fund be established as of July 1, 1977 to account for the following activities of the Municipal Services Administration: electricity, steam and gas, telephone service, custodial services, purchasing and Public Works—Motor Vehicle Maintenance and Garage.

**Trust and Agency Funds**

At least one or more trust or agency funds will be required for existing trust accounts of those listed on pages 451-58 and 556 of the 1974-75 annual report. In addition, an in-depth analysis of the "Special Accounts" of the City may disclose the need for other trust or agency funds. It is recommended that, if practicable, a single trust fund be established for all trust activity, with a separate fund balance account for each individual trust responsibility. Similarly, a separate agency fund is recommended for all agency responsibilities, with a separate fund balance account for each individual agency responsibility.

**Special Assessment Funds**

There is no immediate need to establish any special assessment funds, in view of the present and contemplated future inactivity in creating special improvement districts.

**Account Groups to be Established**

Two account groups should be established for the purposes previously described:
Intragovernmental Service Fund

It is recommended that an intragovernmental service fund be established as of July 1, 1977 to account for the following activities of the Municipal Services Administration: electricity, steam and gas, telephone service, custodial services, purchasing and Public Works--Motor Vehicle Maintenance and Garage.

Trust and Agency Funds

Depending on materiality at least one or more trust or agency funds will be required for existing trust accounts of those listed on pages 451-58 and 556 of the 1974-75 annual report. It is recommended that, if practicable, a single trust fund be established for all trust activity, with a separate fund balance account for each individual trust responsibility. Similarly, a separate agency fund is recommended for all agency responsibilities, with a separate fund balance account for each individual agency responsibility.

If the trust or agency funds are immaterial, then such funds may be consolidated within the general fund and shown as a separate component of fund balance.

Special Assessment Funds

There is no immediate need to establish any special assessment funds, in view of the present and contemplated future inactivity in creating special improvement districts.

Account Groups to be Established

Two account groups should be established for the purposes previously described:
General Fixed Assets

General Long-Term Debt

Modification of Implementation Schedule

Recognition has been given to the limited time frame under the State legislation creating the Municipal Assistance Corporation for the City to have in place by July 1, 1977 a revised general accounting system and correlate therewith improved budgetary procedures and practices. The objective is to permit the City to prepare financial statements that present financial position and results of operations of its various funds and account groups in conformity with generally accepted accounting principles for the fiscal year ending June 30, 1978, the initial year of an independent audit required by the MAC legislation.

To accomplish this objective involves, among other comprehensive assignments, the establishment of full fund accounting. This will encompass segregation of existing account balances into each of the proposed funds, classified under a new chart of accounts now scheduled for implementation on July 1, 1977. In addition, it will involve establishment of fixed asset values and related contribution account balances for the water and sewer systems, for which separate enterprise funds are proposed, and general fixed assets acquired generally through the City's expense and capital budgets in prior years. Considerable research of prior years' accounting, engineering and other cost records will be necessary to establish these values on an acceptable basis.
Accordingly, because of the difficulties foreseen in making the transition to full fund accounting by July 1, 1977, the City sought and received the approval of the Board of Directors of MAC on October 29, 1976 to defer establishing enterprise and intragovernmental service funds until July 1, 1979 and a general fixed assets group of accounts until July 1, 1980.

**Public Authorities and Other Special Funds**

There are several public benefit corporations, authorities, and other agencies operating more or less independently of the City, whose financial statements have not been included in the annual report of the City Comptroller. It is recommended that the annual financial statements of these funds be separately presented in the City's published annual financial report. A list of these authorities and other special funds, identified as to type of fund, is:

<table>
<thead>
<tr>
<th>Name of Entity</th>
<th>Type of Funds</th>
</tr>
</thead>
<tbody>
<tr>
<td>NYC Health and Hospitals Corporation</td>
<td>Enterprise Fund</td>
</tr>
<tr>
<td>NYC Housing Authority</td>
<td>Enterprise Fund</td>
</tr>
<tr>
<td>NYC Off Track Betting Authority</td>
<td>Enterprise Fund</td>
</tr>
<tr>
<td>Research Foundation of the City University of New York</td>
<td>Enterprise Fund</td>
</tr>
<tr>
<td>NYC Housing Development Corporation</td>
<td></td>
</tr>
<tr>
<td>NYC Convention and Exhibition Center Corp.</td>
<td>Capital Projects Fund at inception; enterprise fund upon operation</td>
</tr>
<tr>
<td>NYC Educational Construction Fund</td>
<td>Capital Projects Fund at inception; enterprise fund upon operation</td>
</tr>
</tbody>
</table>
Name of Entity (cont'd)  
City University Construction Fund  
NYC Rehabilitation Mortgage Insurance Corp.  
NYC Industrial Development Agency  

Type of Funds  
Capital Projects Fund  
Enterprise Fund  
Special Revenue Fund  

Accounting Rationale for Fund Identifications of Public Authorities and Other Special Funds

The funds listed above have been categorized as to type on the basis of the following accounting principles:

The enterprise funds have been interpreted to be conducting operations which by their nature and purpose appear to be generally self supporting. User charges for services or materials sold to the public provide a predominant portion of their individual gross revenues. In most instances, the State legislation creating these entities expressed the intent to make each of them self supporting enterprises while filling a specified public purpose. It is an accounting principle that operations or activities of this nature and purpose which meet the financing criteria described above should be accounted for in an enterprise fund.

The capital projects funds, including the two so classified at their inception, appear to have been created to account for specified resources to be used for the acquisition of capital facilities, including the acquisition of land and buildings for general or school purposes, and various improvements other than buildings. These would involve the acquisition or construction of major permanent facilities having a relatively long life and therefore meet the definition of a "capital project."
It is an accounting principle that major capital projects should be accounted for in a capital projects fund.

The New York City Industrial Development Agency was organized (November 1974) to develop industrial projects that will attract business enterprises and increase job opportunities in the City. For each project developed a fee is charged. All fees collected are earmarked for the exclusive use of the agency for the purposes stated above. It is an accounting principle that where a specified revenue source is earmarked by law or administrative regulation to finance a specific activity the related financial transactions should be accounted for in a special revenue fund.

Interfund Transactions

Since each fund prescribed is considered as a separate entity, amounts receivable from or payable to other funds should be reflected in the accounts of each fund and separately presented in the financial statements until liquidated by payment or authorized interfund transfer.

In addition to interfund loans and advances, there are essentially four categories of interfund transactions. Guidelines and examples for proper accounting of these four categories of interfund transfers follow.
The first category includes transfers which are revenues to the recipient fund and expenditures to the disbursing fund. These are transactions which would be treated as revenues or expenditures if they were conducted with outsiders. Examples are: a contribution in lieu of property taxes to the City's general fund from an enterprise fund, such as the water and sewer fund; billings by an intragovernmental service fund to departments of the general fund for services rendered or facilities provided; and for services rendered by the general fund to an enterprise fund, such as engineering, legal, and administrative assistance.

In the second category are transfers which comprise reimbursement of expenditures made by one fund for another and which are credited to the expenditures of the recipient fund or shown as a reduction of total expenditures. Interfund transfers represent reimbursement for an expenditure if the reimbursement is for a specific or allocable cost applicable to the reimbursing fund. Generally, these items will be of the type subject to direct allocation at the point of inception and, where the timing of the transfer (or direct usage) makes this feasible, the City should so record them. An example would be the transfer of materials from a general fund department to an intragovernmental service fund.

The third category includes all transfers except those covered in the first and second categories above and those representing nonrecurring transfers of equity (fourth below).
Typically these represent legally authorized transfers from a fund receiving revenue to a fund which will use the amount transferred. Some examples are as follows:

(a) Annual transfers from the City's general fund to one or more of the City's four debt service funds (sinking funds).

(b) Budgeted transfers from the general fund to a capital projects fund. Expenditure from the capital projects fund of the monies transferred may occur in the year of transfer or in subsequent years.

(c) Transfers from the general fund or a special revenue fund to an enterprise fund that serve as a subsidy for the operations of the enterprise.

(d) Transfers from an enterprise fund, other than payments in lieu of taxes, to the general fund that serve as a resource for general fund expenditures.

The transfers received and the transfers made should appear as separate items in each fund's statement of revenue, expenditures and transfers or equivalent financial statement. For enterprise funds, such transfers should appear on the income statement after operating income or loss, except where a transfer from an enterprise fund (example (d) above) represents a distribution of net income; in such event, it should appear on the income statement after the net income line. The bottom line may then appropriately be titled "Balance - Transferred to Retained Earnings."
Typically these represent legally authorized transfers from a fund receiving revenue to a fund which will use the amount transferred. Some examples are as follows:

(a) All budgeted transfers from the City's general fund to one or more of the City's debt service funds.

(b) Budgeted transfers from the general fund to a capital projects fund. Expenditure from the capital projects fund of the monies transferred may occur in the year of transfer or in subsequent years.

(c) Transfers from the general fund or a special revenue fund to an enterprise fund that serve as a subsidy for the operations of the enterprise.

(d) Transfers from an enterprise fund, other than payments in lieu of taxes, to the general fund that serve as a resource for general fund expenditures.

The transfers received and the transfers made should appear as separate items in each fund's statement of revenue, expenditures and transfers or equivalent financial statement. For enterprise funds, such transfers should appear on the income statement after operating income or loss, except where a transfer from an enterprise fund (example (d) above) represents a distribution of net income; in such event, it should appear on the income statement after the net income line. The bottom line may then appropriately be titled "Balance - Transferred to Retained Earnings."
The fourth category includes nonrecurring transfers between funds which represent a transfer of equity of the funds involved. Nonrecurring transfers of equity between funds that are extraneous to normal operations are not revenues and expenditures of the funds involved. Such transfers, which are analogous to capital transactions, should not be reported in the statement of revenues and expenditures. Examples include: contributions from the City's general fund to an enterprise or intragovernmental service fund; return of part or all of such contributions to the general or other contributing fund; and transfers of residual equity balances in discontinued funds to the general or debt service funds, normally required by statute. In all such cases, the recipient fund should treat the amount received as an addition to fund balance or, in the case of an enterprise or intragovernmental service fund, to a contribution account. The disbursing fund should treat the transfer as a reduction of fund balance, or in the case of an enterprise or intragovernmental service fund, retained earnings, if a contribution account is not properly chargeable.

Legal Compliance and Conflicts With Generally Accepted
Accounting Principles in Financial Accounting and Reporting

The City's accounting system must make it possible to show that all applicable legal provisions have been complied with; and to determine fairly and with full disclosure the financial position and results of financial operations of the constituent funds and account groups of the City.
Application of this principle means that the City must record all financial transactions in a manner that will reflect conformance with applicable legal requirements. These may be found in the State constitution or statutes, the City's home rule charter, resolutions or ordinances of the City Council or, where applicable, of the Board of Estimate, and Executive Orders of the Mayor.

The following are examples of "funds" named or implied in State law or the City Charter. These are recommended to be accounted for as follows:

<table>
<thead>
<tr>
<th>Source</th>
<th>Recommended Fund or Method</th>
</tr>
</thead>
<tbody>
<tr>
<td>City Charter</td>
<td></td>
</tr>
<tr>
<td>Tax deficiency account (Sec. 127a.)</td>
<td>Reserve account in general fund</td>
</tr>
<tr>
<td>Tax appropriation and general fund stabilization reserve fund (Sec. 128a.)</td>
<td>&quot; &quot;</td>
</tr>
<tr>
<td>Real property fund (Sec. 251)</td>
<td>Revenue account in general fund</td>
</tr>
<tr>
<td>Assessable improvement funds (Sec. 300) (in liquidation; all bonds retired)</td>
<td>Fund balance account in general fund</td>
</tr>
<tr>
<td>Traffic improvement fund (Sec. 2103.1.m)</td>
<td>Revenue and expenditure accounts in general fund</td>
</tr>
<tr>
<td>General Municipal Law</td>
<td></td>
</tr>
<tr>
<td>Tax stabilization reserve fund (Sec. 6-e.)</td>
<td>Reserve account in general fund</td>
</tr>
<tr>
<td>Workmen's compensation reserve fund (Sec. 6-j.)</td>
<td>Not currently active</td>
</tr>
<tr>
<td>Reserve fund for proceeds of sale of capital improvements on which there is outstanding indebtedness (Sec. 6-1.)</td>
<td>Reserve account in applicable sinking fund or general fund</td>
</tr>
<tr>
<td>Local Finance Law</td>
<td></td>
</tr>
<tr>
<td>Special bank account for tax assessment revenues against which TANs have been issued, when amount of TANs issued equals anticipated revenue (Sec. 24.00)</td>
<td>Restricted cash account in general fund</td>
</tr>
</tbody>
</table>
Special bank account for revenues against which RANs have been issued, when amount of RANs issued equals anticipated revenue (Sec. 25.00)  

Recommended Fund or Method

Restricted cash account in general fund

Special fund for revenues from an enterprise fund whose debt is excluded in computing debt limit (Sec. 123.00 and 124.10)

Enterprise fund

Education Law

Public library fund (Sec. 259).

Not applicable to City

Social Services Law

Separate account for funds received as guardians of a minor (Sec. 87.3)

Trust and agency fund

Municipal Assistance Corporation Act

Money MAC pays to City for debt service or operating expenses shall be held in trust for the specific purpose (Sec. 3037)

Various accounts in general fund and MAC debt service fund; memorandum entries in MAC general long-term debt group of accounts (please refer also to Chapter

These recommendations will assure accountability; to assure compatibility with legal compliance the City should confirm the above recommended actions with Corporation Counsel.

The basic requirement for compliance to be expressed in the accounting system does not obviate generally accepted accounting principles for purposes of reporting financial position and results of operations. For this reason, authoritative literature provides that in the event of conflict between legal provisions and generally accepted accounting principles, the latter shall take precedence for purposes of financial reporting.

Accordingly, in recording and reporting on financial transactions of the City, the following guidelines are
If a given transaction is required to be recorded in a manner that would be in conflict with generally accepted accounting principles for financial reporting purposes, it must nonetheless be recorded in compliance with the applicable legal requirement. At fiscal year-end, in closing the books and preparing financial statements, it is appropriate to incorporate such accounting information in the records (usually in the form of journal entries in the funds involved) as will permit financial statements prepared therefrom to present fairly the financial position and results of operations of the respective funds and the financial position of the account groups in conformity with generally accepted accounting principles. Where appropriate, it is permissible to reverse such year-end journal entries on the first day of the ensuing fiscal year.

Where there is a need to report the compliance of financial transactions with legal requirements and it can be reported in a supplemental schedule rather than as a basic financial statement in the City Comptroller's annual financial report, that form of reporting should be used.

In those circumstances where compliance of financial transactions with legal requirements must be reported in the form of financial statements then it is not possible for such financial statements to be presented in conformity with generally accepted accounting principles. See material later presented in this chapter under the caption of "Financial Reporting" for further guidance in reporting on matters relating to compliance with legal requirements.
Bases of Accounting

The basis of accounting on which financial transactions are recorded prescribes the timing of revenue and expense recognition. This, in turn, impacts the recording of assets and liabilities and the presentation of financial position. While the use of a prescribed basis of accounting has as its basic purpose the timing of revenue and expense recognition, its practical application would also encompass examples affecting only asset and liability accounts which have no impact on either revenue or expenditure accounts. A specific example would be the recording of a liability for purchase of equipment to be capitalized in an enterprise or intragovernmental service fund.

In authoritative accounting literature applicable to governmental units there are only two formally recognized bases of accounting:

Accrual Basis

The basis of accounting under which revenues are recorded when earned and expenditures are recorded as soon as they result in liabilities for benefits received, notwithstanding that the receipt of the revenue or the payment of the expenditure may take place, in whole or in part, in another accounting period.¹

¹Governmental Accounting, Auditing, and Financial Reporting, p.151.
Modified Accrual Basis

The basis of accounting under which expenditures other than accrued interest on general long-term debt are recorded at the time liabilities are incurred and revenues are recorded when received in cash, except for material and/or available revenues which should be accrued to reflect properly the taxes levied and the revenues earned.\(^1\)

The basis of accounting to be followed in recording transactions in the respective funds of the City depends on the purpose for which a fund has been established. Generally, the funds proposed to be utilized by the City can be classified into two categories:

1. Funds utilizing accrual basis

   (a) Funds similar to commercial enterprises
       (i) Enterprise Funds
           a Water and Sewer Fund
           b Housing Enterprise Fund
              (Mitchell Lama Housing and Municipal Loan Programs)
           (ii) Intragovernmental Service Fund
                a Municipal Services Administration

   (b) Other City funds (see exceptions below)
       (i) Capital Projects Fund
       (ii) Trust and Agency Funds
       (iii) Special Assessment Funds (inactive)

An exception to the use of the accrual basis for funds under (b) above would be those instances wherein revenues received by the fund were not susceptible to accrual; therefore, revenues would be recorded as collected. These exceptions would affect only the City's capital projects fund and then only if current revenues of a self-assessed type were budgeted therefor, such as

\(^1\)Ibid., p. 164.
sales taxes, income taxes, or gross receipts taxes. There are certain technical exceptions to using the full accrual basis in special assessment funds but these would not be applicable to the City since there is no immediate need to establish special assessment funds.

In applying the accrual method to accounting for expenditures in a capital projects fund, it is not compatible therewith to encumber total contract commitments or portions thereof. Instead, it is appropriate to accrue at year-end the cost values of work completed on on-going capital projects. Normally, such accruals would consist of billings received from contractors for progress payments on work completed through the year-end or other regular billing date during the final month of the City's fiscal year. It is common practice for such billing to be computed on the percentage of completion method, a recognized method under generally accepted accounting principles.

2. Funds utilizing modified accrual basis

(a) Budgetary Funds
   (i) General Fund
   (ii) Special Revenue Funds (inactive)
   (iii) Debt Service Funds

These funds are established for the City primarily to account for the resources and expenditures for governmental operations of a general nature. The financial operations of these funds will consist of the marshalling of resources and the expenditure of such resources. Ordinarily, there is no causative relationship as the resources are not expended for the purpose of creating or producing the resources. The resources of budgetary
funds will be derived largely from the imposition of taxes by the City.

A classification and discussion of the factors inherent in the use of the modified accrual basis of accounting for the City's budgetary funds follow:

Revenues shall be recorded as received in cash except for revenues susceptible to accrual, and revenues of a material amount that have not been received at the normal time of receipt, which will be available to meet the expenditures of the related period.

Revenues considered susceptible to accrual are those revenues that are both measurable and available. In substance, "available" means that the item is a resource that can be used to finance the governmental operations during the year. Few types of revenues in budgetary funds possess all of the characteristics essential to meet both criteria of being measurable and available.

Revenue sources that generally are not considered susceptible to accrual include those generated on a self-assessed basis, such as income taxes and sales taxes. However, under the remittance calendar for state-collected sales taxes, inclusive of amounts expected to be retained by MAC, such taxes are concluded to be susceptible to accrual by New York City. Other examples of revenues not considered susceptible to accrual are parking meter revenues, fines and forfeitures, business licenses, non-business licenses and permits, and charges for services. Normally, such items would be recorded as revenues when received. However, known
refunds of income taxes should be recorded as a liability and a reduction of revenue at the time refund claims are filed with the City. All revenues in these funds not considered susceptible to accrual should be recorded as collected.

Real Property Taxes - Special Procedures

One source of City revenue not considered susceptible to accrual to which special procedures apply is real property taxes. Real property taxes should be recorded as revenue in the fiscal year in which collected. A receivable should be established for the total amount billed, based on the official tax roll, excluding amounts applicable to exempt properties. Such receivable should be offset by a credit balance in an amount equal to the portion expected to be collected during the year, based on the recent collection experience, to an account titled "Reserve for Uncollected Taxes," and the remainder to an account titled "Reserve for Uncollectible Taxes."

As collections of property taxes are received monthly, a month-end adjustment of the above receivable and offsetting reserve for uncollected taxes should be made in equal amounts. Similar adjustments should be made to these control accounts for corrections to the original tax rolls, including abatements, waivers or other amendments thereto throughout the year, based on changes officially reported by the Tax Assessor's Office.
This procedure would permit the balance in the "Reserve for Uncollected Taxes" to approximate the amount estimated as revenue in the budget for the current year and thereby establish a control over the amount remaining to be collected at any point during the current year for budget balancing purposes. At the close of each year there should be transferred to this reserve from the "Reserve for Uncollectible Taxes" any portion of the latter reserve expected to be collected in future years. As collected, such taxes would be recorded as revenue from "Real Property Taxes - Prior Years."

Thus, the reserve for uncollected taxes would have a dual purpose: 1) as a budgetary control over taxes expected to be collected in the first year and 2) as a control over delinquent taxes expected to be collected in subsequent years.

The balance in the Reserve for Uncollectible Taxes would, at each year-end, represent the amount estimated as uncollectible from original tax levies of the current and all prior years. All write-offs of uncollectible taxes should be charged to the latter reserve.

For reasons of convenience in maintaining effective control over taxes receivable and the related reserves, it is recommended that a separate control account for "Real Estate Taxes Receivable" and the "Reserve for Uncollected Taxes" be maintained for each year of levy until final collection or liquidation through in-rem foreclosure. It would be appropriate to maintain only a single account for the "Reserve for Uncollectible Taxes."
Wld be recognized as revenue when the taxes are levied. The
difference between the net real estate taxes receivable and the
amount estimated to be currently available will be classified
as a deferred revenue account "Reserve for Uncollected Taxes."

Amounts included in the Reserve for Uncollected Taxes will be
recognized as revenue in the fiscal year such taxes are collected
met the definition of being available.
For purposes of balance sheet presentation, the "Reserve for Uncollectible Taxes" should be deducted from "Real Estate Taxes Receivable;" the "Reserve for Uncollected Taxes" should appear under the reserve caption on the credit side of the balance sheet.

If payments of property taxes are received for a year in advance of the current year, the amount thereof should be credited to a deferred revenue account entitled "Property Taxes Collected in Advance" and not to "Property Tax Revenue."

Revenues Susceptible to Accrual

Under generally accepted accounting principles, the revenues in the City's proposed budgetary funds that are considered susceptible to accrual are listed below.

<table>
<thead>
<tr>
<th>Source of Revenue</th>
<th>Explanation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales Taxes</td>
<td>See explanation below.</td>
</tr>
<tr>
<td>State and Federal categorical grants</td>
<td>See explanation below.</td>
</tr>
<tr>
<td>Interest on investments</td>
<td></td>
</tr>
</tbody>
</table>

Sales Taxes

The calendar for remittance to political subdivisions of sales tax collected by New York State from quarterly remitters provides for quarterly distributions of all
For purposes of balance sheet presentation, the allowance for uncollectible taxes should be deducted from "Real Estate Taxes Receivable"; the "Reserve for Uncollected Taxes" should appear under the "Other Credits" caption on the credit side of the balance sheet.

If payments of property taxes are received for a year in advance of the fiscal year to which they apply, such amounts should be credited to a deferred revenue account entitled "Property Taxes Collected in Advance" and not to "Property Tax Revenue."

Other Revenues Susceptible to Accrual - Special Procedures

Among the revenues considered susceptible to accrual under generally accepted accounting principles, are the following:

<table>
<thead>
<tr>
<th>Source of Revenue</th>
<th>Explanation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales Taxes</td>
<td>See explanation below.</td>
</tr>
<tr>
<td>State and Federal categorical grants</td>
<td>See explanation below.</td>
</tr>
<tr>
<td>Interest on investments</td>
<td></td>
</tr>
</tbody>
</table>

Sales Taxes

The calendar for remittance to political subdivisions of sales tax collected by New York State from quarterly remitters provides for quarterly distributions of all
taxes collected from merchants through the month preceding the end of each quarter. Thus, sales taxes collected by merchants through May 31 each year is required to be remitted to the State Department of Taxation and Finance by June 20. Remittance to cities is made generally by June 28 for approximately 90 percent of their respective shares. The balance is usually remitted by July 12 each year.

Sales tax remittances received after June 20 by the State from merchants for the quarter ending May 31 or prior periods, comprising delinquent remittances, are reported to be commingled with regular remittances for the ensuing current quarter and the amounts thereof are not readily identifiable.

Under the above described remittance calendar, the amount received by June 28 would be accruable as of June 30 if not received by year-end. The amount received by July 12 would also be accruable. All delinquent sales tax received by the State through July 31 for the quarter ended May 31 or prior periods may be accrued provided the total thereof is remitted to the City by August 15 each year.

In addition to quarterly remittances of state-collected sales tax, the State Department of Taxation and Finance began on March 1, 1976 to require the filing of a monthly sales and use tax return by each vendor who had taxable receipts, amusement charges and rents of $300,000 or more in each of the four quarters ended February 29, 1976. Each monthly return shall be filed within 15 days after the close of each month. It is assumed a remittance to the City will be made within 30 days.
Beginning September 1, 1977, any vendor with total taxable receipts, amusement charges, and rents of $100,000 or more in any of the four preceding quarters must file a monthly return.

Under generally accepted accounting principles, sales and use taxes remitted by vendors that are in the hands of the State collection and distributing agency on or before June 30 each year would be accruable by the City whose fiscal year ended June 30, provided they are to be remitted in time to be used as a resource for payment of obligations incurred during the preceding fiscal year. Technically, collections from monthly returns for the month of June each year would not be in the hands of the State distributing agency at June 30, but would be 20 days later. They would, however, normally be distributed to the City in time to be used in payment of obligations incurred during each fiscal year ending June 30.

To be consistent with accrual procedures previously outlined for sales taxes remitted by merchants to the State collection and distributing agency on a quarterly basis, it has been concluded that sales taxes paid to such agency by July 20 each year on monthly returns would be susceptible to accrual by the City as of June 30, provided they were remitted to the City by August 15 each year.

The accounting treatment for sales taxes received directly by MAC for its debt service purposes is the subject of a separate Accounting Systems Directive.
State and Federal Categorical Grants

Revenues from State and Federal categorical grants which are directly related to eligible expenditures may be recognized as the expenditures are incurred; at that point a receivable should be established for the amount not yet collected and the appropriate revenue account should be credited. Amounts received in advance of expenditures should be treated as deferred revenues until the related expenditure is incurred.

To be recognized as a revenue and as a receivable, the related expenditure must be within statutory and regulatory limitations. Revenues and receivables should not be recognized to the extent that: (1) expenditures are not allowable by law or regulation; (2) expenditures exceed the dollar amount of available grants; (3) claimed expenditures are disallowed upon audit; and (4) past experience indicates that claimed expenditures will be disallowed upon audit.

Receivable balances should be confirmed periodically with funding sources and with the City's operating agencies to ensure that they meet the tests of availability and measurability. If such confirmation shows the recorded amounts to be erroneous, differences should be adjusted immediately.
Revenues of a material amount received at other than normal time of receipt. Some revenues, even though not susceptible to accrual, should be recorded prior to actual receipt. Generally, material revenues otherwise not recorded until received should be accrued if receipt is delayed beyond the normal time of receipt.

Material revenues received earlier than time of receipt should be recorded as deferred revenue. For example, if utility tax revenue normally is received after the year-end, but for some reason is received before the year-end, the amount should be recorded as deferred revenue until time of normal receipt.

Non-recognition of Revenue from Budget Notes
Proceeds from issuance of budget notes should no longer be recognized as revenue to the City's general fund. As in the case of tax anticipation notes and revenue anticipation notes, such short-term borrowing serves only the purpose of providing cash to meet normal expenditures prior to collection of revenues during the budget year. Such notes, if issued, should be recorded as a general fund liability.

Expenditures
Expenditures in budgetary funds are recorded on the accrual basis, except as discussed below:

Disbursements for inventory type items may be considered as expenditures at the time of purchase or at the time the items are used.

Prepaid expenses need not be recognized in these funds; instead, they should be recognized as expenditures of the period in which paid. Advances, such as for travel purposes,
technically do not represent prepaid expenses and usually are carried as a receivable from the person to whom advanced until an expense report is submitted and a cash settlement is made.

Interest on long-term debt, usually accounted for in formally established debt service funds, should be recorded as an expenditure on its due date. Accrual of interest expense to the year-end from the due date of the latest interest installment on the City's bond issues and other general long-term debt is not required under generally accepted accounting principles.

The encumbrance method of accounting for expenditures in budgetary funds is required to comply with the City Charter requirement to control appropriations. Accordingly, this method should be applied in the City's general fund, resulting in an additional modification to the accrual method of accounting. Under this method, commitments such as purchase orders, in addition to expenditures made or accrued, are recorded. Subsequently, when the actual expenditure takes place, the accounts are adjusted for any difference between the actual expenditure and the commitment previously recorded. If such a difference is recordable in the same year in which the encumbrance was made, the adjustment should be made to the original expenditure account charged. If the difference is recordable in a year subsequent to the year in which the encumbrance was made, the adjustment should be made to a sundry expenditure account in the nondepartmental category of the related fund. If such an account is not currently available in the City's present accounting system, it is recommended that one be established. It should be specifically provided for in the
revised accounting system. An outstanding encumbrance is recognized as an expenditure and the related obligation is carried until liquidated, either by replacement with an actual liability or by cancellation.

Adoption of full encumbrance accounting in the City's general fund will result in consistently encumbering appropriation accounts for all purchase orders for commodities and various capital outlays, such as road equipment, autos, trucks, furniture, office equipment and similar items.

Where a sizable project is undertaken in a general fund department or agency, such as involving one or more professional consulting contracts, it would be appropriate to encumber the amount on each contract but not encumber the estimated amount of the entire project.

**Unused Vacation Pay and Sick Leave Benefits**

The estimated cost of accumulated unused vacation and sick leave benefits is not required to be recovered at the time the leave or other benefits are accumulated. However, current generally accepted accounting principles require that the estimated amount of such commitments, if material, be disclosed in a note to the financial statements. If accumulated unused vacation pay and sick leave benefits at the end of a fiscal year do not exceed a normal year's accumulation, footnote disclosure is not required.
Budgets and Budgetary Accounting and Reporting

Definition
A budget is a plan of financial operation embodying an estimate of proposed expenditures for a given period of time and the proposed means of financing them.

Legal Requirements
The City's Charter will govern the budgets to be adopted by the City, including the legal steps to be followed in adoption, execution and control thereof. Inclusive of the 1975 revisions, the Charter now provides for the adoption of a single executive (expense) budget for the City on or before June 27 each year for the ensuing fiscal year beginning on July 1 of that year.

Budgeting by Individual Funds
With the formal inauguration on July 1, 1977 of full fund accounting in the City's revised accounting system, it would seem appropriate for the single expense budget provided for in the City Charter to either be:

- segregated by appropriate funds after adoption, or
- adopted initially in the form of a budget for each of the respective funds.

Usually, the second course would be followed. Therefore, until such time as the City Charter can be modified to provide for preparation and adoption of budgets for the appropriate funds prescribed in the revised accounting system, it is recommended that the expense budget be segregated after adoption into each of the
following funds (the funds prescribed in the proposed revised accounting system for which adoption of budgets would be appropriate):

<table>
<thead>
<tr>
<th>Name of Fund</th>
<th>Budget Period</th>
<th>Format of Budget</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Fund</td>
<td>Annual</td>
<td>As specified in Charter</td>
</tr>
<tr>
<td>Debt Service Funds (to extent used)</td>
<td>Annual</td>
<td>As specified in Charter</td>
</tr>
<tr>
<td>Capital Projects Fund</td>
<td>Project Life</td>
<td>As specified in Charter</td>
</tr>
</tbody>
</table>

Enterprise Funds:

<table>
<thead>
<tr>
<th>Water and Sewer Fund</th>
<th>Annual</th>
<th>Management budget in memorandum form</th>
</tr>
</thead>
<tbody>
<tr>
<td>Housing Enterprise Fund (Mitchell Lama Housing and Municipal Loan Programs)</td>
<td>Annual</td>
<td>Management budget in memorandum form</td>
</tr>
</tbody>
</table>

Intragovernmental Service Fund:

| Municipal Services Administration  | Annual         | Management budget in memorandum form |

**Estimating Revenues**

The New York City Charter requires the City's annual expense budget to be balanced by the real property tax levy. In estimating the annual real property tax revenues, the City should include only those real property tax revenues that are expected to be collected and therefore actually available to finance the expenditures of that year.
Accordingly, estimated revenues from real property taxes should be analyzed so as to exclude amounts levied on properties on which taxes will not be collected at all, and on properties on which taxes will not be collected in the current fiscal year. Prior year taxes anticipated to be collected in the current year, estimated interest and penalties thereon, and estimated proceeds from the sale of foreclosed properties should be separately budgeted.

The reasonableness of the tax estimate in the budget should be tested by a comparison with the trends of real property taxes actually collected over the preceding five years, after giving consideration to such factors as changes in assessed valuations and tax rates, prepayment discounts and in-rem policies.

Revenues from State and Federal categorical aid grants may be accrued at the point where the incurrence of an expenditure creates an entitlement to such aid. In those instances, estimated revenue may be included in the budget to the extent that the directly related expenditures have been budgeted. Estimated revenues should be budgeted only to the extent that projected expenditures are allowable pursuant to law and regulation, and are within the amounts of actual or anticipated grants; further, where experience shows that anticipated expenditures may not be fully reimbursed by the funding source, budgeted revenues should be reduced accordingly.
Budgetary Control

It is assumed that the structure of the general fund budget will be aligned with the accounting and will follow organizational and responsibility lines, based on department, agency, function, activity, and sub-activity levels, to achieve budget control through individuals with administrative responsibility at those organizational levels. The budgetary line items should conform to the operating accounts provided in the revised accounting system.

Under generally accepted accounting principles, it is optional whether budgetary accounts for estimated revenues and appropriations are set up in the general ledger of the various funds for which budgets are adopted. If not set up, as a minimum, subsidiary appropriation ledgers to control expenditure comparisons should be established.

Accounting for Fixed Assets

Fixed assets are assets of a long-term character which are intended to continue to be held or used, such as land, buildings, structures or other improvements than buildings, machinery, furniture, autos and trucks and other equipment. Generally, assets having a useful economic life beyond one year and with a significant (more than nominal) value constitute essential criteria of a fixed asset.
The accounting treatment for acquisition of fixed assets varies according to the fund through which they are acquired. The appropriate method of recording fixed assets at point of acquisition by the City, classified by types of funds, follows.

**Enterprise, Intragovernmental Service and Certain Trust Funds**

Because enterprise and intragovernmental service funds are similar to commercial enterprises, they follow the same accounting principles generally; accordingly, fixed assets acquired by the City in its water and sewer fund, and its Municipal Services Administration intragovernmental service fund should be capitalized by being charged to a properly classified fixed asset account.

Only those trust funds acquiring fixed assets for operating purposes would follow the above accounting treatment. In practice, trust and agency funds are seldom involved in acquiring fixed assets.

All fixed assets acquired by the above described funds, whether purchased intact, constructed on a contractual basis by outsiders, or built by City personnel, should be recorded at cost. In addition to the contract price of a fixed asset, certain related charges should be included in the book cost of the asset. These charges include transportation costs, engineering services, legal and financial expenses, interest and insurance during construction and other significant costs essential to placing fixed assets in their proper location and intended state of operation.
Management determination as to the cost value of projects to be financed, in part or in full, in each year for the purpose of determining borrowing needs is an administrative function having no impact on the accounting requirements for recording the cost value of such assets.

Generally accepted accounting principles require that the cost of fixed assets should be charged against current revenues through annual depreciation charges over the estimated useful economic life of the assets, as classified by type. Normally, these assets are depreciated on the straight line method over useful lives prescribed by qualified engineers.

Accounting for Contributions in Enterprise Funds

In accounting for utility revenues, care must be exercised in differentiating between items which are revenues and those which constitute contribution of fund capital. Examples of the latter applicable to the City's water and sewer fund might consist of special connection charges paid for by water consumers or sewer users, contributions by subdividers and developers for the cost value of water distribution mains or sewer collection lines paid for by them and contributed to the City, and Federal and State grants. To the extent that general obligation bonds of the City have been issued to acquire such assets in prior years and have been repaid from general revenues of the City, such amounts would constitute "municipality's contributions" on the records of the water and sewer fund.
General, Special Revenue, Capital Projects and Special Assessment Funds

In each of these funds expenditures for capital outlay, of whatever type, are treated in the same manner as other current expenditures, such as personnel services, materials, supplies and services and similar operating expenses. Under generally accepted accounting principles fixed assets are not carried as an asset of any of the above funds. They are, however, capitalized in the self-balancing account group entitled General Fixed Assets.

General Fixed Assets

General fixed assets are those fixed assets of a governmental jurisdiction which are not accounted for in an enterprise, intragovernmental service or trust fund. To be classified in this category, a specific piece of property must possess three attributes: tangible nature; a life lasting longer than one year; and a significant value. The latter is a matter of judgment, based on the size of the City and other relevant circumstances.

The purposes of recording general fixed assets are primarily stewardship needs to provide for physical and dollar value control and secondarily for an accountability for general government capital expenditures over the years. Such assets should be recorded at historical cost, or estimated historical cost if the original cost is not available, or, in the case of gifts or contributions, at fair market value at the time received.
It is optional whether certain improvements other than buildings, consisting of non-enterprise capital expenditures relating to roads, bridges, curbs and gutters, streets and sidewalks, drainage systems, and lighting systems are recorded in the general fixed asset group of accounts. Such assets normally are immovable and of value only to the governmental unit. For the same reasons, the need for cumulative accountability is less significant.

It is also optional whether depreciation is recorded on general fixed assets. Accordingly, as long as original cost or other appropriate amounts are maintained and reported, there is no objection to reflecting an allowance for depreciation in the general fixed assets group of accounts with a corresponding reduction in the amount shown as the investment in such assets. Where the amount shown as the investment in such assets is categorized by source of investment, the reduction may be shown as a reduction of the total of such categories.

**Accounting for Long-Term Liabilities**

Except in enterprise, intragovernmental service, special assessment, and certain trust funds, long-term liabilities should not be carried with the current liabilities of any fund, but should be set up in a separate self-balancing group of accounts titled the General Long-Term Debt Group of Accounts. A long-term liability is generally defined as any liability that, by its terms, is payable after one year. Generally, these will consist of bonds or other contractual obligations of the City.
General obligation bonds and other forms of long-term debt supported by general revenues are obligations of a governmental unit as a whole and not its individual constituent funds. Moreover, the proceeds of such debt may be spent on facilities which are utilized in the operations of several funds. For these reasons, the amount of unmatured long-term indebtedness which is backed by the full faith and credit of the government should be recorded and accounted for in a separate self-balancing group of accounts titled the "General Long-Term Debt Group of Accounts."

The purpose of the General Long-Term Debt Group of Accounts is to record and fairly present a governmental unit's liability for long-term debt at any time from date of issuance until the debt is finally retired. Therefore, whenever general obligation debt is incurred, the liability is recorded in the General Long-Term Debt Group of Accounts by credits to Term Bonds Payable or Serial Bonds Payable, as appropriate, for the principal amount of the debt. The offsetting debits are to Amounts to be Provided for the Payment of Term Bonds and Amounts to be Provided for the Payment of Serial Bonds, depending on the type of bond issued. This entry is made at the time the bonds are sold and the proceeds are placed in an appropriate Capital Projects Fund. In the event that a given project had been pre-financed by loans or advances from another fund, these liabilities should be repaid upon receipt of the related bond proceeds. Where revenues are accumulated in debt service funds, a charge should appropriately be made to Amount Available for Payment of (insert type) Bonds and a credit to the related account
Amount to be Provided for Payment of (insert type) Bonds.

Financial Reporting

Public financial reporting may be broadly defined as the total process of communicating any facts, events, and judgments concerning the financial condition and results of operations of a governmental jurisdiction and providing evidence of compliance with legal provisions and budgetary restrictions as a means of determining the stewardship and efficiency of its various administrative departments and officers. Within the past two decades increasing interest and concern has been publicly shown that financial statements of governmental units present fairly financial position and results of operations in conformity with generally accepted accounting principles. Hence, the importance of New York City's major revision of its general accounting system in a manner that will permit preparation of its financial statements by June 30, 1978 (or as soon thereafter as all proposed funds and account groups can be established) in conformity with such principles is emphasized.

Financial Statements Required in City Comptroller's Annual Report (Effective for the Year Ended June 30, 1978 or Upon Establishment of All Proposed Funds and Account Groups)

The financial statements required for conformity with generally accepted accounting principles vary in both format and terminology, depending on the particular fund or type of fund for which statements are prepared. Since each fund of the City will comprise a separate fiscal entity, the appropriate financial statements must be presented for each fund. A single set of consolidated funds and account groups will not fairly present
financial position and results of operations in conformity with generally accepted accounting principles. Therefore, separate financial statements are needed. A list of the financial statements expected to be required of the City, based on full implementation of the fund structure proposed and the applicable accounting principles enumerated in this Chapter follows:

Budgetary Funds (general, special revenue (if any) and debt service funds):

Balance Sheet
Statement of Revenues and Expenditures
Statement of Changes in Fund Balances

Capital Projects Fund

Balance Sheet
Statement of Revenues - Estimated and Actual
Statement of Changes in Fund Balance

Enterprise Funds (Water and Sewer Fund and Housing Enterprise Fund)

Balance Sheet
Statement of Revenue and Expense
Statement of Changes in Retained Earnings
Statement of Changes in Financial Position

Intragovernmental Service Fund (Municipal Services Administration fund):

Balance Sheet
Statement of Operations
Statement of Changes in Retained Earnings

Trust and Agency Funds:

Balance Sheet
Statement of Changes in Fund Balance(s)

Account Groups

Statement of General Fixed Assets
Statement of General Long-Term Debt
financial position and results of operations in conformity with generally accepted accounting principles. Therefore, separate financial statements are needed. A list of the financial statements expected to be required of the City, based on full implementation of the fund structure proposed (depending on materiality and conclusions reached concerning the requirement to establish enterprise funds) and the applicable accounting principles enumerated in this Chapter follows:

**Budgetary Funds** (general, special revenue (if any) and debt service funds):

- Balance Sheet
- Statement of Revenues and Expenditures
- Statement of Changes in Fund Balances

**Capital Projects Fund**

- Balance Sheet
- Statement of Revenues and Expenditures - Estimated and Actual
- Statement of Changes in Fund Balance

**Enterprise Funds**

- Balance Sheet
- Statement of Revenue and Expense
- Statement of Changes in Retained Earnings
- Statement of Changes in Financial Position

**Intragovernmental Service Funds**

- Balance Sheet
- Statement of Operations
- Statement of Changes in Retained Earnings

**Trust and Agency Funds**

- Balance Sheet
- Statement of Changes in Fund Balance(s)

**Account Groups**

- Statement of General Fixed Assets
- Statement of General Long-Term Debt
Reporting Budgetary Comparisons

For financial reporting purposes, generally accepted accounting principles require that the statements of revenues and expenditures of the general fund and certain special revenue funds (none presently contemplated for New York City) include a comparison with a formal budget. It is recommended that budget comparisons be included in the operating statements in the annual report of the City Comptroller of all City funds for which formal budgets have been adopted.

Combined Balance Sheet; Consolidation of Fund Balance Sheets for Inclusion Therein

The individual balance sheets of the respective funds may be presented in a combined balance sheet. A combined balance sheet is a single statement that displays the separate balance sheets of individual funds, groups of funds or account groups in separate, adjacent columns. If a balance sheet of each fund is presented, a combined balance sheet is not required; conversely, if a combined balance sheet is presented, the presentation of separate fund balance sheets is not required. However, in practice, both the individual fund balance sheets and a combined balance sheet are customarily presented. It is recommended that both types of statements be included in the City Comptroller's annual report effective with the fiscal year ending June 30, 1978.

A combined balance sheet may have a total column, which aggregates the amounts from all funds and account groups. If such a total column is shown, it should be captioned "Memorandum Only."
The total column on a combined balance sheet is not comparable to a consolidation; it does not fairly present financial position in conformity with generally accepted accounting principles, even if interfund eliminations were made. It is not customary to make such eliminations in the combined balance sheet of a governmental unit.

As a guideline in the presentation of individual fund balance sheets, homogeneous funds within the same type may be consolidated in a single balance sheet; however, it is not appropriate to consolidate balance sheets in funds of different types or to consolidate account groups. Homogeneous funds are funds of like nature and purpose. For example, the balance sheets of all of the City's trust and agency funds could be consolidated into a single balance sheet for presentation in conformity with generally accepted accounting principles. A combined balance sheet may present a consolidation of nonhomogeneous funds of the same type, such as two or more nonrelated enterprise funds. While this may be done for presentation purposes, if nonhomogeneous funds are consolidated separate balance sheets of the respective funds would be required in addition to the combined balance sheet in order for financial position to be presented fairly in conformity with generally accepted accounting principles.
Disclosure Requirements

Generally accepted accounting principles and reporting standards require that financial statements include disclosure of all information considered essential to make the financial statements not misleading. Such information may be presented on the face of the financial statements or in notes thereto.

Adequate Disclosure Defined

American Institute of Certified Public Accountants Accounting Principles Board Statement No. 4, paragraph 106, defined adequate disclosure as follows:

Financial information that meets the qualitative objectives of financial accounting also meets the reporting standard of adequate disclosure. Adequate disclosure relates particularly to objectives of relevance, neutrality, completeness, and understandability. Information should be presented in a way that facilitates understanding and avoids erroneous implications. The headings, captions, and amounts must be supplemented by enough additional data so that their meaning is clear but not by so much information that important matters are buried in a mass of trivia.

Paragraph 199 of APB Statement No. 4 elucidates further on the meaning of full disclosure:

In addition to informative classifications and segregation of data, financial statements should disclose all additional information that is necessary for fair presentation in conformity with generally accepted accounting principles. Notes that are necessary for adequate disclosure are an integral part of the financial statements.
Financial statements cannot provide all of the information available about an enterprise. They are essentially summaries of a large quantity of detailed information. Furthermore, the information given on the face of the statements is largely restricted to that which can be represented by a number described by a very few words. Normally information of that type needs amplification to make it most useful, and both the financial statements and the notes are necessary for adequate disclosure.

**A Special Disclosure Requirement**

A special disclosure requirement that applies to financial statements of state and local governmental units is that lack of compliance with legal requirements dealing with financial matters should be disclosed in the financial statements, usually in a note. This disclosure is considered to be a matter of accounting principle.

**Supplemental Information**

With respect to some disclosures, the volume of information reported will be such that it can best be presented in a separate schedule. In such situations, the separate schedule should be incorporated into the basic financial statements by reference either on the face of the statements or in a related footnote.
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Where supplemental information is presented in the City Comptroller's annual report that is considered essential to fair presentation of the financial statements included therein, it should always be referenced to the basic financial statements in the manner indicated above. Supplemental information that is not considered essential to fair presentation of the financial statements should not be referenced to the financial statements.
Supplemental Information

With respect to some disclosures, the volume of information reported will be such that it can best be presented in a separate schedule. In such situations, adequate disclosures required by GAAP for fair presentation should be incorporated into the basic financial statements of the City Comptroller's annual report. Additional information should then be disclosed in an "Other Financial Information" section. There should be no supplemental information considered essential to fair presentation of the financial statements presented in the Other Financial Information section that is not adequately disclosed in the basic financial statements.
CHAPTER 2

BUDGETING, ACCOUNTING AND FINANCING OF CAPITAL OUTLAYS AND EXPENSE PROGRAMS ELIGIBLE FOR BORROWING UNDER LAW

Introduction

The capital budget may be financed through borrowings, current revenues, or a combination of the two. From the viewpoint of conservative public finance, ideally all governmental programs of an expense nature and a general or normal annual level of capital expenditures should be financed from current revenues. It is recognized, however, that public finance requires a balanced financing approach and that depending on circumstances, borrowings may be used to finance all projects that can be clearly defined as capital in nature.

This Chapter provides a more conservative approach to financing capital construction than has been previously followed by New York City. It defines those particular elements of capital construction that may be financed through borrowing, as distinguished from those which should be financed through current revenues. It also establishes practices and procedures to account for all capital outlays of the City that will conform to generally accepted accounting principles and widely followed budgetary practices, and is compatible with the phase-out financing program authorized in the MAC legislation.
Capital Outlays Defined

Capital outlays are defined as those expenditures which result in the acquisition of, replacement, or additions to fixed assets. Broadly speaking, these consist of:

Capital expenditures which meet the definition of a "capital project," as hereinafter defined; and

Capital expenditures other than those meeting the definition of a capital project, consisting of machinery and equipment, including autos and trucks, furniture, office equipment and related items.

Capital Projects Defined

Capital projects are "those capital outlays other than special assessment and enterprise fund projects, which involve the construction of major, permanent facilities having a relatively long life. These projects do not include fixed assets with a comparatively limited life, such as various types of machinery and office equipment. The latter are not generally appropriate objects for long-term borrowing by state and local governments and consequently are financed by current revenues..."¹

¹Governmental Accounting, Auditing, and Financial Reporting, p.43.
The City Charter states that capital project "shall mean any physical public betterment or improvement or any preliminary studies and surveys relative thereto, which would be classified as capital expenditures under generally accepted accounting principles for municipalities."

In accordance with the above definition, capital project expenditures shall include the acquisition or construction cost of land, buildings and major improvements other than buildings.

Capital project construction costs shall include all direct costs for materials and labor, engineering and "first line" architectural costs for design and supervision of construction. (Such costs shall be included whether the architectural work is performed by consultants or by in-house personnel. If in-house personnel are used, the related costs should not exceed that which would be charged by consultants.)

This would permit the City to treat as project costs, the personnel and related costs directly applicable to specific capital projects such as the costs of site survey and site selection. To insure a reasonable limitation and control over such capital project expenditures, such charges or allocations must originate from a controlled time distribution system, accounting for all time of the unit performing these services, and be reasonable in the light of that which would be charged by consultants.
Costs of fixed equipment and machinery, furniture and office equipment may be included as part of a capital project where such costs represent an initial outfitting of a specific capital project. In addition, capital outlays for certain major equipment, whether an initial or replacement acquisition, shall be considered to meet the definition of a capital project where the unit cost thereof is $15,000 or more and its useful economic life is at least five years, provided that it is other than a passenger type automobile or light truck. This latter definition is applicable only to the extent that the resulting financial statements of the capital projects fund will be fairly stated in conformity with generally accepted accounting principles.

**Budgeting and Accounting for Capital Outlays**

**Basic Principles**

Generally accepted accounting principles should be followed for the purpose of determining the appropriate fund in which to account for the two types of capital outlay, as previously defined. The budgeting practice should be based on and follow the accounting principles applicable thereto.

**Capital Projects Fund**

A capital budget is a plan of proposed capital projects and the means of financing them. On adoption it shall cover such period of time as is required to complete all capital projects included therein.
Generally, all projects included in the City's capital budget for successive fiscal years can be accounted for in a single capital projects fund. Within said fund an individual capital project account should be established for each authorized project except for a series of related projects, which can be consolidated as a single project. Major projects for which a detailed classification of expenditures is deemed desirable may be accounted for by the use of sub-expenditure accounts, as provided for in the prescribed chart of accounts for the capital projects fund. Charges to an individual capital project account are limited to those costs that result in the addition of fixed assets through construction and/or acquisition, as heretofore defined.

General Fund

Those capital outlays which do not meet the definition of a capital project should be budgeted and accounted for in the general fund. Generally, these will include all equipment (not part of the initial outfitting of a specific capital project) required to be used by City departments and agencies, which operations are to be accounted for in the general fund, such as normal annual replacement purchases of machinery, automotive equipment, furniture, office equipment, and similar items.

Recurring City expenditures not directly related to the acquisition or construction of specific capital projects should be excluded from the capital budgets. Exclusions would cover such items as: recurring costs for ongoing surveys and studies of prospective project sites, general planning and administrative costs of departments or agencies involved in capital project
activities, processing and audit of vouchers, budget and accounting personnel assigned to overall planning for capital projects, general administrative overhead related to such work, costs of supervising the work of consultant architects, and such extraneous items as judgments and claims, which are not directly related to capital projects. These items and any phase-out financing authorized by the MAC legislation should be budgeted and accounted for in the general fund.

Financing of Capital Outlays and Expense Type Programs Under MAC Legislation

Whether capital outlays (and eligible expense programs under the Local Finance Law) are to be financed by borrowing or from current revenues are matters of City financial policy and legal directives, not accounting principles or budgetary practices. Regardless of the method of financing they should be budgeted and accounted for in the appropriate fund; based on generally accepted accounting principles, as set forth heretofore. Appropriations in the capital projects fund will, of course, be made for the life of each individual project instead of for each fiscal year.

For many years the City has financed by borrowing all of its true capital projects, other capital outlay items, and many expense type programs permitted under the Local Finance Law to be so financed. The MAC law now mandates that the City will, on
activities, processing and audit of vouchers, budget and accounting personnel assigned to overall planning for capital projects, general administrative overhead related to such work, costs of supervising the work of consultant architects, and such extraneous items as judgments and claims which are not directly related to capital projects. These items and any phase-out financing authorized by the MAC legislation should be budgeted and accounted for in the general fund.

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For many years the City has financed by borrowing all of its true capital projects, other capital outlay items, and many expense type programs permitted under the Local Finance Law to be so financed. The MAC law now mandates that the City will, on
a phased basis, eliminate from its capital budget those expenses that are properly includible only in its expense budget. Under such legislation, expense type programs financed by borrowing during the authorized phase-out period will nonetheless be accounted for in the general fund.

Since the practice of the City is to prefinance these types of expenditures and subsequently sell bonds or notes to reimburse itself when the exact amounts are determined, the amounts so expended should be recorded as set forth below until such time as the phase-out financing program is completed. For purposes of simplicity in financing and accounting, the sample entries hereafter illustrate the recording of improvements authorized in the capital budget and the sale of bonds to be handled through the capital projects fund, including operating expenses and certain equipment items to be accounted for in the general fund. Separate entries in both general and capital projects funds reflect an interfund loan from the general fund to provide cash for capital costs pending sale of bonds and the ultimate repayment of such cash to the general fund. An illustrative capital projects fund budget and journal entries follow:
Capital Projects Fund

Budget for Fiscal Year Ending June 30, 19XX

Estimated Revenues:

Contributions:

Federal grants XXX
State grants XXX
Private grants XXX
Proceeds from sale of bonds or bond anticipation notes XXX

Total Estimated Revenues XXX

Appropriations:

Capital projects XXX

Note: The budget to be set up on the books of the capital projects fund would exclude operating expenses and eligible equipment items included in the capital budget as formally adopted but expected to be accounted for in the general fund.

Capital Projects Fund

Illustrative Journal Entries

Initial Year - All Transactions Except Sale of Bonds

(1)

Improvements authorized - Capital Projects XXX
Improvements authorized - General Fund XXX
Reserve for authorized improvements XXX
Due to general fund XXX
To record adopted capital budget, including expense items and other capital outlays to be accounted for in general fund, for year ending June 30, 19XX.

(2)

Cash XXX
Due to general fund XXX
To record interfund loan
(3)
Reserve for authorized improvements
  Vouchers payable (or cash)
To record expenditures on projects
  (sub-identify specific project no.)

(4)
Grants receivable - Federal government
Grants receivable - State government
  Contributions from Federal grants
  Contributions from State grants
To accrue revenue from Federal and
  State grants

(5)
Cash
  Grants receivable - Federal government
  Grants receivable - State government
  Contributions by private grants
To record collection of various grants

(6)
Investments - Federal securities
Cash
To record temporary investment

(7)
Cash
  Investments - Federal securities
  Interest income
To record liquidation of temporary
  investment and interest earned
  thereon

(8)
Contributions from Federal grants
Contributions from State grants
Contributions from private grants
Interest income
  Improvements authorized-Capital
  Projects
  Fund balance
To close revenue accounts to improvements
  authorized account in an amount equal
  to budget estimates and excess thereover
  to fund balance account
Succeeding year - Illustrating Sale of Bonds, Liquidation of amount due General Fund from Bond Proceeds, and Disposition of Unexpended Balance in Reserve for Authorized Improvements on Completed Projects

(9)
Cash
Proceeds from sale of bonds XXX
To record sale of bonds XXX

(10)
Due to General Fund
Cash XXX
To record payment to general fund for its share of bond proceeds XXX

(11)
Due to general fund
Cash XXX
To record payment of interfund loan XXX

(12)
Proceeds from sale of bonds
Improvements authorized - Capital Projects XXX
Improvements authorized - General Fund XXX
To close above revenue account to improvements authorized accounts XXX

(13)
Reserve for authorized improvements
Fund balance XXX
To transfer net unexpended balances on projects completed during year to fund balance account XXX
General Fund

Illustrative Journal Entries
Initial Year - Excluding Sale of Bonds to Finance Operating Expenses and Capital Outlay During 10 Year Phase-out Period Under MAC Law

(1)
Due from Capital Projects Fund XXX
Cash XXX
To record interfund loan to Capital Projects Fund

(2)
Due from Capital Projects fund XXX
Accrued Revenue - commitments to purchase City securities XXX
To record amount due from Capital Projects fund from future bonding for operating expenses and capital outlays during 10 year phase-out period, as based on written agreements to purchase City bonds on a when-issued basis

(3)
Operating expenses XXX
Cash XXX
To record expenditures by City for items to be subsequently refinanced by bonding

Succeeding Year - Illustrating Receipt of Proceeds from Sale of Bonds Through Capital Projects Fund and Settlement of Interfund Loan to that Fund

(4)
Cash XXX
Due from Capital Projects fund XXX
To record receipt of General fund's share of bond proceeds

(5)
Cash XXX
Due from Capital Projects fund XXX
To record settlement of interfund loan
Special reference is made to illustrative journal entry (2) in the general fund; such entry would usually read "Proceeds from the sale of bonds," as based on an actual and not a prospective sale of securities. In the manner illustrated, a binding legal commitment for purchase of City bonds would be precedent to an accrual within a current fiscal year where the sale of bonds was not scheduled to occur until the following year. Further, for such a revenue item to be susceptible to accrual at a current year-end, it should meet the criteria of being "measurable and available" at such year-end. It would be measurable if the amount were fixed in a binding legal agreement. Under generally accepted accounting principles, the term "available" means being realized in cash either during the current year or in the period following the year-end in which final operating costs for the prior year are fully paid. Normally, such period of time would terminate at the point of actual closing of the City's accounts and records for the year.

If the practice of prefinancing expenditures within the City's capital budget before selling bonds is planned to be continued, the procedures suggested herein as a basis for accruing revenue in the General fund prior to actual bond sales should be reviewed by Corporation Counsel.

For purposes of financial presentation in the statement of revenues and expenditures of the general fund for the year in which the revenue is accrued (as in illustrative journal entry (2) above), such amount should appear in a line item below the line showing the "excess of revenues over expenditures (or vice versa) before transfers and other items."
CHAPTER 3

ACCOUNTING FOR FINANCING AND DEBT SERVICE TRANSACTIONS ON BEHALF OF NEW YORK CITY BY MUNICIPAL ASSISTANCE CORPORATION AND OF OTHER CITY-RELATED DEBT TRANSACTIONS

Introduction

The debt refinancing programs authorized or mandated in legislation creating the Municipal Assistance Corporation (MAC) and the Emergency Financial Control Board (EFCB) will pose some unusual accounting and financial reporting problems for New York City. While MAC's debt and operating expenses are not those of the City, they will be funded from sources which would otherwise be made available to the City by the State. MAC operations and debt service should be reflected on the City's books to the extent they reduce sales and compensating use tax, stock transfer tax, and state per capital aid which would otherwise be made available to the City, and which under present law will become available to the City after the retirement of MAC debt and the termination of MAC operations.

This chapter provides guidelines and supporting rationale for specific accounting treatment of various known and expected recurring-type transactions. Specific examples are appended to this chapter.

Accounting Premises for Reflecting Transactions of MAC on City Records

Some of MAC's financial transactions will directly involve counterpart transactions with the City. Other MAC transactions will consist of financing or refinancing City note-type debts (generally short term, i.e., due in less than one year). Such financing may or may not involve exchanges of cash between MAC
and the City. Nonetheless, in performing its legislative and administrative functions, MAC financial transactions generally are considered to be conducted on behalf of and for the benefit of the City.

Through issuance of its own long-term bonds MAC will be refinancing substantial portions of the City's outstanding note-type debt. Over the years, City revenue sources will be preempted by MAC, but only for MAC debt service and related administrative expenses. In essence, certain debts of MAC represent substitutions of existing note-type City debt, to be repaid from future City revenues. Accordingly, since most financial transactions of MAC are for the direct benefit of the City, for accounting purposes such applicable transactions are considered virtually equivalent to City transactions.

Based on the foregoing, it has been concluded that a fair presentation of the financial position of the City's various funds and account groups, the results of operations of its individual funds, and the obligation for full disclosure of its debt transactions, in conformity with generally accepted accounting principles, requires that the effect on the City of the related financial transactions of MAC be recorded on the City's books and duly reflected in its published financial statements.

**Legal Premises and Rationale**

**Types of Debt Authorized**

The New York State Constitution (Article 8, Section 2) authorizes cities to contract indebtedness for lawful City purposes. Such indebtedness shall not be contracted for a term
longer than the period of probable usefulness of the object or purpose for which the indebtedness is contracted, to be determined by or pursuant to general or special laws. No such indebtedness shall be contracted by a city unless such city shall have pledged its faith and credit for the payment of the principal thereof and interest thereon. This type of debt, historically described by the City as funded debt, consists of bonds or other obligations that come within the constitutional debt limit of the City.

In addition to its funded debt, the City is authorized to issue tax anticipation notes (TANs), revenue anticipation notes (RANs), urban renewal notes (URNs), and budget notes. These obligations constitute note-type debts, defined as obligations of the City to which the exclusions from the debt limit provisions of Article 8, Section 5A of the State Constitution apply. Accordingly, such notes at point of issue do not come within the general debt limit of the City. The City may also issue bond anticipation notes (BANs), part of which may come within the general debt limit of the City. All municipal debt (whether evidenced by bonds or by notes) is backed by the full faith and credit pledge of the City.

TANs, RANs, and URNs have been historically recorded as liabilities on the City's books. Under the revised accounting system, they would be incorporated into the new general fund. Under that system, BANs would be recorded as a liability in the Housing Enterprise Fund, Capital Projects, or other constituent fund pending conversion to funded debt by the sale of bonds.
Provision for Payment of Interest On and Redemption of Indebtedness

Provision shall be made annually by appropriation by every city for the payment of interest on all indebtedness and for the amounts required for: amortization and redemption of term bonds, sinking fund bonds, and serial bonds; redemption of certificates or other evidence of indebtedness contracted to be paid in such year out of the tax levy or other revenues applicable to a reduction thereof; and redemption of certificates or other evidence of indebtedness issued in anticipation of the collection of taxes or other revenues, or renewals thereof, which are not retired within five years of original issue date.

If at any time the respective appropriating authorities shall fail to make such appropriations, a sufficient sum shall be set apart from the first revenues thereafter received and shall be applied to such purposes. The fiscal officer of any city may be required to set apart and apply such revenues if any holder of obligations issued for any such indebtedness sues therefor.

Interest due at the respective maturity dates of RANs and TANs has been included as a separate item in the City's annual expense budget. There are no outstanding URNs. Under the revised accounting system, interest due annually on these note-type debts would be budgeted as a line item expenditure in the general fund. Interest on BANs would be budgeted and accounted for as
an expense of the fund in which the liability is carried.\(^{(1)}\)

Historically, redemption of BANs, RANs and TANs at maturity has not been provided for in the expense budget. Under the revised accounting system, redemption of RANs and TANs would not be budgeted in the general fund; rather, they would be redeemed out of cash collected from the taxes or other receivables on which the borrowings were based. BANs ordinarily would be redeemed out of the proceeds of bonds issued in substitution of such notes.

**Limitations on Terms of Tax Anticipation Notes and Revenue Anticipation Notes**

Section 24.00 (a) (6) of the Local Finance Law provides that:

Tax anticipation notes issued pursuant to this paragraph shall mature within one year from the date of their issuance and may be renewed from time to time, but each renewal shall be for a period not to exceed one year. Such notes or the renewals thereof shall be retired within five years after their date of original issue and in any event not later than five years after the close of the fiscal year for which were levied the taxes or assessments in anticipation of the collection of which such notes were issued...

Section 25.00 (f) of the Local Finance Law provides that:

Revenue anticipation notes shall mature within one year and may be renewed from time to time, but each renewal shall be for a period not exceeding one year and in no event shall such notes, or the renewals thereof, extend beyond the close of the second fiscal year succeeding the fiscal year in which such notes were issued. Such notes shall not be renewed in an amount in excess of the

\(^{(1)}\)Since the City Charter requires the appropriations to be in the "expense budget," such budget would need to be reclassified to the appropriate fund in the revised accounting system.
difference between the amount of the uncollected or unreceived revenue in anticipation of which they were issued and the amount of any other outstanding revenue anticipation notes issued in anticipation of the collection or receipt of such revenue.

To clarify the above, a roll-over of a RAN or TAN is deemed to be a renewal, even though a new note is issued and new creditors provide the proceeds with which to pay off the old note. To conclude otherwise would allow the roll-over procedure to evade the restrictions on renewals of such notes contained in Section 24.00 and Section 25.00 of the Local Finance Law. In support of this view, Section 39.00 of the Local Finance Law requires a resolution authorizing a TAN to state the fiscal year for which the taxes are levied and, in the case of a RAN, the fiscal year in which the revenues are due and payable.

Thus, the Local Finance Law places a legal limit on the ultimate terms from date of original issue to redemption, including all renewals, of five years for tax anticipation notes and three years for revenue anticipation notes. As noted in the Local Finance Law, TANs and RANs are renewable only to the extent of uncollected taxes and revenues on which their original issuance was based.

However, Article 8, Section 5 of the New York State Constitution, in describing note-type indebtedness, states:
§ 5. [Ascertainment of debt-incurring power of... cities,...certain indebtedness to be excluded]

In ascertaining the power of a...city...to contract indebtedness, there shall be excluded:

A. Certificates or other evidence of indebtedness (except serial bonds of an issue having a maximum maturity of more than two years) issued for purposes other than the financing of capital improvements and contracted to be redeemed in one of the two fiscal years immediately succeeding the year of their issue, and certificates or other evidences of indebtedness issued in any fiscal year in anticipation of (a) the collection of taxes on real estate for amounts theretofore actually levied and uncollected or to be levied in such year and payable out of such taxes, (b) moneys receivable from the state which have theretofore been apportioned within one year after their issue and (c) the collection of any other taxes due and payable or to become due and payable within one year or of other revenues to be received within one year after their issue; excepting any such certificates or other evidences of indebtedness or renewals thereof which are not retired within five years after their date of original issue. (underscored supplied)

Required Redemption of Note-Type Debt

Thus, even though Sections 24.00 (a) (6) and 25.00 (f) of the Local Finance Law restrict the maximum legal terms of TANs to five years and RANs to three years, Article 8, Section 5 of the State Constitution covers the contingency of non-payment within five years, for whatever reason, by providing for their inclusion within the debt limit of the City. Article 8, Section 2 concurrently provides for their redemption in the first budget year beyond the five year limit for each type of note, i.e., the sixth year.
Accordingly, under Article 8, Section 2 of the State Constitution, the legal impact of successive renewals of TANs and RANs beyond five years from date of original issue would be to: terminate their tax limit exclusion because the revenues which formed the basis of their issuance are either no longer available for their redemption or have not been received; and require such notes to be treated as funded debt.

During the 1975 extraordinary session of the State Legislature, the New York State Emergency Moratorium Act for the City of New York was enacted (Laws 1975, Chapter 874). This act defined "short-term obligations," as "tax anticipation notes, revenue anticipation notes, bond anticipation notes, budget notes and urban renewal notes of the city which are outstanding on the effective date of this act," and it established a three-year moratorium period with respect to such note-type debt obligations.

Even though the court of appeals has now concluded that the Moratorium Act is unconstitutional, it is possible that a TAN or RAN which had already been renewed for several years, with payment further deferred during the moratorium period, could have reached a point where its total term exceeded the five-year period specified in Article 8, Section 5 of the State Constitution and thus have been propelled into the City's debt limit. In such event, Article 8, Section 2 of the State Constitution would require that an appropriation be made by the City to redeem such a TAN or RAN, unless payment thereof is otherwise made under the court-approved program to repay notes covered under the moratorium.
A similar situation may also arise in connection with any other agreement to extend the terms of repayment of note-type debts.

**Impact of MAC Legislation and Transactions on New York City Debt**

MAC obligations for the City of New York are not the obligations of the City or the State. Debt incurred by MAC is not within the City's debt limit, nor does the City have any legal obligation to make any budgetary appropriations with respect to such debt. This is clearly indicated by Section 3016 of the Public Authorities Law, as follows:

The notes, bonds or other obligations of a municipal assistance corporation shall not be a debt of either the State or the municipality being assisted, and neither the State nor such municipality shall be liable thereon, nor shall they be payable out of any funds other than those of such corporation; and such notes and bonds shall contain on the face thereof a statement to such effect.

The obligations of MAC are payable only out of its funds. A detailed statutory structure has been created which, during the period MAC obligations are outstanding, diverts certain revenue sources formerly available to the City and transfers them to certain State funds. This structure also provides, subject to State appropriation, for their payment to MAC, at which point they become funds of MAC, out of which MAC debt and expenses are to be paid.
The practical effect of the foregoing is to eliminate City note-type debt and substitute long-term MAC obligations to be repaid from revenues that would otherwise be available to the City.

Application of Legal Conclusions to Process of Accounting for MAC-Originated or Other Related Financing Transactions

TANs and RANs not redeemed within five years become subject to redemption pursuant to the State Constitution and must be treated accordingly for accounting purposes (see Required Redemption of Note-Type Debt).

Bond anticipation notes comprise a debt category distinct from other forms of City debt. Basically, BANs are indebtedness subject to the constitutional debt limit of the City unless they are issued for a purpose which may be specifically excluded therefrom by the Constitution. Such a purpose is indebtedness issued for a public improvement or part thereof that annually produces net revenue proportionate to such indebtedness and is used in the specific manner prescribed in Article 8, Section 5C of the State Constitution or related sections of the Local Finance Law. Housing projects qualifying under this section constitute one example thereof. Eligibility for such treatment is subject to approval of the State Comptroller.
Since BANs are issued in expectation of the issuance of long-term bonds in substitution thereof, they generally have been classified as "temporary debt" in the City Comptroller's Annual Financial Report, notwithstanding that some part thereof came within the constitutional debt limit of the City. However, since under the Local Finance Law, BANs, or renewals thereof, uniformly have maturity dates not to exceed one year, this treatment conforms to the accounting classification relating to short-term debt, i.e., an obligation with a maturity date of one year or less.

Accordingly, except as noted in the preceding paragraph, there is no conflict between the applicable provisions of the State Constitution and State statutes and generally accepted accounting principles with respect to the definitions of New York City note-type debt as short-term debt and funded debt as long-term debt.

Accounting Treatment of City-Related Transactions of MAC and of Note-Type Debts Subject to Extended Payment Terms

Under generally accepted accounting principles, the accounting treatment for RANs and TANs differs materially from the accounting treatment for long-term or funded debt. New York City note-type debt has been appropriately treated as a liability of its "expense fund." Under the revised accounting system such debt would become a liability of the newly established general fund.
MAC obligations issued in exchange for or in lieu of City note-type debt will be accounted for in the City's accounts and records in a separately established MAC long-term debt group of accounts, offset by appropriately titled memorandum accounts, such as "amount available in debt service fund" and "amount to be provided from future revenue for payment of MAC bonds."

If proceeds of long-term bonds issued by MAC are used to redeem City note-type debt (or if other MAC transactions produce an equivalent effect), the accounting result will be to eliminate a liability for TANs and RANs from the City's general fund and to record the substitute debt in the MAC long-term debt group of accounts. If City note-type debt should become subject to extended payment terms, the liability for such notes would be eliminated from the City's general fund and the substitute debt would be recorded in the City's long-term debt group of accounts. Each type of transaction would leave an unapplied credit in the general fund. Under generally accepted accounting principles, the amount arising from each pertinent transaction would appropriately be credited to the fund balance account of the general fund. However, because the term "fund balance" is a generic term, in this instance it is necessary to segregate the fund balance of the general fund into its component elements:
Fund balance (deficit), and credits arising from liquidation of City note-type debt by MAC; conversion of City note-type debt to long-term debt through issuance of City bonds for notes; and conversion of City note-type debt to long-term debt through extended payment terms. Therefore, the credits arising from each of the above described categories of special transactions will be appropriately classified by type and credit balances relating to each type accumulated under appropriate account titles. Examples thereof are set forth in the illustrative journal entries and their presentation in the equity section of a general fund balance sheet is portrayed in material which follows.

A Statement of General Long-Term Debt, including City-funded debt and obligations of Municipal Assistance Corporation, prepared in a format considered appropriate for inclusion in the City Comptroller's Annual Financial Report is also illustrated. It is contemplated that several of the statements and summaries of details of City-funded debt appearing in prior published annual reports of the City would be presented in the form of supplemental schedules in future annual reports.
Examples of Transactions by MAC and Various City Funds Affecting City’s Short-Term (Note-Type) and Long-Term (Non-Note-Type or Funded) Debt and Illustrations of Accounting Entries Therefor to be Recorded in Various Funds and Account Groups of City

Assumptions and Premises Upon Which Illustrative Journal Entries are Based

1. All entries are illustrated in the context of the fund structure in the revised accounting system of the City.

2. References in entries to notes payable refer generally to TANs, RANs and/or BANs, which constitute note-type or short-term debt.

3. In all instances, provision is presumed to be made in formally adopted budgets of the City for payment of debt service on funded (long-term) debt and interest expense on note-type debt. Under the revised accounting system these would be budgeted and accounted for as follows:

   a. Interest on maturing TANs and RANs would be budgeted in and accounted for as an expenditure of the general fund, as the liability for such notes would be carried in that fund. Because no accounting complications are involved, payment of interest on maturing TANs and RANs is not illustrated in the sample entries. No budget provision for redemption of TANs and RANs would be appropriate as the liability therefor would be shown in the general fund. Interest on BANs should be accounted for as an expense of the fund in which the liability is carried. Such notes will normally be refunded from the issuance of the related bonds.
b. Payment of interest on all City-funded debt, together with any amounts required for amortization installments payable to the City's four sinking funds, and redemption of serial bonds due annually would be budgeted and accounted for in appropriate debt service funds or, at the option of the City, with certain exceptions, in the general fund. In the latter event, separate sinking funds would be required (one each for the City Sinking fund, Water Sinking fund, Transit Sinking fund, and Transit Unification Sinking fund), and a debt service fund for MAC-related debt transactions.

A separate long-term debt group of accounts for City-related outstanding debt of MAC will be established. Long-term debt created through issuance of City bonds for notes or by extension of the terms of City note-type debt should be included in the long-term debt group of accounts established for all other City-funded debt.

4. Reference to "future revenue" means sales taxes, stock transfer taxes, or State aid, as the case may be, as provided for in the Municipal Assistance Corporation for the City of New York Act.

5. The respective accounts in illustrative journal entries (11) and (12) in the City's general fund entitled "contribution from long-term bonds borrowed by MAC" (a revenue account) and "contribution from income earned by MAC" (a revenue account) should appear in the statement of revenues and expenditures in a line item below the line showing the "excess of revenues over expenditures (or vice versa) before transfers and other items."
Description of Transactions

1. City receives cash from MAC to liquidate existing TANs and RANs and issues new short-term notes to mature in one year; this transaction would be equivalent to the usual roll-over of short-term notes.

2. City receives cash from MAC to repay existing TANs and RANs, but no new short-term notes or other instrumentality issued therefor; source is sale of long-term MAC bonds to public, State or City pension or sinking funds or other State and City agencies.

3. MAC issues its long-term bonds to holders of City's short-term notes (TANs and RANs) under MAC's exchange offer.

Illustrative Journal Entries

General Fund:
Cash XXX
Notes Payable XXX
Notes Payable XXX
Cash XXX

General Fund:
Cash XXX
Fund balance-credits arising from MAC liquidation of City short-term debt XXX
Notes Payable XXX
Cash XXX

MAC Long-Term Debt Group of Accounts:
Amount to be provided from future revenue for payment of MAC bonds XXX
Long-term bonds issued by MAC XXX

General Fund:
Notes Payable XXX
Fund balance-credits arising from MAC liquidation of City short-term debt XXX

MAC Long-Term Debt Group of Accounts:
Amount to be provided from future revenue for payment of MAC bonds XXX
Long-term bonds issued by MAC XXX
Description of Transactions

4. City's TANs and RANs become subject to extended payment terms following the appeal court's nullification of the New York State Moratorium Act for the City of New York (see explanation in chapter on the effect on note-type debt after five years from original date of issue).

Illustrative Journal Entries

General Fund:

Where period from original issue through date extended is less than five years:
  Notes payable (maturities affected) XXX
  XXX

Where period from original issue through date extended is greater than five years:
  Notes payable
  Fund balance-credits arising from conversion to long-term debt through extended payment terms XXX

City General Long-Term Debt Group of Accounts:
  Amount to be provided for payment of City notes with extended payment terms XXX
  Long-term City notes payable XXX

General Fund:
  Notes payable
  Fund balance-credits arising from conversion to long-term through extended payment terms XXX

City General Long-Term Debt Group of Accounts:
  Amount to be provided for payment of City notes with extended payment terms XXX
  Long-term City notes payable XXX

5. City or State pension funds and various banks holding City notes become subject to an extended date of July 1, 1986 on certain short-term notes now held.
Description of Transactions

6. Available cash in City sinking funds, being held for ultimate payment of outstanding term bonds of the City, is used to purchase new bonds issued by the City upon payment of certain City bond anticipation notes now held by such sinking funds. Pertinent examples are:

(a) Bond anticipation notes carried in current liabilities of the Housing Enterprise Fund

(b) Bond anticipation notes carried in liabilities of Capital Projects Fund

Illustrative Journal Entries

Assuming no cash is exchanged between sinking funds and City:

(a) Housing Enterprise Fund:

Bond anticipation notes payable (current liabilities) XXX

Bonds payable (long-term liabilities) XXX

(b) Capital Projects Fund:

Bond anticipation notes payable (liability account) XXX

Proceeds from sale of bonds (a revenue account) XXX

City General Long-Term Debt Group of Accounts:
Amount to be provided for payment of serial bonds XXX
Serial bonds payable XXX

General Fund:

Notes payable (maturities affected) XXX
Notes payable (maturities affected) XXX

7. Exchange by MAC of certain short-term notes of the City it now holds for notes of the City maturing at later dates, presumably to be dates not later than one year beyond the current maturity dates.
8. MAC pays interest and principal installments on its bonds, using sales tax (and/or stock transfer taxes to extent necessary) diverted to MAC from the State from taxes otherwise available to the City.

9. MAC retains sales taxes in amounts required for annual additions to bond reserves.

10. MAC retains sales taxes to cover its administrative expenses, including billings from State Comptroller's Office for service rendered on behalf of City's debt service program.
Description of Transactions

11. City receives cash advances for operating expenses from MAC's sale of long-term bonds.

Illustrative Journal Entries

General Fund:
Cash
Contribution from long-term bonds borrowed by MAC (a revenue account) XXX

MAC General Long-Term Debt Group of Accounts:
Amount to be provided from future revenue for payment of MAC bonds XXX
Long-term bonds issued by MAC XXX

General Fund:
Interest on City short-term notes XXX
Cash XXX

Cash
Contributions from income earned by MAC (a revenue account) XXX

MAC Debt Service Fund:
Interest on MAC bonds XXX
Retirement of MAC bonds and/or Administrative expenses of MAC XXX
Interest or other income applied by MAC (a revenue account) XXX

MAC General Long-Term Debt Group of Accounts:
Long-term bonds issued by MAC XXX
Amount to be provided from future revenue for payment of MAC bonds XXX

12. City receives cash advances from MAC for operating expenses from MAC's receipt of interest payments by the City on RANs and TANs held by MAC.

13. MAC retains its earnings and subsequently uses such amounts, or a part thereof, to meet its debt service payments or administrative expenses.
Description of Transactions

14. MAC sells its short-term (one year) notes to City or State pension funds and advances cash to City pending availability of sales taxes. City disburses amount received for operating expenditures.

15. MAC repays short-term notes issued to City or State pension funds upon receipt of sales taxes allocated to the Corporation.

16. MAC receives sales taxes (and/or stock transfer taxes to extent necessary) diverted to MAC in accordance with pre-set schedule from the State which, however, because of changes in schedule will not be applied for debt service or bond reserve requirements until the following City fiscal year. (Note: Illustrative journal entry 9 above details the recording of the bond reserve aspects of this transaction.)

Illustrative Journal Entries

<table>
<thead>
<tr>
<th>General Fund:</th>
<th>XXX</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td></td>
</tr>
<tr>
<td>Deferred revenue-sales taxes allocated to MAC</td>
<td>XXX</td>
</tr>
<tr>
<td>Expenditures</td>
<td>XXX</td>
</tr>
<tr>
<td>Cash</td>
<td>XXX</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>General Fund:</th>
<th>XXX</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deferred revenue-sales taxes allocated to MAC</td>
<td>XXX</td>
</tr>
<tr>
<td>Sales tax allocated to MAC (revenue account)</td>
<td>XXX</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>MAC Debt Service Fund:</th>
<th>XXX</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amounts held by MAC for debt service</td>
<td></td>
</tr>
<tr>
<td>Deferred revenue-sales taxes allocated to MAC</td>
<td>XXX</td>
</tr>
<tr>
<td>-in subsequent fiscal year-Interest on MAC bonds</td>
<td>XXX</td>
</tr>
<tr>
<td>Amounts held by MAC for debt service</td>
<td>XXX</td>
</tr>
<tr>
<td>Deferred revenue-sales taxes allocated to MAC</td>
<td>XXX</td>
</tr>
<tr>
<td>Sales taxes allocated to MAC (revenue account)</td>
<td>XXX</td>
</tr>
</tbody>
</table>
Illustration of Financial Reporting of MAC or Other Debt Related Transactions Affecting Fund Balance Account of City's General Fund

The segregation of the fund balance account into its component elements in order to portray the classified credits arising from MAC or other debt related transactions heretofore described is illustrated as follows:

Fund Balance Section of General Fund Balance Sheet at a Given Statement Date:

Fund Balance:
Fund balance (deficit) (XXX)
Less credits arising from:
MAC liquidation of City note-type debt XXX
Conversion of City note-type debt to long-term debt through issuance of City bonds for notes XXX
Conversion of City note-type debt to long-term debt through extended payment terms XXX XXX

Fund Balance (deficit)-net (XXX)

The initial line in the foregoing statement would represent the year-end balance of the fund balance account in any year. Any qualifying debits or credits to the account during any year would be reflected in the required Statement of Changes in Fund Balances in the City Comptroller's Annual Report.

The debt-related credits to the General Fund balance account, as shown above, would appropriately become a part of the normal General Fund fund balance account with the retirement of the related MAC debt and other City-related debt, as illustrated above. Optionally, portions of such credit balances could be transferred annually in amounts equal to actual retirements of such related debt.
**CITY OF NEW YORK**

**STATEMENT OF GENERAL LONG-TERM DEBT**

New York City Funded Debt and Obligations of Municipal Assistance Corporation Issued in Exchange for or in Lieu of New York City Note-Type Debt

---

**Amount Available and to be Provided for the Payment of General Long-Term Debt**

<table>
<thead>
<tr>
<th></th>
<th>City Funded Debt</th>
<th>City Assistance Funded Corporation Debt</th>
<th>Combined (See Note 2)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Corporate Stock:</strong></td>
<td>XXX</td>
<td>XXX</td>
<td>XXX</td>
</tr>
<tr>
<td>Amount available in sinking funds</td>
<td>XXX</td>
<td>XXX</td>
<td>XXX</td>
</tr>
<tr>
<td>Amount to be provided from future taxes</td>
<td>XXX</td>
<td>XXX</td>
<td>XXX</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>XXX</td>
<td>XXX</td>
<td>XXX</td>
</tr>
</tbody>
</table>

**General Obligation Serial and Other Bonds:**

| Amount available in debt service funds | XXX                   |
| Amount to be provided from future taxes | XXX                   |
| **Total**                              | XXX                   |

**Short-term Notes Subject to Extended Payment Terms with Maturities Beyond Five Years from date of Original Issue:**

| Amount to be provided from future taxes | XXX                   |
| **Total Amount Available and to be Provided for Payment of City Funded Debt** | XXX                   |

**Obligations of Municipal Assistance Corporation Issued in Exchange for or in Lieu of City Note-Type Debt (not a legal obligation of City):**

| Amount available in MAC debt service fund | XX                   |
| Amount to be provided from future MAC revenue | XXX                   |
| **Total**                                  | XXX                   |

**Grand Total**

| XXXXXX | XXX | XXXXX |
## General Long-Term Debt

<table>
<thead>
<tr>
<th>City-Funded Debt</th>
<th>Obligations of Municipal Assistance Corporation (Note 1)</th>
<th>Combined (See Note 2)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate stock redeemable from sinking funds</td>
<td>XXX</td>
<td>XXX</td>
</tr>
<tr>
<td>Serial and other bonds redeemable from current appropriations in general (debt Service) funds</td>
<td>XXXXX</td>
<td>XXXXX</td>
</tr>
<tr>
<td>Short-term notes subject to extended payment terms with maturities beyond five years from date of original issue</td>
<td>XXXXX</td>
<td>XXXXX</td>
</tr>
<tr>
<td><strong>Total City Funded Debt</strong></td>
<td></td>
<td></td>
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<td>XXXXX</td>
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<td>XXXXX</td>
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</tbody>
</table>

### Obligations of Municipal Assistance Corporation Issued in Exchange for or in Lieu of City Note-Type Debt (not a legal obligation of City)

| | | |
| | | XXXXX |

### Grand Total

| | | |
| | | XXXXX |

### Notes:

1. The above obligations of Municipal Assistance Corporation are not a legal obligation of or payable out of any funds of the City of New York or the State of New York. They are an obligation of the Corporation and are payable out of revenues formerly available to the City but which have been diverted to Municipal Assistance Corporation by statute during the period its bonds are outstanding.

2. For financial statement presentation purposes it would be acceptable to show only the two separate columns without the extension of line-item amounts into the combined column. If a combined balance sheet of the City's various funds and account groups is also presented, each of the separate debt columns as shown above should be included therein, with the accompanying Note 1 above.
CHAPTER 4

ACCOUNTING PRINCIPLES APPLICABLE TO ACCOUNTING FOR THE COST OF PENSION PLANS

Introduction

Pension plans have developed in an environment characterized by a complex array of social concepts and pressures, legal considerations, actuarial techniques, income tax laws and regulations, governmental business philosophies, and accounting concepts and practices. Each plan reflects the interaction of the environment with the interests of the persons concerned with its design, interpretation and operation. These factors resulted in widely divergent practices in accounting for the cost of pension plans.

An increased significance of pension cost in relation to the financial position and results of operations of many businesses and governmental units has been brought about by the substantial growth of private pension plans and public employee retirement systems, both in numbers of employees covered and in amounts of retirement benefits. The assets accumulated and the future benefits to employees under these plans have reached such magnitude that changes in actuarial assumptions concerning pension fund earnings, employee mortality and turnover, retirement age, etc., and the treatment of differences between such assumptions and actual experience, can have important effects on the pension cost recognized for accounting purposes from year to year.
A long-standing concept has been that costs based on current and future services should be systematically accrued during the expected period of active service of the covered employees. Also, that costs based on past services should be charged off over some reasonable period, provided the allocation is made on a systematic and rational basis and does not distort the operating results in any one year.

Because of the increasing importance of pensions and variations in accounting for them, the Accounting Principles Board of the American Institute of Certified Public Accountants issued Opinion No. 8, "Accounting for the Cost of Pension Plans." The Institute's guide for "Audits of State and Local Governmental Units" states that APB Opinion No. 8 is applicable to the cost of pension plans for contributing governmental units.

However, APB Opinion No. 8 does not address the subject of accounting for the operations of a pension or retirement fund itself. The Financial Accounting Standards Board (successor organization to the American Institute of Certified Public Accountants as to public responsibility for promulgating generally accepted accounting principles in both the private and public sectors) has underway a study of pension funds. A pronouncement thereon is expected in the next several months.
Accounting Principles Applicable to Accounting for the Cost of New York City Retirement Systems

New York City makes annual contributions to five separate retirement systems:

- New York City Employees Retirement System
- New York City Teachers Retirement System
- New York City Police Pension Fund
- New York City Fire Department Pension Fund
- New York City Board of Education Retirement System

Contributions to the above systems have been funded in the City's annual expense budget. Under the proposed new fund structure, annual pension contributions would be budgeted in the general fund.

It is important to distinguish between the "provision for pension costs," namely, the annual pension cost to be expensed in the City's general fund, and the amount to be "funded" or paid into the system during the year. The former is a matter of accounting principle and the major subject of this chapter; the latter is a financial management decision and not within the purview of this document.

**Basic Accounting Method**

The specific elements of generally accepted accounting principles applicable to accounting for the City's annual provision for pension cost are:
The pension cost should be accounted for on the assumption that the City will continue to provide the benefits called for in the five pension plans. This assumption implies a long-term undertaking and the cost should be recognized annually whether or not funded. Therefore, accounting for pension cost should not be discretionary.

The entire cost of benefit payments to be ultimately made (derived primarily from annual City contributions) should be expensed after the adoption or amendment of a plan; no portion of such annual provision for pension cost should be charged against the fund balance account of the general fund.

Pension cost, including related administrative expense, should be accounted for on the accrual basis.

The annual provision for pension cost should be based on an accounting method that uses an acceptable actuarial cost method and results in an annual provision between the minimum and maximum limits described below. The accounting method and the actuarial cost method should be consistently applied from year to year.

**Actuarial Methods**

**Actuarial Valuations**

An actuarial valuation of a pension plan determines the amounts an employer is to contribute to the plan. The actuary makes a valuation as of a specific date, which need not coincide with the end of the period for which a payment based on the valuation will be made.
An initial step in making a valuation is to determine the present value of benefits to be paid over varying periods of time in the future to retired employees. An actuarial cost method is then applied to this present value to determine the contributions to be made by the employer.

The annual cost determination is an estimate, since a valuation is based on several actuarial assumptions concerning future events, such as:

- interest, i.e., return on funds invested
- expenses of administration, and
- amounts and timing of benefits to be paid with respect to presently retired employees, former employees whose benefits have vested, and present employees. This includes the actuarial estimate of future salary increases.

**Actuarial Cost Methods**

Actuarial cost methods have been developed by actuaries as funding techniques to be used in actuarial valuations. Actuarial cost methods that conform to generally accepted accounting principles are described briefly as follows:

**Accrued Benefit Cost or Unit Credit Method**

Under the unit credit method, future service benefits (pension benefits based on service after the inception of a plan) are funded as they accrue—that is, as each employee works out the service period involved. Thus, the normal cost
under this method for a particular year is the present value of the units of future benefit credited to employees for service in that year (hence unit credit).

The past service cost under the unit credit method is the present value at the plan's inception date of the units of future benefit credited to employees for service prior to the inception date.

The annual contribution under the unit credit method ordinarily comprises (1) the normal cost and (2) an amount for past service cost. The latter may comprise only an amount equivalent to interest on the unfunded balance or may also include an amount intended to reduce the unfunded balance.

As to an individual employee, the annual normal cost for an equal unit of benefit each year increases because the period to the employee's retirement continually shortens and the probability of reaching retirement increases. Also, in most plans, the retirement benefits are related to salary levels, which usually increase during the years. As to the employees collectively, the step-up effect is masked, since older employees generating the highest annual cost are continually replaced by new employees generating the lowest. For a mature employee group, the normal cost would tend to be the same each year.
Projected Benefit Cost Methods

The accrued benefit cost method (unit credit method) recognizes the cost of benefits only when they have accrued (in the limited sense that the employee service on which benefits are based has been rendered). By contrast, the projected benefit cost methods look forward. That is, they assign the entire cost of an employee's projected benefits to past, present and future periods. This is not directly related to the service periods on which the benefits are based. The principal projected benefit cost methods are discussed briefly below:

Entry Age Normal Method

Under the entry age normal method, the normal costs are computed on the assumptions that (1) every employee entered the plan (thus, entry age) at the time of employment or at the earliest time he would have been eligible if the plan had been in existence, and (2) contributions have been made on this basis from the entry age to the date of the actuarial valuation. The contributions are the level annual amounts which, if accumulated at the rate of interest used in the actuarial valuation, would result in a fund equal to the present value of the pensions at retirement for the employees who survive to that time.
Normal cost under this method is the level amount to be contributed for each year. When a plan is established after the governmental entity has been in existence for some time, past service cost under this method at the plan's inception date is theoretically the amount of the fund that would have been accumulated had annual contributions equal to the normal cost been made in prior years.

In theory, the entry age normal method is applied on an individual basis. It may be applied, however, on an aggregate basis, in which case separate amounts are not determined for individual employees. Further variations in practice often encountered are (1) the use of an average entry age, (2) the use, particularly when benefits are based on employees' earnings, of a level percentage of payroll in determining annual payments and (3) the computation of past service cost as the difference between the present value of employees' projected benefits and the present value of the employer's projected normal cost contributions. In some plans, the normal cost contribution rate may be based on a stated amount per employee. In other plans the normal cost contribution itself may be stated as a flat amount.

In valuations for years other than the initial year, the past service cost may be frozen (that is, the unfunded amount of such cost is changed only to recognize payments and the effect of interest). Accordingly, actuarial gains and losses are spread into the future, entering into the normal cost for future years. If past service cost is not frozen, the unfunded amount includes the effects of actuarial gains and losses realized prior
to the date of the valuation being made.

The annual contribution under the entry age normal method ordinarily comprises the normal cost and an amount for past service cost. The latter may comprise only an amount equivalent to interest on the unfunded balance or may also include an amount intended to reduce the unfunded balance.

**Individual Level Premium Method**

The individual level premium method assigns the cost of each employee's pension in level annual amounts, or as a level percentage of the employee's compensation, over the period from the inception date of a plan (or the date of entry into the plan, if later) to retirement date. Thus, past service cost is not determined separately but is included in normal cost.

The individual level premium method generates annual costs which are initially very high and which ultimately drop to the level of the normal cost determined under the entry age normal method. The high initial costs arise because the past service cost (although not separately identified) for employees near retirement when the plan is adopted is, in effect, amortized over a very short period.

**Aggregate Method**

The aggregate method applies on a collective basis the principle followed for individuals in the individual level premium method. That is, the entire unfunded cost of future pension benefits (including benefits to be paid to employees who have retired as of the date of the valuation) is spread over the average future service lives of employees who are active as of the date of the valuation. In most cases this is done by
the use of a percentage of payroll.

The aggregate method does not deal separately with past service cost (but includes such cost in normal cost). Actuarial gains and losses enter into the determination of the contribution rate and, consequently, are spread over future periods.

Annual contributions under the aggregate method decrease, but the rate of decrease is less extreme than under the individual level premium method. The aggregate cost method amortizes past service cost (not separately identified) over the average future service lives of employees, thus avoiding the very short individual amortization periods of the individual level premium method.

The aggregate method may be modified by introducing past service cost. If the past service cost is determined by the entry age normal method, the modified aggregate method is the same as the entry age normal method applied on the aggregate basis. If the past service cost is determined by the unit credit method, the modified aggregate method is called the attained age normal method.

Attained Age Normal Method

The attained age normal method is a variant of the aggregate method or individual level premium method in which past service cost, determined under the unit credit method, is recognized separately. The cost of each employee's benefits assigned to years after the inception of the plan is spread over the employee's future service life. Normal cost contributions
under the attained age normal method, usually determined as a percentage of payroll, tend to decline but less markedly than under the aggregate method or the individual level premium method.

As with the unit credit and entry age normal methods, the annual contributions for past service cost may comprise only an amount equivalent to interest on the unfunded balance or may also include an amount intended to reduce the unfunded balance.

**Actuarial Gains and Losses**

Actuarial assumptions necessarily are based on estimates of future events. Actual events seldom coincide with events estimated; also, as conditions change, the assumptions concerning the future may become invalid. Adjustments may be needed annually to reflect actual experience, and from time to time the actuarial assumptions might have to be revised. These adjustments constitute actuarial gains and losses and are factors to be considered in the use of any actuarial method. Such adjustments may be regularly recurring (for example, minor deviations between experience and actuarial assumptions) or they may be unusual or recurring at irregular intervals (for example, substantial investment gains or losses, substantive changes in the actuarial assumptions, etc.).
In dealing with actuarial gains and losses, the primary question concerns the timing of their recognition in providing for pension cost. In practice, three methods are used: immediate-recognition, spreading and averaging. Under the immediate-recognition method (not ordinarily used at present for net losses), net gains are applied to reduce pension cost in the year of occurrence or the following year. Under the spreading method, net gains or losses are applied to current and future cost, either through the normal cost or through the prior service costs.

Under the averaging method, an average of annual net gains and losses, developed from those that occurred in the past with consideration of those expected to occur in the future, is applied to the normal cost.

The use of the immediate-recognition method sometimes results in substantial reductions in, or the complete elimination of, pension cost for one or more years.

Unrealized appreciation and depreciation in the value of investments in a pension fund and unusual turnover experience are forms of actuarial gains and losses. Although appreciation is not generally recognized in providing for pension cost, it is sometimes recognized through the interest assumption or by introducing an assumed annual rate of appreciation as a separate actuarial assumption. In other cases, appreciation is combined with other actuarial gains and losses and applied on the immediate-recognition, spreading or averaging method.
Unrealized depreciation is recognized in full or on a basis similar to that used for unrealized appreciation.

Conclusions on Accounting and Actuarial Methods Applicable to City's Retirement Systems

In summary, generally accepted accounting principles require that the annual provision for pension cost of a contributing governmental unit, such as New York City, should be:
- recognized annually whether funded or not;
- expensed in the general fund of the City;
- accounted for on the accrual basis, and
- based on an accounting method that uses an acceptable actuarial cost method and results in an annual provision between certain minimum and maximum limits, as follows:

Minimum

The annual provision for pension cost should not be less than the total of (1) normal cost, (2) an amount equivalent to interest on any unfunded prior service cost, and (3) a provision for vested benefits, if applicable. A provision for vested benefits should be made if there is an excess of the actuarially computed value of vested benefits over the total of (1) the pension fund and (2) any balance-sheet pension accruals, less (3) any balance-sheet pension prepayments or deferred charges, at the end of the year, and such excess is not at least 5 percent less than the comparable excess at the beginning of the year. The provision for vested benefits should be the lesser of (A) the amount, if any, by which 5 percent of such excess at the beginning of the year is more than the amount of the reduction, if any, in such excess during the year or (B) the amount necessary to make the aggregate annual provision for pension cost equal
to the total of (1) normal cost, (2) an amount equivalent to amortization, on a 40-year basis, of the past service cost (unless fully amortized), (3) amounts equivalent to amortization, on a 40-year basis, of the amounts of any increases or decreases in prior service cost arising on amendments of the plan (unless fully amortized) and (4) interest equivalents on the difference between provisions and amounts funded.

**Maximum**

The annual provision for pension cost should not be greater than the total of (1) normal costs, (2) 10 percent of the past service cost (until fully amortized), (3) 10 percent of the amounts of any increases or decreases in prior service cost arising on amendments of the plan (until fully amortized) and (4) interest equivalents on the difference between provisions and amounts funded.

The difference between the amount charged against income and the amount paid should be shown in the balance sheet as accrued or prepaid pension cost. If the City has a legal obligation for pension cost in excess of amounts paid or accrued, the excess should be shown in the balance sheet as both a liability and a deferred charge. Except to the extent indicated in the preceding sentences of this paragraph, unfunded prior service cost is not a liability which should be shown in the balance sheet.

For the purpose of satisfying the requirements of an acceptable actuarial cost method that results in an annual provision between the minimum and maximum limits described above, any of the actuarial cost methods described in this Chapter can be used.
Changes in Accounting Method

The City may change its method of accounting for pension cost from one acceptable method to another. Such a change might be a change in the actuarial cost method, in the amortization of past and prior service cost, in the treatment of actuarial gains and losses, or in other factors. When such a change is made, a question arises about the accounting for the difference between the cost actually provided under the old method and the cost that would have been provided under the new method. Generally accepted accounting principles require that pension cost provided under an acceptable method of accounting in prior periods should not be changed subsequently. Therefore, the effect on prior-year cost of a change in accounting method should be applied prospectively to the cost of the current year and future years, and not retroactively as an adjustment of fund balance or otherwise. The change and its effect should be disclosed in a note to the financial statements.

Disclosure Requirements

Because pension plans are of sufficient importance to an understanding of financial position and results of operations of the general fund of the City, the following disclosures should be made in a note to the financial statements:

A statement that such plans exist, identifying or describing the employee groups covered.
A statement of the City's accounting and funding policies.

The provision for pension cost for the period.

The excess, if any, of the actuarially-computed value of vested benefits over the total of the pension fund and any balance-sheet pension accruals, less any pension prepayments or deferred charges.

Nature and effect of significant matters affecting comparability for all periods presented, such as changes in accounting methods (actuarial cost method, amortization of past and prior-service cost, treatment of actuarial gains and losses, etc.), changes in circumstances (actuarial assumptions, etc.), or adoption or amendment of a plan.

Generally, APB Opinion No. 8 does not require disclosure of the amount of unfunded past service costs, but this information is increasingly sought by users of financial statements.

Accrual of Prior Years' Contributions

According to a recent City Pension System Task Force Study, there has existed for many years a two-year lag between the date of the actuarial valuation and the date when the City's contributions to the retirement systems are paid. To compensate for the lag in payment, interest at the valuation rate has been added to the amount of the contributions.
Technically, under the transition rules of APB Opinion No. 8, the "lag" at June 30, 1967 should have been added to the past service cost and amortized over future accounting periods. Since this was not done, an unidentified portion of the two-year lag, representing the amount amortizable in future years commencing July 1, 1976, would properly be excluded therefrom.

However, to adhere to the technically correct approach under APB Opinion No. 8, a substantial amount of staff time would be required to review the transactions with the retirement systems for the last ten years. It is not known whether the amount required under a correct calculation to be excluded from the two year lag figure is a material or immaterial amount.

In the absence of definitive data on the correct amount to be excluded, it was considered a reasonable approach to accrue the computed amount of $2,167 million of unpaid contributions for these two years. As of June 30, 1976, such amount was accrued and reflected as a liability in the City's general fund balance sheet in the City Comptroller's annual report for the year then ended.

It would appear that recording of this liability represented the correction of an error in the financial statements of a prior period discovered subsequent to their issuance by the City, and therefore should be reported as a prior period adjustment. On this basis, the amount of such liability was appropriately charged to the fund balance account of the general fund of the City as of June 30, 1976.
The nature of such error and the effect of its correction on the general fund's statement of revenues and expenditures (of the year of the error) should be disclosed in the statements of the period in which the error was discovered and corrected. In the absence of relevant statements for the years of error (the practice has been a continuous one for many years), it would be sufficient to disclose that the amount thereof had been charged to the fund balance account. Financial statements of subsequent periods need not repeat the disclosures. Appropriate disclosure was made of the foregoing pension matter in the City Comptroller's annual report for the fiscal year ended June 30, 1976.

In addition to the foregoing, the City's current year contribution to its actuarial pension systems had been based on actuarial data two years prior to the current year, resulting in an understated "provision for pension cost" in an undetermined amount. Such annual understatement was expected to continue pending availability of current actuarial data in a given year. As of June 30, 1976, as based on an estimate of the City Actuary, the City accrued $200 million of additional "provision for pension cost" in excess of the annual contribution budgeted and paid into the various retirement systems. It is understood that the correct amount of such accrual adjustments is still subject to final determination.
Appropriate disclosure of the above pension matter was likewise made in the City Comptroller's annual report for the fiscal year ended June 30, 1976.

The Task Force study indicates the likelihood of a change in actuarial cost method; therefore, it would seem appropriate to give effect to the interest payment factor in formulating the new actuarial assumptions under any proposed change to a new actuarial cost method. This conclusion is made subject to any further findings and recommendations of the pension study Task Force.

Glossary

A glossary of the significant terms referred to in this chapter follows.
Actuarial Assumptions - Factors which actuaries use in tentatively resolving uncertainties concerning future events affecting pension cost; for example, mortality rate, employee turnover, compensation levels, investment earnings, etc.

Actuarial Cost Method - A particular technique used by actuaries for establishing the amount and incidence of the annual actuarial cost of pension plan benefits, or benefits and expenses, and the related actuarial liability. Sometimes called funding method.

Actuarial Gains (Losses) - The effects on actuarially calculated pension cost of (a) deviations between actual prior experience and the actuarial assumptions used or (b) changes in actuarial assumptions as to future events.

Actuarial Liability - The excess of the present value, as of the date of a pension plan valuation, of prospective pension benefits and administrative expenses over the sum of the amount in the pension fund and the present value of future contributions for normal cost determined by any of several actuarial cost methods. (Sometimes referred to as unfunded actuarial liability.)

Actuarial Valuation - The process by which an actuary estimates the present value of benefits to be paid under a pension plan and calculates the amounts of employer contributions or accounting charges for pension cost.

Interest - The return earned or to be earned on funds invested or to be invested to provide for future pension benefits. In calling the return interest, it is recognized that in addition to interest on debt securities the earnings of a pension fund
may include dividends on equity securities, rentals on real
estate, and realized and unrealized gains or (as offsets)
losses on fund investments.

**Mortality Rate** - Death rate - the proportion of the number
of deaths in a specified group to the number living at the
beginning of the period in which the deaths occur. Actuaries
use mortality tables, which show death rates for each age, in
estimating the amount of future retirement benefits which will
become payable.

**Normal Cost** - The annual cost assigned, under the actuarial
cost method in use, to years subsequent to the inception of
a pension plan or to a particular valuation date. See past
service cost, prior service cost.

**Past Service Cost** - Pension cost assigned, under the
actuarial cost method in use, to years prior to the inception
of a pension plan. See normal cost, prior service cost.

**Present Value (Actuarially Computed Value)** - The current
worth of an amount or series of amounts payable or receivable
in the future. Present value is determined by discounting the
future amount or amounts at a predetermined rate of interest.
In pension plan valuations, actuaries often combine arithmetic
factors representing probability (e.g., mortality, withdrawal,
future compensation levels) with arithmetic factors representing
discount (interest). Consequently, to actuaries, determining
the present value of future pension benefits may mean applying
factors of both types.
Prior Service Cost - Pension cost assigned, under the actuarial cost method in use, to years prior to the date of a particular actuarial valuation. Prior service cost includes any remaining past service cost. See normal cost, past service cost.

Service - Employment taken into consideration under a pension plan. Years of employment before the inception of a plan constitute an employee's past service; years thereafter are classified in relation to the particular actuarial valuation being made or discussed. Years of employment (including past service) prior to the date of a particular valuation constitute prior service; years of employment following the date of the valuation constitute future service.

Turnover - Termination of employment for a reason other than death or retirement. See withdrawal.

Vested Benefits - Benefits that are not contingent on the employee's continuing in the service of the employer. In some plans the payment of the benefits will begin only when the employee reaches the normal retirement date; in other plans the payment of the benefits will begin when the employee retires (which may be before or after the normal retirement date). The actuarially computed value of vested benefits represents the present value, at the date of determination, of the sum of (a) the benefits expected to become payable to former employees who have retired, or who have terminated service with vested rights, at the date of determination; and (b) the benefits based on service rendered prior to the date of determination, expected to become
payable at future dates to present employees, taking into account the probable time that employees will retire, at the vesting percentages applicable at the date of determination. The determination of vested benefits is not affected by other conditions, such as inadequacy of the pension fund, which may prevent the employee from receiving the vested benefits.

Withdrawal - The removal of an employee from coverage under a pension plan for a reason other than death or retirement. See turnover.
CHAPTER 5

RECOMMENDATIONS RESPECTING MISCELLANEOUS ACCOUNTING PRACTICES AND PROCEDURES

Introduction

To assure that City financial transactions are recorded and reported on in conformity with generally accepted accounting principles, it is essential that sound accounting practices be adopted and followed on a consistent basis in each succeeding fiscal year.

Revenue and Expenditure Accounts in all Operating Funds Should be Formally Closed at each Fiscal Year End

In prior years, the appropriation/expenditure accounts have not been formally closed at each fiscal year end; instead, charges against unexpended appropriation account balances have been permitted under the Mayor's Executive Orders for six months after the end of the fiscal year or until all encumbrances existing on June 30 are liquidated. The Department of Purchase has been given one year after the close of the year to liquidate its existing encumbrances. Accordingly, the "Statement of Operations for the Year" or the subsequent "Summary of Expenses by Function" in the City Comptroller's annual report, which is required to be issued within 120 days after the close of each fiscal year, does not reflect charges made after June 30 to appropriation accounts. The actual excess or deficiency in revenues over expenditures in the expense budget therefore has not been reflected in the City Comptroller's annual report.
The City Comptroller's Office made substantial progress in consolidating all appropriate accounts in a general fund of the City as of June 30, 1976. Those accounts that are properly includible in the water and sewer fund (enterprise fund) and in the Municipal Services Administration fund (intragovernmental service fund)/now scheduled to remain in the general fund until June 30, 1979, pending completion of system changes and development of related asset values essential to establishing appropriate enterprise and intragovernmental service funds.

It is recommended that to the extent practicable at the close of the year-end of June 30, 1976, but not later than June 30, 1977, the following year-end practices and procedures be implemented:

1. Permit charges against unexpended appropriation balances in expense budget accounts beyond June 30 only to the extent of: (a) properly accruable items, such as purchases of supplies or equipment on which delivery had been made or title had otherwise passed to the City; and (b) encumbrances, based on valid purchase orders, and supplies or personal service contracts that had been issued by the Department of Purchase or other authorized agency on June 30 or prior thereto. Differences between amounts encumbered on purchase orders and actual invoice amounts should be adjusted in the manner described in Chapter 1. Included also would be billings to the City on personal service
contracts for services rendered to June 30 and similarly, billings on construction or other non-personal service contracts for work completed through June 30. In large cities, the above process normally requires 30 to 60 days to accomplish.

2. Recognize all general fund revenues in the expense budget in the current year in the general fund established as of June 30, 1976 when collected in cash except those sources considered susceptible to accrual, as follows:

   Sales taxes                      Subject to the provisions in Chapter 1
   State and Federal categorical grants Subject to the provisions in Chapter 1

   Investment income

3. Once all appropriate accruals for revenues and accruals for all expenditures are recorded, all revenue and expenditure accounts should be closed into the newly established fund balance account of the general fund for the year ended June 30, 1976. The same practice should be continued in future years.

4. A formal statement of revenues and expenditures prepared in an integrated format should be presented in the City Comptroller's annual report. The amounts of revenues and expenditures appearing in such statement should be the final amounts appearing on the related ledger accounts as closed to the fund balance account.
contracts for services rendered to June 30 and similarly, billings on construction or other non-personal service contracts for work completed through June 30. In large cities, the above process normally requires 30 to 60 days to accomplish.

2. Recognize all general fund revenues in the expense budget in the current year in the general fund established as of June 30, 1976 when collected in cash except those sources considered susceptible to accrual.

3. Once all appropriate accruals for revenues and accruals for all expenditures are recorded, all revenue and expenditure accounts should be closed into the newly established fund balance account of the general fund for the year ended June 30, 1976. The same practice should be continued in future years.

4. A formal statement of revenues and expenditures prepared in an integrated format should be presented in the City Comptroller's annual report. The amounts of revenues and expenditures appearing in such statement should be the final amounts appearing on the related ledger accounts as closed to the fund balance account.
5. Include encumbrances recognized as stated in 1(b) above in the statement of revenues and expenditures and supporting schedule of expenditures classified by function in the City Comptroller's annual report. In the latter schedule, for example, these items might be set forth under captions somewhat as follows:

<table>
<thead>
<tr>
<th>Department/Agency</th>
<th>Amended Budget</th>
<th>Expenditures</th>
<th>Encumbrances</th>
<th>Unencumbered Balance</th>
</tr>
</thead>
</table>

Procedures for Encumbering of Purchase Orders and Contracts

Under generally accepted accounting principles, encumbrances are defined as "obligations in the form of purchase orders, contracts, or salary commitments which are chargeable to an appropriation and for which a part of the appropriation is reserved. They cease to be encumbrances when paid or when the actual liability is set up"\(^1\) or when there is no longer a need for the reservation of appropriated funds.

In contrast, the term expenditures, as applied generally to governmental funds (general, debt service, and capital projects funds), "designates the cost of goods delivered or services rendered, whether paid or unpaid, including expenses, provision for debt retirement not reported as a liability of the fund from which retired, and capital outlays."\(^2\)

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\(^1\)Governmental Accounting, Auditing, and Financial Reporting, p. 159.
\(^2\)Ibid., p. 160.
Technically, therefore, an encumbrance is not an expenditure because when a purchase order is issued or contractual commitments are made no merchandise or goods have been received (or title thereto passed) or services rendered. In substance, an expenditure may be accrued if not paid; a purchase order may not be accrued, but it may be encumbered.

Clearly, encumbrance accounting is a feature of budgetary accounting and doubtless came into usage many years ago for the probable singular purpose of committing available funds in an appropriation account within the budget of a given fund, which funds would otherwise lapse at the end of a given fiscal year. Conversely, encumbering of appropriations prevents the total appropriation from being overspent. Historically, it presumably became an instrument of budgetary control throughout the year, and for these purposes has provided governmental units with an effective device to prevent overspending of appropriations for many decades of time.

The use of an encumbrance system during the year generally causes no special accounting problems; however, such a system creates a number of accounting situations requiring special consideration and decisions at the end of a fiscal year, such as but not limited to:
1. Can encumbrances optionally be charged to either the current or ensuing fiscal year?

2. Should personal service consulting contracts be encumbered?

3. Should capital construction contracts be encumbered?

4. Should an encumbrance system be utilized in enterprise and intragovernmental service funds?

5. Should the placing of purchase orders be permitted through the last day of the fiscal year for encumbrance purposes, or should the placing of purchase orders be cut off 30, 60 or 90 days prior to the close of the fiscal year to minimize the number and dollar volume of outstanding encumbrances at the close of the year?

For the purpose of establishing an appropriate foundation on which to formulate guidelines for the operation of an encumbrance system within the framework of the Accounting Systems Directives prescribed for the City, the following basic explanation is set forth:

Use of an encumbrance method of accounting for expenditures in the City's expense budget is required. Under the method described in Chapter 1, an outstanding encumbrance is recognized as an expenditure and the related obligation is carried until liquidated, either by replacement with an actual liability or by cancellation.

That section of Chapter 1 pertaining to the City's capital projects fund, recommends in substance that in lieu of adopting a formal encumbrance method of accounting for construction
contracts, accrued expenditures should, at the end of each year, include amounts due contractors for work completed through June 30, or through such date in June as coincided with the billing date for monthly or other periodic billings for work completed. This approach is consistent with the generally accepted accounting principle that the accrual basis and not the modified accrual basis should be followed in accounting for transactions within the City's capital projects fund.

For reasons set forth earlier, use of an encumbrance system constitutes a modification of the accrual method of accounting and should, therefore, be employed only in funds utilizing the modified accrual basis of accounting. Accordingly, this conclusion would also be applicable to the City's proposed enterprise funds (housing enterprise fund and water and sewer fund) and to the planned intragovernmental service fund (Municipal Services Administration fund), where the accrual basis would be applicable. However, there is no conflict with such accounting principles, if for purposes of budgetary control and uniformity of administration, an encumbrance system is employed in such types of funds during the year, providing outstanding encumbrances at year-end are cancelled and then reopened at the beginning of the following year.
Within this framework, the encumbrance system prescribed for the City's general fund contemplates that uniformly the placing of a purchase order for commodities or any form of capital outlay, such as autos, trucks, furniture or office equipment (purchased through the general fund), would automatically result in encumbering the related appropriation account. Although a normal procedure for encumbering purchase orders or contracts does not distinguish between fiscal years in which the benefits are to be received or service rendered in order to record the charge therefor in the appropriate accounting period, the operation of the encumbrance system should be consistent with the fact that the general fund budget constitutes a financial plan of proposed expenditures applicable to a single year, and should reflect as accurately as possible the expenditures, including outstanding encumbrances, incurred in that year.

We are concerned with encumbrances outstanding at the end of any fiscal year because the cost will have been recorded in the current year but the goods will be received or services rendered in the following year. Accordingly, the questions enumerated earlier basically are resolved in light of this basic characteristic of an encumbrance system.

Although the primary purpose of such an encumbrance system is to reserve a portion of an unencumbered appropriation before it lapses at year-end, and not to match the year in which the costs are recorded with the year in which the benefits are derived, discipline in the system can be attained only if a set of rules are adhered to which discourage encumbering where utilization of available funds is the primary motive, such as those proposed below.
Given the above description of the true purposes of an encumbrance system and the accounting "mismatch" created with respect to each purchase order or contract encumbered at any fiscal year-end, it is obvious that establishment of administrative control over the placing of purchase orders or execution of professional consulting contracts relating to the general fund offers a more viable form of control over the encumbrance system than an attempt to segregate recorded encumbrances between fiscal years. For such purposes, it is recommended that consideration be given to the following administrative rules and criteria for issuance of purchase orders by the City. These rules would have the basic purposes of permitting the issuance and encumbering of purchase orders where genuine need therefore exists and to discourage their issuance where utilization of available funds is the primary motive.

1. With respect to the normal flow of requisitions, an appropriate year-end cutoff date should be set for filing with Municipal Services Administration.

2. Require that each requisition from an agency be accompanied by a simple form of certification that (a) the goods or merchandise are needed during the current fiscal year, or the stated lead time is required to receive such goods or merchandise by the date needed, and (b) that they are not being ordered merely to utilize funds available in the current year appropriation.
3. Municipal Services Administration should be required to complete processing by June 30 all requisitions filed with it by all City agencies on or prior to the cutoff date. No encumbrances applicable to that year would be accepted by FISA after June 30. City agencies should be instructed to use the above definitions in determining or estimating their requirements as part of the budgetary process.

4. With respect to consulting contracts let to evaluate performance of work on other contracts or similarly contracted for audit services, City agencies should, wherever possible, execute such contracts prior to June 30, charging the same year funds as are chargeable for the principal services being rendered, even though the evaluation of audit services are not expected to be rendered until the succeeding year.

Eliminate Use of Tax Deficiency Account

Section 127 of the City Charter requires the establishment of the Tax Deficiency Account (TDA) and specifies the debits and credits to be applied to this account as follows:

Debits:

1. All discounts allowed for the prepayment of taxes and

2. The amount of all remissions or cancellations of real estate taxes.
Credits:

1. All balances of Expense Budget appropriations no longer required;
2. Gains on the extension of the current tax rate to the nearest hundredth of a cent;
3. Collection of prior year's cancelled real estate taxes previously charged to this account, and
4. Proceeds from the sale of property taken over by in rem action.

The apparent intent of the TDA was to provide primarily for a reserve for uncollectible real estate taxes due to remissions, cancellations, and discounts. Since real estate taxes are to be recorded as revenue in the fiscal year in which collected, and the procedures for establishment of a reserve for uncollected taxes, with partial segregation into a reserve for uncollectible taxes, has already been provided for, the use of a tax deficiency account will serve no useful purpose. A revision to the City Charter is therefore recommended to eliminate the provision establishing the tax deficiency account and its earlier version, the Tax and Appropriation Surplus Deficiency Account.

The recommended fund structure of accounting will absorb the TDA into the general fund. For control purposes, the total amount of the real estate levy (after exclusion of exempt properties) should be charged to "property taxes receivable" and credited to "reserve for uncollected property taxes" in the general fund.
Under the above procedure, the debits previously charged to the TDA for discounts, remissions and cancellations, will now be charged to the reserve for uncollected taxes, with an offsetting credit to the "property taxes receivable" account. Two of the TDA credit items cited above (unexpended expense budget appropriations and gains on the extension of the current tax rate) should remain in their respective accounts until closed to the fund balance account of the general fund as of June 30, 1976. The other two TDA credit items (collection of prior year's real estate taxes previously cancelled and charged to this account and proceeds from the sales of in rem properties) will be credited to current real estate tax revenue accounts and closed to the fund balance account at the end of each fiscal year. The balances, debit or credit, in the Tax Deficiency Account and the Tax and Appropriation Surplus Deficiency Account at June 30, 1976 should be transferred to the fund balance account of the general fund as of that date.

General Fund Financial Transactions Involving Operations of Prior Years

From time to time financial transactions involving operations of prior years will arise, requiring accounting interpretations as to whether the related revenue or expenditure elements should appropriately be included in the current year's operations or credited or charged, as the case may be, to the fund balance account of the general fund. To assist in readily making such determinations in conformity with generally accepted accounting principles the following guidelines are set forth.
Types and Examples of Transactions Which Qualify as Prior Period Adjustments to Fund Balance Account

In all instances only transactions involving material amounts are considered to qualify for prior period adjustments. Such transactions are limited to the following types and examples:

1. Correction of an error in the financial statements of a prior period discovered subsequent to their issuance. Examples would include (a) adjustments resulting from mathematical mistakes, (b) mistakes in the application of accounting principles, or (c) oversight or misuse of facts that existed at the time the financial statements were prepared.

A correction of a material error should be treated as a prior period adjustment because the financial statements of the affected prior period, when originally issued, should have reflected the adjustment. An error arises where the facts and circumstances as they existed as of the date of the issuance of the financial statements were improperly reflected in such statements. If economic or other events occurring subsequent to the date of the financial statements affect the determination of the existence of an adjustment or the amounts involved, then the adjustment would be based on subsequent additional information and not be a correction of a prior period error.
2. A change from an unacceptable accounting method to an acceptable accounting method, which is treated as a correction of an error. Examples are:
   a. A change from reporting revenues on the cash or accrual basis to the modified accrual basis.
   b. A change from reporting expenditures on the cash basis to the accrual basis of accounting.

Measures of Materiality

Generally accepted accounting principles do not define materiality levels applicable to financial transactions, expressed either in dollar values or percentages of specific levels of operating results or equity values. Authoritative accounting literature states merely that materiality is a basic feature of financial accounting because financial reporting is only concerned with information that is significant enough to affect evaluations or decisions.

Materiality is a concept which cannot be precisely defined because it is highly dependent on judgment. Many factors are considered in the perception of materiality. A primary consideration of whether an adjustment is material is if it must be accounted for in order to prevent the financial statements from being misleading. Size alone is not the sole determinant of materiality. The effect of the item on revenues or expenditures, when compared to a reasonable base, the nature of the items, e.g., whether it is unusual or contingent, or a result of management discretion and its overall sensitivity must also be considered in determining materiality. Likewise, in determining
materiality, not only the amounts of individual items relating to prior years but the aggregates of all such items occurring during a given fiscal year should be considered.

For the purpose of adequately serving the requirements of financial management of the City, particularly during its period of establishing new accounting procedures and controls and of regaining public confidence in its financial data, a materiality level applicable to general fund revenue or expenditure items needs to be measured by its effect on the total revenue from the same source for the current year or the total expenditures of the department or agency to which the individual adjustment or aggregate of all similar adjustments during the current year relate. This approach appears necessary, inasmuch as total expenditures by department or agency are being reported for purposes of fair presentation in the general fund statement of revenues and expenditures for each fiscal year.

Applicable Disclosure Requirements Respecting Prior Period Adjustments to Fund Balance Account

When prior period adjustments are recorded, the resulting effects on the revenues and expenditures of prior periods should be disclosed in the annual report for the year in which the adjustments are made.
When financial statements for a single period only are presented, this disclosure should indicate the effects of such restatement on the fund balance at the beginning of the period and on the revenues and expenditures of the immediately preceding period. When financial statements for more than one period are presented (which is recommended where meaningful), the disclosure should include the effects for each of the periods included in the statements. The prior years' statements should be restated and disclosure should include the effects of such corrections.

The nature of an error in previously issued financial statements and the effect of its correction on total revenue or total expenditures of the general fund should be disclosed in the period in which an accounting error is discovered and corrected.

Financial statements of subsequent periods need not repeat any of the above disclosures. Restated statements should remain restated.

Types and Examples of Transactions Includible in Current Year Operations

1. All types and examples of financial transactions involving operations of prior years (items 1 and 2 above) that are not material in amount.
2. Recurring corrections and adjustments which are
the natural result of the use of estimates inherent in the
accounting process. These should not be confused with correction
of errors. Changes in estimates used in accounting are necessary
consequences of periodic presentations of financial statements.
Future events and their effects cannot be perceived with
certainty; estimating, therefore, requires the exercise of
judgment. Accounting estimates change as new events occur, as
more experience is acquired or as additional information is
obtained.

Examples of changes in estimates include: (a)
differences between estimated accounts receivable, including
grants where these have been accrued, and later actual values;
(b) normal adjustments of encumbrances and accrual of accounts
payable from prior years; (c) collections of taxes and accounts
receivable previously written off; and (d) adjustments in
accounts or vouchers payable for related revenue or expenditure
items.

3. Adjustments based on some uncertainties, for
example, those relating to the realization of assets, such as
collectibility of accounts receivable, real estate taxes, or
mortgages receivable originating in a prior period would not
qualify for prior period adjustments because economic events
subsequent to the date of the financial statements must of
necessity enter into the resolution of the uncertainty.
ACCOUNTING OPINION NO. 1
ON
PARTICULAR FINANCIAL TRANSACTIONS OF NEW YORK CITY

Statement of Facts

Claims for reimbursement of expenditures under Federal and State aid programs are subject to Federal or State audits; partial or even full disallowances of City claims for reimbursement may result from such audits.

Through June 30, 1975 the City followed the practice of recording accruals for amounts estimated to be due under Federal and State aid programs on the basis of 100% reimbursement with no provision in the respective years of accrual for possible disallowance of the related claims for reimbursement.

When the three year financial plan for the City was formulated and approved by the City and the Emergency Financial Control Board in October 1975 the possibility of either disallowance or overstatement of some of the Federal and State aid claims was recognized. Provision was made in the 1975-76 financial plan to reduce estimates for current year revenue from such sources because of possible disallowances or overclaims related separately to claims rendered by the City for fiscal years ended June 30, 1975 and prior thereto ($145 million), and those for fiscal year ending June 30, 1976, for which no provision was made in the expense budget ($150 million).
Subsequently, in reviewing the status of the financial plan, City officials concluded that these estimated provisions for disallowances were excessive, and revisions were made as follows:

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<th>Original Provision</th>
<th>Revised Provision</th>
<th>Excess Provision</th>
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**Question**

Should actual audit disallowances, when finally determined and agreed to by the concerned agencies in the City and the State and/or Federal governments, be charged to the fund balance account or current revenue accounts for Federal and State aid, respectively? By "fund balance account" is meant such account in the general fund recommended for establishment in Chapter 1 of the Accounting Systems Directives.

**Accounting Opinion**

As to reimbursement claims for years ended June 30, 1975 and prior thereto, generally accepted accounting principles, had they been followed, would have required that a provision for uncollectible claims arising from disallowance through audits be established, with an offsetting allowance for uncollectible receivables, in each of the related years. The failure to do so resulted in an error in each of the annual operating statements.
and reflected an overstatement of cumulative claims receivable and the fund balance account (or understatement of the deficit) in the balance sheet at each succeeding year end. Thus, the cumulative effect of such errors was reflected in total in the balance sheet comprised of the asset, liability, reserve, and equity accounts related to the City's "expense budget" in the City Comptroller's Financial Report for the fiscal year ended June 30, 1975.

Current recognition and recording of actual audit disallowances of claims related to years ended June 30, 1975 and prior thereto represent correction of an error in prior years' financial statements. Under generally accepted accounting principles, correction in the year of discovery of a material error in the financial statements of a prior year should be reported as a prior period adjustment. Therefore, the charge for actual audit adjustments as they develop or, preferably, of a reasonable estimate of total disallowances on all original accruals should be made to the fund balance account of the proposed new general fund of the City. If not already recorded, the adjustment for estimated total disallowances should be made to the newly established fund balance account not later than June 30, 1976.

If the amount of specific audit adjustments or the estimate of total disallowance were considered not material, then the charge would appropriately be made in the current year to an expenditure account "provision for uncollectible receivables," with an offsetting credit to an account "allowance for uncollectible
receivables." Materiality should be considered in relation to both the effects of each adjustment and the combined or aggregate effect of all adjustments within a given year.

As to the 1975-76 fiscal year receivables for Federal and State grants in aid, a provision for uncollectible claims, with an offsetting allowance account, should be established during the current year. Materiality of the amounts involved would not be a factor in determining the appropriateness of this accounting treatment.

The nature of an error in previously issued financial statements and the effect of its correction on total revenue or total expenditures of the general fund for that year (fund balance account) should be disclosed in the period in which an accounting error is discovered and corrected. Financial statements of subsequent periods need not repeat the disclosures.
MUNICIPAL ASSISTANCE CORPORATION - AN EXPLANATION

The Municipal Assistance Corporation (MAC) is a nonprofit State established corporation whose purpose is to assist New York City in borrowing money on the money markets. Through the issuance of its own long term debt, MAC is refinancing a substantial portion of the City's note type debt. Previous New York City revenue sources such as the sales and compensating use tax, Per Capita Aid and the stock transfer tax have all been preempted by MAC for the purpose of paying MAC obligations - bonds, interest and administrative expenses. These revenue sources will revert back to New York City when all forms of MAC debt have been retired.

Section 3016 of the Public Authorities Law states that, "The notes, bonds or other obligations of a municipal assistance corporation shall not be a debt of either the State or the municipality being assisted, and neither the State nor such municipality shall be liable thereon, nor shall they be payable out of any funds other than those of such a corporation."

However, since most MAC financial transactions are on behalf of and for the benefit of the City for accounting purposes, such transactions should be considered equivalent to City transactions. Hence, MAC transactions should be recorded on the City's books and reflected in its published financial statements.
ACCOUNTS WHICH AFFECT THE FUND BALANCE (Generally should have credit balance)

- Contributions arising from Longterm Bonds issued by MAC (Account #850) - This account represents cash received from MAC for operating expenses. This account is used as follows:
  1. Debit with the amount of related MAC debt that is retired.
  2. Credit with the amount of money received from MAC for operating expenses.

- Fund Balance Credits arising from MAC Acquisition of Short term debt (Account #851) - This account represents cash received from MAC in exchange for City notes. This account is used as follows:
  1. Debit with the amount of related MAC debt used to purchase (retire) City notes.
  2. Credit with the amount of cash received from MAC in exchange for the City note type debt.

- Fund Balance Credits Arising From Extension of Short Term To Longterm Debt (Account #852) - This account represents the amount of moratorium debt which has been transferred to the general longterm debt group of accounts. The account is used as follows:
  1. Debit with the amount of related debt that is retired.
  2. Credit with the amount of short term debt which is under moratorium and is being reflected in the general longterm debt group of accounts.
Conversion of Note Type Debt Through Issuance of MAC Bonds

for City Notes (Account # ) - This account represents the exchange of MAC longterm bonds for City notes (maturity 11/15/78). The account is used as follows:

1. Debit with the amount of related MAC debt that is retired.

2. Credit with the amount of City notes which is now being reflected in the MAC Longterm Debt Group of Accounts.

The Following accounts within the MAC Debt Service Fund (Fund #340) should be utilized:

- Asset Accounts (generally debit balance)
  - Amounts Held by MAC (Account #030) - This account represents funds available for the retirement of MAC Debt. This account is used as follows:
    1. Debit with funds specifically earmarked by MAC for the retirement of debt.
    2. Credit with the amount of MAC debt actually retired.
  - Amount Held By MAC Capital Reserve (Account #051) - This account represents funds earmarked for the MAC Capital Reserve, as prescribed by public law. This account is used as follows:
    1. Debit with the amount of funds earmarked for the Capital Reserve.
    2. Credit with the amount of MAC Capital Reserve disposed of as a result of payment of MAC debt.
  - Amount available for Payment of Interest (Account #190) - This account represents funds available for the payment of interest on MAC debt. This account is used as follows:
    1. Debit with the amount of funds earmarked for payment of interest on MAC bonds.
    2. Credit with the amount of funds actually paid for interest
on MAC bonds.

- Amount Held Pending Distribution (Account #) - This account represents funds collected by MAC but haven't as yet been earmarked. This account is used as follows:
  1. Debit with the amount of funds collected by MAC that have not been specifically earmarked.
  2. Credit with the amount of funds that have been specifically earmarked.

- Fund Balance
  (generally Credit balance)
  - Fund Balance (Account #840) - This account represents the excess of the fund's assets over its liability and reserves. This account is used as follows:
    1. Debit with excess of actual expenditures over actual revenues at year-end.
    2. Credit with excess amount of actual revenues over actual expenditures.

- Revenue Accounts
  - Sales Tax - MAC (Revenue Source Code ) - Credit this account with revenue received by MAC from taxes imposed upon the sale of consumption of goods and services.
  - Stock Transfer Tax - MAC (Revenue Source Code ) Credit this account with revenues received by MAC from taxes imposed upon the transfer of stock.
  - New York City State Per Capita Aid Allocation (Revenue Source Code 54000) Credit this account with revenues received by MAC from the New York City State Per Capita Aid Allocation as mandated by public law.
  - Interest and Other Income Applied by MAC (Revenue Source Code ) - Credit this account with interest income earned on MAC investments.
- Expense Accounts
  
  - MAC Interest Expense (Object #) - Debit this account with interest payment made by MAC.
  
  - Operating Expenditures of MAC (Object #302) - Debit this account for all revenues which are used for MAC operating expenses.
  
  - Retirement of MAC Bonds (Object #) - Debit this account for all revenues which are used to redeem MAC bonds.

- The following accounts within the MAC Long-Term Debt Group of accounts (Fund #910) should be used:

- Asset Accounts (generally should have debit balance)
  
  - Amounts to be provided from Future Revenues for Payment of MAC Debt (Account #152) - The purpose of this account is to indicate the amounts to be provided in future budgets for outstanding MAC bonds. This account is used as follows:
    1. Debit with the principal of MAC bonds issued when the proceeds of the MAC bonds are recorded in the appropriate fund.
    2. Credit with the amounts disbursed for principal on bonds.

  - Amounts Available in MAC Debt Service Fund (Account #162)
    The purpose of the account is to indicate the amount of assets available in the Debt Service Fund for the retirement of MAC Debt. This account is used as follows:
    1. Debit with the amount of assets placed in the MAC Debt Service Fund for the future retirement of MAC bonds.
    2. Credit with the amount of assets disposed of in the payment of MAC Bonds.
- Liability Accounts (generally should have credit balance)
  
  MAC Notes Payable (Account #454) - This account is used as follows:
  1. Debit with amount disbursed to pay principal on MAC notes payable issued.
  2. Credit with principal amount of MAC notes payable issued.

  Long - Term Bonds Issued by MAC (Account #552) - This account is used as follows:
  1. Debit with amounts disbursed to pay principal on MAC Bonds.
  2. Credit with principal amount of long term bonds issued by MAC.

- Reserve Account (generally should have credit balance)
  
  MAC Capital Reserve (Account # ) - This account is used as follows:
  1. Debit with the amount of MAC Capital Reserve disposed of as a result of payment of MAC debt.
  2. Credit with amount of funds earmarked for the MAC Capital Reserve.

GUIDELINES FOR ALL COMMON MAC ENTRIES

The following entries are guidelines which are intended to cover all common MAC financial transactions to be recorded on the City's books in conformance with ASD #7:

I. PROCEEDS OF MAC BONDS

  - MAC exchanges its own long term bonds for the City's short term notes.
    
    General Fund
    
    Notes Payable (Account # 450, 451, 452, or 453) xxx
    Conversion of Note type Debt through issuance of MAC bonds for City Notes
MAC Longterm Debt Group of Accounts

Amounts to be provided from future revenue for xxx payment of MAC bonds (Account #152)

Longterm bonds issued by MAC (Account #552) xxx

MAC Transfers Cash From the Sale of Longterm Bonds to the City for the purpose of redeeming City notes.

General Fund:

Cash (Account #001) xxx

Fund balance credits arising from MAC acquisition of Short term debt. (Account #851) xxx

Notes payable (Account #450, 451, 452, or 453) xxx

Cash (Account #001) xxx

MAC Longterm Debt Group of Accounts

Amounts to be provided from future revenues for xxx payment of MAC bonds (Account #152)

Longterm bonds issued by MAC (Account #552) xxx

MAC Issues Longterm Bonds and Transfers the Resulting Monies for City Operating expenses.

General Fund:

Cash (Account #001) xxx

Contributions arising from Longterm Bonds issued by MAC (Account #850) xxx

MAC Longterm Debt Group of Accounts:

Amounts to be provided from future Revenues for Payment of MAC Bonds (Account #152) xxx

Longterm Bonds Issued by MAC (Account #552) xxx
MAC issues Longterm Bonds at a discount

- General Fund - just record actual cash received from MAC. Follow procedures set forth in the aforementioned transactions.

  Cash (Account #001)  

  An appropriate Account (Account #850, 851, or 852)

- MAC Longterm Debt Group of Accounts - record total obligation of issue

  Amounts to be provided from Future Revenue for Payment of MAC Bonds (Account #152)

  Longterm Bonds Issued by MAC (Account #552)

- City Short Term Debt subject to the moratorium and transferred to Longterm Group of Account.

  General Fund:

  Notes Payable (Either Account #450, 451, 452, or 453)  

  Fund Balance Credits arising from Extension of Short term to Longterm Debt. (Account #852)

  MAC Longterm Debt Group of Accounts:

  Amounts to be provided from Future Revenue Payment for MAC Bonds (Account #152)

  Longterm bonds Issued by MAC (Account #552)

II. MAC REVENUE AND APPLICATION OF RECEIPTS TRANSACTIONS

MAC revenues, except for interest earned on MAC investments, are recorded in the General Fund. Interest earned on MAC investments is just recorded in MAC Debt Service Fund. MAC'S application of receipts are just recorded in the MAC Debt Service Fund.

- In the General Fund the following account titles are debited:
- Sales Tax Allocated to MAC
- Per Capita Aid Allocated to MAC
- Stock Transfer Tax Allocated to MAC

In the General Fund the following account titles are credited:
- Revenue - Sales Tax (Revenue Source Code 00050)
- Revenue - Per Capita Aid (Revenue Source Code 54000)
- Revenue - Stock Transfer Tax (Revenue Source Code 00078)

Application of receipts in MAC Debt Service Fund should be recorded as debits. The following are accounts where receipts are applied:
- Amount Held by MAC. (Account #050)
- Amount Held by MAC Capital Reserve. (Account #051)
- Amount Held Pending Distribution. (Account # )
- Amount available for Payment of Interest. (Account # )
- Operating expenditures of MAC. (Object Code 802)
- Interest Expense. (Object Code )
- Retirement of MAC Bonds. (Object Code )

Revenue in the MAC Debt Service Fund should be recorded as credits.

The following are the appropriate account titles:
- Sales Tax - MAC. (Revenue Source Code )
- Stock Transfer Tax - MAC. (Revenue Source Code )
- Per Capita Aid - MAC. (Revenue Source Code )
- Interest and Other income applied by MAC. (Revenue Source Code )

MAC Increases its Capital Reserve Account.

MAC Debt Service Fund

Amount Held by MAC Capital Reserve (Account #051)  xxx
Credit from appropriate Revenue Source  xxx

(i.e Sales Taxes, Per Capita Aid, Stock Transfer Tax)
• MAC Longterm Debt Group of Account
  Amount available in MAC Debt Service Fund (Account #162) xxx
  MAC Capital Reserve (Account # ) xxx

- Grants to MAC for the City

  • General Fund:
    Cash xxx

  Contributions arising from longterm Bonds issued by MAC xxx

III. Retirement of MAC Debt

- Redeem Longterm MAC Bonds

  • General Fund – see Section entitled IV. Amortization of Credits to General Fund Balance within this Section of the manual

  • MAC Debt Service Fund
    Retirement of MAC Bonds (Object # ) xxx
    Amount Held by MAC (Account #050) xxx

  • MAC Longterm Debt Group of Account
    Longterm Debt Issued by MAC (Account #552) xxx
    Amounts available in MAC Debt Service Fund (Account #162) xxx

- Principal is paid with funds not previously earmarked for payment

  • MAC Debt Service Fund
    Amount Held Pending Distribution (Account # ) xxx
    Retirement of MAC Bonds (Object Code ) xxx

  • MAC Longterm Debt Group of Accounts
    Amounts Available in MAC Debt Service Fund xxx
    (Account #162)

    Amounts to be provided from Future xxx
Revenues for Payment of MAC bonds (Account #152)
Long-term Debt Issued by MAC (Account #552) 
Amounts Available in MAC Debt Service Fund (Account #162)

- Retire MAC Bonds At Discount
  - MAC Debt Service Fund - don't show discount - but do:
    - Retirement of MAC Bonds (Object # )
  - Amounts Held by MAC (Account #050)
  - MAC Longterm Debt Group of Account
    - Longterm Debt Issued by MAC (Account #552)
    - Amounts available in MAC Debt Service Fund (Account 162)
    - Amounts to be provided from Future
    - Revenue for Payments of MAC Debt (Account 152)
      (Account #152 represents the discount).

IV. Amortization of Credits to General Fund Balance

- Redemption of old MAC principal
  - General Fund
    - Fund Balance Credit arising from MAC
    - Acquisition of Short term Debt (Account #351)
    - Cash (Account #001)
    - MAC Longterm Debt Group of Account (see III retirement of MAC Debt).

- Redemption of New MAC Principal
  - General Fund
    - Conversion of Note type debt through issuance of MAC Bonds for City notes. (Account # )
Cash (Account #001)

- MAC Longterm Debt Group of Accounts (see III Retirement of Bonds)
  - Redemption of moratorium debt
    - General Fund
      - Fund Balance Credits arising from Extension of Short term to longterm Debt. (Account #352)

Cash (Account #001)

- MAC Longterm Debt Group of Accounts

Notes Payable (Account #154)

Amounts available in MAC Debt Service Fund (Account #162)