CITY OF NEW YORK

DEVELOPMENT OF

INTEGRATED FINANCIAL MANAGEMENT SYSTEM

FOR FISCAL YEAR 1977/78

PRELIMINARY IMPLEMENTATION PLAN

NOVEMBER 20, 1975
INTRODUCTION

This preliminary implementation plan for the Integrated Financial Management System (IFMS) outlines the major task and completion dates for creating an integrated accounting and budgeting system supported by a single data center. (One of the first milestones, due January 15, is a fully detailed project plan.)

The project will be implemented by a single team led by two co-directors representing the Mayor and Comptroller.

In brief, the project will:

1) define budgetary and accounting principles, policies, and procedures;
2) develop public and management reporting systems;
3) design and implement the manual and EDP systems required to accomplish the above goals by July 1, 1977.

This succinct description belies both the difficulty and impact of the project. Developing and installing IFMS by July 1, 1977 may well be one of the most ambitious financial management systems projects ever undertaken. Its success will give New York City the basic tool for sound financial management and control. To ensure that the project proceeds on schedule, effective action—in particular, complete and immediate cooperation at all levels—will be necessary.

The full cost of the project cannot yet be estimated. A complete project budget will be ready by January 15, 1976. Meanwhile, to start the project a commitment of $500,000 to carry through January 1976 is needed immediately.
MAJOR TASK MILESTONES

January 15, 1976

- Define accounting principles in cooperation with State Comptroller.
  . Recognition of revenues and expenses
  . Basic structure of budget and accounting systems
- Adopt accounting policies.
  . Fund accounting - general expense, enterprise, debt service, trust and agency, capital projects
  . Accounting for fixed assets
  . Encumbrances
  . Year end closing
- Specify external reporting needs for
  . EFCB
  . Investment community
  . Public
  . Systems to be developed (refer attached list)
  . Unified files to be developed
- Define structure for chart of accounts.
  . General needs
  . Coding structure
- Develop project plan for definition, analysis, and implementation phases.
  . To extent possible, specific tasks lists and due dates for the remainder of whole project or due
dates for issuing tasks and dates which cannot be prepared at this time.

- Start documentation of existing budget and accounting procedures and systems.
  - Flow chart with supporting documentation all central functions, major departments, and all departments which receive non-tax levy funding.
  - Immediate start in Budget, Comptroller's and two major departments
- Define EDP organization alternatives.
  - Identify NYC data centers which might be used to support the new integrated systems.
  - Evaluate NYC data center personnel and their potential.
  - Develop pros and cons of facilities management by vendor in NYC data center and vendor facilities.
- Complete study of recent changes in the law (e.g. MAC and EFCB legislation and Charter Revisions).
  - All applicable laws should be reviewed.
  - Conflicts and impractical laws should be identified for necessary remedy (this will be an ongoing task).
- Identify potential additional hardware requirements.
  - Is current hardware adequate or complete enough to support proposed new systems?
  - Can current hardware both support current systems and an intensive programming and testing effort?
. Can current hardware support old and new systems in parallel for the July to December 1977 period?
. Will there be adequate capacity to handle the new systems peak periods?

March 1, 1976

- Define capital budget accounts.
- Decide on EDP organization alternative.
- Define fund, department, and major expense categories.
- Define detailed coding structure for expense budget transactions.
- Specify managerial reporting needs.

April 1, 1976

- Complete documentation of current budget and accounting procedures.
- For current budget, identify and document on a detailed level all sources of revenue.
- Complete definition of new expense and capital budget and accounting structures and reporting requirements.
- Design computer system to reorganize, to the extent practical, the 76/77 budget to the new format (to ease conversion from 76/77 to 77/78).
- Issue NYC systems and programming standards.
- Define revenue section of chart of accounts.
June 1, 1976
- Complete basic design of new budget computer systems.
- Prepare procedures for preparation of 77/78 budget.
- Start development of training programs which use audio-visual and programmed learning techniques for all new budget and accounting procedures.
- Complete definition of chart of accounts.

August 1, 1976
- Issue manuals and prepare training programs for new budget system.
- Issue instructions to departments on how to develop encumbrance (purchasing) systems consistent with the new accounting principles.
- Complete basic design of all other new computer systems (refer attached list).

September 1, 1976
- Complete training of budget examiners and departmental personnel in new budget procedures.
- Issue computer reports to assist budget personnel in reorganizing and restructuring their budgets.

October 1, 1976
- Complete departmental preparation of initial "baseline" 77/78 budget submissions under new budget structure.
- Complete computer systems to process baseline budget submissions and assist in budget preparation and review process.
-Design and document procedures, internal controls and job descriptions for Comptroller's Bureau of Accountancy.

November 1, 1976
- Train Bureau personnel in new input procedures and standards.

January 1, 1977
- Complete budget conversion process and submit proposed 77/78 budgets in new structure.
- Issue detailed and summary computer prepared reports on the 77/78 budget in new structure.
- Issue forms and procedures to departments for converting payrolls to match the revised budget structure.
- Begin training of department personnel in new payroll procedures.

March 1, 1977
- Begin full-scale systems test for new financial management systems software.
- Issue instructions to agencies on preparation of monthly spending and revenue plans and begin training on preparation of monthly plans.
April 1, 1977
-Begin "dry run" on encumbrance control system with all purchase orders and requisition amounts submitted to the central accounting system.
-Start training of agencies in use of EDP encumbrance control system procedures.

May 1, 1977
-Complete budget review and issue public reports produced under the new structure (Executive Budget, including revenues, and supporting schedules).
-Start training of departmental and central accounting personnel in use of new accounting system.
-Departments submit preliminary monthly spending plans and revenue plans.
-Complete departmental recasting of payrolls and begin "dry runs" of new payroll system.

July 1, 1977
-Start operation in batch mode of new financial management systems. (Old systems continue in parallel to close out 76/77 and prior year books.)
-Departments submit final monthly spending and revenue plans.

December 1, 1977
-Convert open 76/77 and prior year accounts to new structure; operation of old systems terminated.
July 1, 1978

- Convert to "on-line" systems for most agency functions (purchasing, payroll, personnel input, and budget modifications).
- Complete new disbursements and check reconciliations systems.
- Complete automation of major agency timekeeping and cost allocation (labor distribution) systems.
ATTACHMENT

The new Integrated Financial Management Systems will have to have the capability to handle:

- The Expense Budget and Accounting
- The Revenue Budget and Accounting
- The Relationships between Expense and Revenue
- The Capital Budget and Accounting
- The Relationship between the Capital and Expense Budget
- Fund Accounting for Trust and Agency Accounts, Enterprise Funds, etc.
- Entries to the Accounting Systems
- Payroll
- Monitoring of Aid Receivables and Collections
- OTPS Encumbrance (Purchasing Control)
- Departmental Timekeeping and Cost Allocation (Labor Distribution)
- Disbursement Control and Check Reconciliation
- Cash Flow Projections
- Key Personnel Data (might be combined with payroll)
- Issuance of Required Public Reports
- Management Reporting
SUMMARY OF CITY COMPTROLLER'S PROPOSED ACCOUNTING STANDARDS

I Accounting Principles

(The following is an attempt to describe the highlights of the Comptroller's proposal. It should not be construed as an in-depth analysis of explanation of his suggestion.)

The enabling legislation which created the Municipal Assistance Corporation requires, in part, that the City of New York adopt as its method of accounting those principles and practices set forth in the State Comptroller's uniform system of accounts. While the City must initiate steps toward this goal within ninety (90) days, full implementation of these standards is not required until the 1977-78 fiscal year.

The thrust of the Comptroller's recommendation is that the City move to adopt these standards in its current fiscal year. While this is a seemingly modest proposal, the resulting fiscal impact on the 1975-76 and subsequent City budgets and the fundamental policy changes required to implement it, make this proposal by far the most important of the Comptroller's recommendations. The result of such action would be to move at once to a system in which expenditures are accounted for on an accrued basis (i.e., in the fiscal year in which they are incurred) and revenues are accounted for on a cash basis (i.e., in the fiscal year in which they are received). Altering the present policies governing how the City accounts for and expends funds would mean that a substantial amount of what is now considered revenue would have to be excluded from the City's books. Further, expenditures which the City would normally account for in a future fiscal year would have to be included in the 1975-76 budget. The following example cited by the Comptroller illustrates the impact of these changes:

<table>
<thead>
<tr>
<th>Real Estate Taxes</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current practice</td>
</tr>
<tr>
<td>Proposed standard</td>
</tr>
</tbody>
</table>
Fiscal impact - Reduce estimated revenues in the 1975-76 City budget by $480 million.

The Comptroller proposes that the resources of Big MAC be used to assist the City in implementing the accounting reforms. In effect, the Corporation would use its funds to purchase outstanding City obligations which had been issued in anticipation of the types of revenue noted above. This basic policy changes would be accompanied by the imposition of strict controls on and revision of the City's account structure to insure the revised approach is adhered to.
II Account Structure

The Comptroller recommends replacing the City's present complex structure of revenue fund accounts with the system of eight governmental fund account categories recommended by the Municipal Finance Officers Association.

III Control Systems

The Comptroller recommends development of a system of aggregate expenditure controls for personal service. This would include the establishment of personal service expenditure ceilings by appropriation unit or program, and a system of allotments or apportionments to control and monitor spending within appropriation or program units during the year.

IV Accounting Methods and Procedures

The Comptroller's report recommends analysis and reorganization as an essential part of the overall accounting procedure revisions. This should include a review of the current operations, work flows, controls and organization of the Comptrollers Bureau of Treasury (Finance). This study should result in the reallocation of major functions among Departments and Bureaus.

V Management Information Systems

The Comptroller's report recommends a review of information requirements at all levels (to be accomplished in conjunction with the systems analysis described in section IV). This would entail documenting the uses, sources and methods of production of accounting and budgetary information presently generated, as well as listing new types of information which are required but not currently produced.
VI  Financial Reporting

The annual report of the City Comptroller should, in the future, be designed to avoid the confusion which the current format generates. This would be accomplished by dividing the report into two entities: (1) a concise summary for the public and the financial community; and (2) a detailed report, available to the public, but designed primarily for more specialized use.

VII  Audit Procedures

An annual independent audit should be contracted for, to include a verification of revenues and receipts, expenditures and disbursements, assets and liabilities, as well as relevant comments on the fund accounting structure, operative accounting principles and internal control systems. Such a full and complete audit would be possible only subsequent to the institution of the other MFOA accounting procedures.
STATE OF NEW YORK
DEPARTMENT OF AUDIT AND CONTROL
DIVISION OF AUDITS AND ACCOUNTS

ACCOUNTING SYSTEMS DIRECTIVES FOR NEW YORK CITY

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 Act (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, as such system may be modified by the State Comptroller for application to the City. 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 its transition to the State Comptroller's method as promptly and as reasonably practicable so that audited financial statements may be available for the fiscal year ended June 30, 1978. The Act permits the City and MAC to formulate a mutually acceptable method of phasing the adjustments resulting from the State Comptroller's method into its accounting system over a reasonable period, not to exceed ten years.
Pursuant to this authorization, the State Comptroller is issuing a series of accounting systems directives for New York City. These directives, which are consecutively numbered, will be codified from time to time. The first of these directives accompanies this introduction.

The State Comptroller encourages early implementation of these accounting principles.
STATE OF NEW YORK
DEPARTMENT OF AUDIT AND CONTROL
DIVISION OF AUDITS AND ACCOUNTS

ACCOUNTING SYSTEMS DIRECTIVES FOR NEW YORK CITY

Accounting Systems Directive No. 1

BUDGETARY PRACTICES

1. Budgetary accounts shall be maintained in each fund for which a budget is required to be adopted. Separate general ledger accounts should be used for recording actual revenues and expenditures or accruals thereof.

2. In estimating revenues for budgetary purposes, the revenues must be both measurable and available within the budgeted fiscal year. To be "measurable" the estimated revenues should be ascertainable with a reasonable degree or precision. To be "available" means, generally, that the revenues would be available in cash to finance operations during the year.

3. An exception to the foregoing is estimated revenue from State and Federal categorical aid grants, 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.
OPERATING ACCOUNTS IN GENERAL AND SPECIAL REVENUE FUNDS

General Principle for Recognizing Revenues

The previously described budgetary practices are equally applicable to the recording of actual revenues. Revenues should be recognized in the books of account only to the extent they are measurable and available.

State and Federal Categorical Grants

1. Revenues from State and Federal categorical grants which are directly related to eligible expenditures may be recognized as the expenditures are incurred, if the budget is prepared on that basis. In this event, a receivable should be established for the amount not yet collected. Amounts received in advance of expenditures should be treated as deferred revenues until the related expenditure is incurred.

2. 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:
   (a) expenditures are not allowable by law or regulation; (b) expenditures exceed the dollar amount of available grants; (c) claimed expenditures are disallowed upon audit; and (d) past experience indicates that claimed expenditures will be disallowed upon audit.

3. 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.
STATE OF NEW YORK
DEPARTMENT OF AUDIT AND CONTROL
DIVISION OF AUDITS AND ACCOUNTS

ACCOUNTING SYSTEMS DIRECTIVES FOR NEW YORK CITY

Revised Accounting Systems Directive No. 2

BUDGETARY PRACTICES

Real Property Tax Revenues

The New York City Charter requires the City's annual operating 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 which 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 trend of real property taxes actually collected over the preceding five years, after giving consideration to such factors as assessed valuation changes and rate changes.
Real Property Tax Revenues

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 equal amount in an account titled "Reserve for Uncollected Taxes."

As collections of property taxes are received monthly, a month-end adjustment of the above receivable and offsetting reserve 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.
Budgetary Practices

The New York City Charter requires the City's annual operating 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 assessed valuation changes and rate changes.
Operating Accounts in General Fund

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.
The balance in the Reserve for Uncollectible Taxes would, at all times, represent the amount estimated to not be collected at all from the original tax levy recorded on the books. All writeoffs of uncollectible taxes should be charged to the latter reserve.
Accounting Systems Directive No. 3

ACCOUNTING AND BUDGETARY PRACTICES

General Fund Accounts

A General Fund "fund balance" account should be established to record the results of the City's expense budget annually. As stated in the State Comptroller's Uniform System of Accounts for Cities, "The balance of this account is the net result of all City operations. A credit balance indicates revenues in excess of expenses. A debit balance indicates expenses in excess of revenues."

Special Accounts and Miscellaneous Revenue Accounts Funds

1. The Special Accounts and Miscellaneous Revenue Accounts, as currently constituted, should be eliminated. The balances in the approximately 700 individual accounts making up these two funds should be analyzed and classified among the specific funds shown in the State Comptroller's Uniform System of Accounts for Cities. Following are examples of the necessary changes:

   . Expense budget deficits or surpluses should be recorded in the General Fund "fund balance" account.

   . Loans or advances made to others should be recorded as a receivable of the Fund making such loan or advance.

   . Loans or advances received from others should be shown as a liability of the Fund receiving such loan or advance.

   . Monies held in an Agency or trust capacity should be separately accounted for within one or more trust and agency funds.

   . Revenues and expenditures of prior years should be recorded in the General Fund "fund balance" account.

2. True "Miscellaneous Revenues" should be estimated each year and budgeted as part of General Fund Revenues. The full amount of actual Miscellaneous Revenues should be recorded as General Fund revenues for the year in which the revenues are received.
STATE OF NEW YORK
DEPARTMENT OF AUDIT AND CONTROL
DIVISION OF AUDITS AND ACCOUNTS

ACCOUNTING SYSTEMS DIRECTIVES FOR NEW YORK CITY

Accounting Systems Directive No. 4

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 upon circumstances, borrowings may be used to finance all projects that can be clearly defined as capital in nature.

This directive is designed to provide 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 is also designed to establish 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, at the same time being compatible with the phase-out financing program authorized in the MAC legislation. This directive is intended, however, to cover only capital outlays to be budgeted and
accounted for in the City's capital projects fund and general fund.

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 will consist of:

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

2. 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 defined as "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, Page 43.
The City Charter states that "the term '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 serv' be reasonable in the light of that which would be charg 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 project 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. Upon adoption it shall cover such period of time as is required to complete all capital projects included therein.
Those capital outlays which meet the definition of a "capital project" should be budgeted and accounted for in a capital projects fund. As previously stated, such capital expenditures would include the acquisition or construction cost of land, buildings, and major improvements other than buildings. Machinery and related equipment would be included only when such costs represented an initial outfitting of a capital project, or consisted of major equipment with a unit cost of $15,000 or more and a useful economic life of at least five years, as heretofore defined.

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 to 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 whose 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 budget. 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. 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 financed by borrowing or from current revenues are matters of City financing policy and legal directives, not accounting principles or budgetary practices. Regardless of the method of financing they should nonetheless be budgeted and accounted for in the appropriate fund, based on generally accepted accounting principles, as set forth heretofore.

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. Proceeds from sale of bonds or other long-term debt would be recorded in a revenue account entitled "Proceeds from sale of bonds (or other appropriate form of long-term debt)" in the general fund until such time as the phase-out financing program is completed.

The fact that equipment or machinery is estimated to last more than a specified number of years or cost more than a specified amount are criteria for such items being included in the general fixed assets group of accounts but normally not for purposes of capital projects budgeting and accounting.
STATE OF NEW YORK
DEPARTMENT OF AUDIT AND CONTROL
DIVISION OF AUDITS AND ACCOUNTS

Accounting Systems Directive for New York City

Accounting Systems Directive No. 5

Adoption of Fund Accounting

Introduction

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:

1. 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 basically benefit all of the taxpayers or citizens as a whole. Generally, such activities are financed by revenues collected from the broad general public;

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

3. **Debt Service Funds** to account for the payment of interest and principal on long-term debt other than revenue or general obligation bonds intended to be repaid from earnings or other resources of enterprise funds;

4. **Capital Projects Funds** to account for resources used for the acquisition of capital facilities, as defined in Accounting Systems Directive No. 4, for general City purposes (other than those in enterprise, intragovernmental service, special assessment, and certain trust funds);

5. **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;

6. **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;

7. **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;
8. 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:

1. 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.

2. 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 upon an analysis of existing financial transactions of the City, generally as classified in the City Comptroller's Annual Report for fiscal year 1974-75 (Annual Report), the funds set forth below are prescribed for adoption by New York City on or before July 1, 1977. (These determinations are subject to future changes based on consultation and discussion with the State Comptroller's Office.) The types of existing funds or elements thereof that would be incorporated into each proposed new fund are delineated under each separate fund caption, as follows:
General Fund

1. Present 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")

2. Property Tax Revenues

3. 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 under (1) above. 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 enterprise fund.

4. **Miscellaneous revenue accounts**, as now so classified, 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 accumulated in prior years in these accounts. To the extent such expenditures qualify as true general fund expenditures, they would, of course, be made direct 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.

5. **Special accounts**, as presently 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.

6. **Expense budget**, as categorized and reflected in the City Comptroller's annual report, excluding those revenues and expenditures and other proprietary financial transactions designated elsewhere in this directive to be accounted for in other types of funds. Major expenditures in such excluded category included in the present expense budget are summarized as follows:
<table>
<thead>
<tr>
<th>Budget No.</th>
<th>Department</th>
<th>Function or Activity</th>
<th>Code No.</th>
</tr>
</thead>
<tbody>
<tr>
<td>40</td>
<td>Board of Education</td>
<td>Debt Service</td>
<td>0090-810</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>0090-850</td>
</tr>
<tr>
<td>68</td>
<td>NYC Health and Hospitals Corporation</td>
<td>various</td>
<td>various</td>
</tr>
<tr>
<td>99</td>
<td>Debt Service</td>
<td>&quot;</td>
<td>&quot;</td>
</tr>
<tr>
<td>856</td>
<td>Municipal Services Adm.</td>
<td>&quot;</td>
<td>&quot;</td>
</tr>
<tr>
<td>806</td>
<td>Housing and Development Adm.</td>
<td>&quot;</td>
<td>&quot;</td>
</tr>
<tr>
<td>826</td>
<td>Environmental Protection Adm. Water Pollution Control</td>
<td>&quot;</td>
<td>0801-001</td>
</tr>
<tr>
<td></td>
<td>Water Supply</td>
<td>&quot;</td>
<td>0901-001</td>
</tr>
<tr>
<td></td>
<td>Water Register</td>
<td>&quot;</td>
<td>1001-001</td>
</tr>
<tr>
<td></td>
<td>Water Supply</td>
<td>&quot;</td>
<td>0000-variant</td>
</tr>
<tr>
<td></td>
<td>Sewage</td>
<td>&quot;</td>
<td>0093-variant</td>
</tr>
</tbody>
</table>

7. **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. These types of expenditures are represented generally in appendix B of the annual report.

8. **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 annual report, should be closed into the fund balance account of the general fund at the point of its formal inception.

9. **Residue equity in special assessment funds,** consisting of past due assessments receivable. Advances have been made by the general fund in prior years to meet scheduled bond payments which have now been completed. The proceeds from collection of the assessments receivable would otherwise have been used to repay the general fund.
10. 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.

**Special Revenue Funds**

Based on an analysis of existing accounts and financial transactions of the City, there appears to be no immediate need to establish any special revenue funds. There is a substantial number of restricted revenues of a general fund nature, but all of these can be appropriately accounted for in the general fund, as separately described.

**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 in the general fund, as heretofore. In the interest of simplicity, the minimum number of separate funds permitted under the applicable bond resolutions should be established. General obligation bonds outstanding at June 30, 1975, classified by purpose for which issued, appear on pages 462-3 of the City Comptroller's annual report. A review of the related bond resolutions would be requisite to a final decision as to 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 is a management decision as to whether these bonds should be repaid out of the earnings of the water and sewer systems (when an enterprise fund is established as contemplated) or from property taxes or other designated revenue
sources of the City. If the former were decided upon, 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. If the latter were decided upon, the debt repayments and interest would be made from appropriately established debt service funds.

While it is preferable to allocate common revenues between the general and debt service funds for the purpose of providing a direct financing source for annual debt service, a permissible accounting alternative would be to credit all such revenue direct to the general fund and appropriate for transfer to the debt service fund on amount equal thereto in each annual budget of the general fund.

**Capital Projects Fund**

All expenditures for qualified capital projects, as defined in Accounting Systems Directive No. 4, 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.

Accordingly, 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 meet the criteria of an enterprise fund. It is therefore recommended that a separate enterprise fund for each of these operations be formally established as of July 1, 1977. 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, as now reported in the City Comptroller's annual report. Since this entity is included in the list of public benefit corporations appearing on page 12 of this directive, 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 in such report.

In addition, Housing and Development Administration revenues now included in supplementary revenues and expenditures of that department which respectively 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, including its mortgages and other receivables and its
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, including gas and oil, etc.

**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 further 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 of the City.

**Special Assessment Funds**

In view of the present and contemplated future inactivity in creation of special improvement districts there is no immediate need to establish any special assessment funds.

**Account Groups**

There should also be established two account groups, for the purposes previously described, as follows:

- **General Fixed Assets**
- **General Long-Term Debt**
Modification of Implementation Schedule

Recognition is 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 budgetary procedures and practices so as to permit the City to prepare financial statements that present financial positions 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.

To accomplish the foregoing 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 starting to be developed. In particular, 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, it is recommended that every effort be made to enable the City to make the transition to full fund accounting on or before July 1, 1977. In pursuing this undertaking, however, priority should be given to the research required to establish asset values as of July 1, 1977 first, for enterprise funds, and, secondly, for general fixed assets. If it is determined by the City
that it cannot meet this date then the City should immediately place under cost control assets currently being acquired and establish a time phased plan for bringing previously acquired fixed assets into the General Fixed Assets Groups of Accounts.

**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 are not currently 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 summary of these authorities and other special funds, identified as to type of fund, is as follows:

<table>
<thead>
<tr>
<th>Name of Entity</th>
<th>Types 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>Enterprise Fund</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</td>
</tr>
<tr>
<td>City University Construction Fund</td>
<td>Capital Projects Fund</td>
</tr>
<tr>
<td>NYC Rehabilitation Mortgage Insurance Corp.</td>
<td>Enterprise Fund</td>
</tr>
<tr>
<td>NYC Industrial Development Agency</td>
<td>Special Revenue Fund</td>
</tr>
</tbody>
</table>
Accounting Rationale for Fund Identifications

The accounting principles upon which the funds listed above have been categorized as to type are as follows:

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 fund, including the two, as 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, 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 capital projects should be accounting 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 financial transactions thereof should be accounted for in a special revenue fund.
ACCOUNTING SYSTEMS DIRECTIVE FOR NEW YORK CITY

Accounting Systems Directive No. 6

Accounting Principles Applicable to Recording and Reporting of Financial Transactions

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 and professional pronouncements by interested governmental organizations and professional accounting bodies that over the years have prescribed such principles for governmental units to adopt and follow in the conduct of their financial operations. Among these professional bodies whose publications and pronouncements constitute generally accepted

¹Governmental Accounting, Auditing and Financial Reporting, page 3
accounting principles applicable to governmental units are the following:

- 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);


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

In the interest of simplicity of presentation, the accounting principles hereinafter set forth include 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 are delineated in logical sequence as follows:

Fund Accounting

The application of fund accounting to the financial transactions of the City and the individual funds recommended to be established on or before July 1, 1977 were outlined in detail in Accounting Systems Directive No. 5, now incorporated herein by reference.

With respect to the detailed principles which 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 directive.

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 are set forth in the following paragraphs:

1. 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. An example would be
a contribution in lieu of property taxes to the city's general fund from an enterprise fund, such as its water utility fund. Other examples include 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.

2. 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.

3. The third category is comprised of recurring transfers between two or more budgetary funds for the purpose of shifting resources from the fund legally
required to receive the revenue to the fund authorized to expend the revenue, which should be segregated from normal revenues or expenditures. The statutes or City Charter may not permit a direct allocation of a revenue source between two funds. Accordingly, it is necessary to have an annual transfer from the fund legally required to receive the revenue to a fund authorized to expend all or some portion of the revenue. An example might be an annual transfer from the City's general fund to its debt service funds. Such transfers would not represent true revenues and expenditures of the respective funds. However, the total transfers received and the total transfers disbursed should be included as separate items in each fund's statement of revenues and expenditures or equivalent financial statement.

4. The last 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 would 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 (a)
to show that all applicable legal provisions have been complied
with; and (b) 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.

In application 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><strong>1. City Charter</strong></td>
<td></td>
</tr>
<tr>
<td>a. Tax deficiency account (Sec. 127a.)</td>
<td>Reserve Account in General Fund</td>
</tr>
<tr>
<td>b. Tax appropriation and general fund</td>
<td>&quot;</td>
</tr>
<tr>
<td>stabilization reserve fund (Sec. 128a.)</td>
<td>Revenue Account in General Fund</td>
</tr>
<tr>
<td>c. Real property fund (Sec. 250)</td>
<td>Fund Balance Account in General Fund</td>
</tr>
<tr>
<td>d. Assessable improvement funds (Sec. 300)</td>
<td>Revenue and Expenditure Accounts in General Fund</td>
</tr>
<tr>
<td>(in liquidation; all bonds retired)</td>
<td></td>
</tr>
<tr>
<td>e. Traffic improvement fund (Sec. 2103.1.m)</td>
<td></td>
</tr>
<tr>
<td><strong>2. General Municipal Law</strong></td>
<td></td>
</tr>
<tr>
<td>a. Tax stabilization reserve fund (Sec. 6-c.)</td>
<td>Reserve Account in General Fund</td>
</tr>
<tr>
<td>b. Workmen's compensation reserve fund (Sec.</td>
<td>Not currently active</td>
</tr>
<tr>
<td>6-j.)</td>
<td></td>
</tr>
<tr>
<td>c. Reserve fund for proceeds of sale of</td>
<td>Reserve Account in applicable debt</td>
</tr>
<tr>
<td>improvements on which there is outstanding</td>
<td>service fund</td>
</tr>
<tr>
<td>indebtedness (Sec. 6-l.)</td>
<td></td>
</tr>
<tr>
<td><strong>3. Local Finance Law</strong></td>
<td></td>
</tr>
<tr>
<td>a. Special bank account for tax assessment</td>
<td>Restricted cashaccount in General Fund</td>
</tr>
<tr>
<td>revenues against which TANS have been</td>
<td>&quot;</td>
</tr>
<tr>
<td>issued, when amount of TANS issued equals</td>
<td>&quot;</td>
</tr>
<tr>
<td>anticipated revenue (Sec. 24.00)</td>
<td></td>
</tr>
<tr>
<td>b. Special bank account for revenues against</td>
<td></td>
</tr>
<tr>
<td>which TANS have been issued, when amount</td>
<td></td>
</tr>
<tr>
<td>of TANS issued equals anticipated revenue</td>
<td></td>
</tr>
<tr>
<td>(Sec. 25.00)</td>
<td></td>
</tr>
<tr>
<td>c. Special fund for revenues from an</td>
<td>Enterprise Fund</td>
</tr>
<tr>
<td>enterprise whose debt is excluded in</td>
<td></td>
</tr>
<tr>
<td>computing debt limit (Sec. 133.00 and 124.10)</td>
<td></td>
</tr>
<tr>
<td><strong>4. Education Law</strong></td>
<td></td>
</tr>
<tr>
<td>a. Public library fund (Sec. 255)</td>
<td>Not applicable to City</td>
</tr>
</tbody>
</table>
Source

5. Social Services Law

a. Separate account for funds received as guardians of a minor (Sec. 87.3) Trust and Agency Fund

6. MAC Act

a. Moneys MAC pays to City for debt service Various accounts or operating expenses shall be held in trust for the specified purpose (Sec. 3037)

in general fund and debt service fund; memorandum entries in general long-term debt group of accounts (please refer also to ASD 47)

While the recommendations set forth above will assure accountability, it would be desirable for the City to obtain an opinion from Corporation Counsel as to legal compliance.
However, this 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. Therefore, authoritative literature now 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, with respect to recording and reporting on financial transactions for the City, the following guidelines are applicable: If a given transaction is required to be recorded in a manner which would be in conflict with generally accepted accounting principles for financial reporting purposes, it must nevertheless be recorded in compliance with the applicable legal requirement. At fiscal year-end, in the process of closing the books and preparation of 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 under the caption of "Financial Reporting" for further guidance in reporting on matters relating to compliance with legal requirements.

**Base of Accounting**

The basis of accounting upon 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, namely, the accrual basis and modified accrual basis. Each of these bases is separately defined as follows:

**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

**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." ²

¹Governmental Accounting, Auditing and Financial Reporting, page 152
²MSA, page 164
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 Utility Fund
      b. Sewer Fund
      c. Mitchell Loan 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, in which instance 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 sales taxes, income taxes, or gross receipts taxes. There are certain technical exceptions to use of 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.

Apart from the limited exceptions noted above, all revenues and expenditures (or expenses) in the other funds should be recorded strictly on the accrual basis, as previously defined.
In application of the accrual method to accounting for expenditures in a capital projects fund, it is incompatible therewith to encumber total contract commitments or portions thereof representing work completed or uncompleted. 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 the common practice for such billings 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 (inventive)
   (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. Other than as described in ASD No. 1, dealing with Federal and State aid, there ordinarily 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 is as follows:

1. Revenues shall be recorded as received in cash except for (a) revenues susceptible to accrual, and (b) 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.

   a. Revenues susceptible to accrual. Generally revenues shall be recorded on the accrual basis only if they are susceptible to accrual. Being susceptible to accrual implies more than being receivable. Revenues considered susceptible to accrual are those revenues that are both receivable 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, which are requisite to being considered susceptible to accrual.

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 tax, inclusive of amounts expected to be retained by NYC, 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 as of the time refund claims are filed with the City. Under generally accepted accounting principles, the revenues in the City's proposed budgetary funds that are considered susceptible to accrual are set forth below. All other revenues in these funds are not considered susceptible to accrual and therefore should be recorded as collected.

<table>
<thead>
<tr>
<th>Source of Revenue</th>
<th>Explanation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Sales Taxes</td>
<td>See explanation below.</td>
</tr>
<tr>
<td>2. State and Federal categorical grants</td>
<td>Subject to the provisions of Accounting Systems Directive No.1</td>
</tr>
<tr>
<td>3. Interest on Investments</td>
<td></td>
</tr>
</tbody>
</table>

Source of Revenue

1. Sales Taxes
2. State and Federal categorical grants
3. Interest on Investments
The calendar for remittance to political subdivisions from quarterly remitters of sales tax collected by New York State/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 95% of their respective shares. The balance is remitted normally 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 normally received by June 28 would be accruable as of June 30 if not received by year-end. The amount normally received by July 12 would also be accruable. All delinquent sales tax received by the State through July 31 in delinquent remittances from merchants for the quarter ended May 31 or prior periods may be accruable provided the total thereof can be identified and the City notified in writing by August 31 each year.
In addition to quarterly remittances of State-collected sales tax, as described above, the State Department of Taxation and Finance will begin effective March 1, 1976 to require the filing of a monthly sales tax return by every vendor having taxable receipts, amusement charges and rents of $300,000 or more in the quarter ended May 31, 1975, August 31, 1975, November 30, 1975 or February 29, 1976. The March return is due on or before April 25, 1976 and each subsequent monthly return shall be filed within fifteen days after the close of each month. Thus, the return from each vendor for the month of June in each year thereafter shall be filed on or before July 20 each year. It is assumed a remittance to the City from such returns will be made by August 15 each year.

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 tax remittances made by vendors that are in the hands of the State collection and distributing agency on or before June 30 each year would be allowable by a 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 due June 30. They would, however, normally be distributed to the City for time to be used in payment of
obligations incurred during each fiscal year ending June 30.

In order to be consistent with accrual procedures, 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 each agency by July 15 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 entertainment purposes is the subject of a separate Accounting System Directive.
b. Revenue 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. For example, if material utility revenues
should have been received prior to the year-end but are delayed
until after the year-end, the amount should be accrued.

Material revenues received prior to normal
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.

Property Taxes Collected in Advance

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."

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.

Appendix

2. Expense and Revenues in Simplified Form:

<table>
<thead>
<tr>
<th>Item Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales Revenue</td>
<td>$1000</td>
</tr>
<tr>
<td>Operating Costs</td>
<td>$500</td>
</tr>
<tr>
<td>Net Income</td>
<td>$500</td>
</tr>
</tbody>
</table>
a. Disbursements for inventory type items may be considered as expenditures at the time of purchase or at the time the items are used.

b. 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 normally are carried as a receivable from the person to whom advanced until settlement is made by way of an expense report and return of unused cash, if any.
c. Interest on long-term debt, to be accounted for in formally established debt service funds, should be recorded as an expenditure on its due date. Accrual of interest expense to the yearend from the due date of the latest interest installment on the City’s long-term and other general long-term debt is not required under generally accepted accounting principles.

d. The encumbrance method of accounting for expenditures for benefit funds is recommended to be adopted in the City’s general fund, representing 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. Outstanding encumbrances in excess of the commitments and the related obligations in each departmental or other expenditure account should be recorded.
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 executed contract but to not consider 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 recorded 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 sources of funds required.
Legal Requirements

The City's Home Rule 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, it can be noted provide for the adoption of a single executive (expense) budget for the City on or before June 30 of each year for the ensuing fiscal year beginning on July 1 of that year.

Indicating the Full Year

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 by:

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

Normally, 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 (those 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>As specified in Charter</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Fund</td>
<td>Annual</td>
<td>As specified in Charter</td>
</tr>
<tr>
<td>Debt Service Funds</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>
<tr>
<td>Enterprise Funds:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Water Utility Fund</td>
<td>Annual</td>
<td>Management budget, in memorandum form</td>
</tr>
<tr>
<td>Sewer Fund</td>
<td>Annual</td>
<td>Management budget, in memorandum form</td>
</tr>
<tr>
<td>Mitchell Area Housing and Municipal Loan Programs</td>
<td>Annual</td>
<td>Management budget, in memorandum form</td>
</tr>
<tr>
<td>Intergovernmental Service Fund:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Municipal Services Administration</td>
<td>Annual</td>
<td>Management budget, in memorandum form</td>
</tr>
</tbody>
</table>

**Budgetary Control**

It is assumed that the structure of the general fund budget will be aligned with the accounting and will follow organizational lines, based on department, agency, function, activity, and sub-activity levels, in order 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, subsidiary
appropriation ledgers to control expenditure comparisons should,
as a minimum, 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 other 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, is
as 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 Utility Fund, Sewer Fund, and the
Public Improvement and other Districts funds, are classified as
Fixed assets.
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 current 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, contributions must be considered in determining amounts from which the accounts and those which constitute contribution of fund capital. Examples
of the latter applicable to the City's Water Utility or Sewer funds 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 finance such accounts 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 Fund and the 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. The accounting treatment for such assets is set forth under the caption below.

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: (1) tangible assets; (2) useful; lasting longer than one year; and (3) 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, if the original cost is not available, 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 nature, 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.

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 the financial statements in a timely manner and inclusion of the financial statement component of the General Revenue Fund is a valuable step in better informing the public of the financial status of the City.
principles is emphasized.

Financial Statements Required in City Comptroller's Annual Report Effective for the Year Ended June 30, 1978

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 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 summary of the financial statements expected to be required of the City, based on the fund structure proposed and the applicable accounting principles enumerated in this directive, is set forth below.

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

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

Capital Projects Fund

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

Enterprise Funds (Water Utility, Sewers, and Mitchell Lame Housing and Redevelopment Fund Funds)

- Balance Sheet
- Statement of Revenues and Expenses
- Statement of Changes in Fund Balance
- Statement of Changes in Financial Position
Intragovernmental Service Fund (Municipal Services Administration fund):

Balance Sheet
Statement of Operations
Statement of Changes in Retained Earnings

Depot and Livery Funds:

Balance Sheet
Statement of Changes in Fund Balance(s)

Accrued Costs:

Statement of General Fixed Assets
Statement of General Liabilities

Reporting Boundary Comparisons

For financial reporting purposes generally accepted accounting principles require that the statement of revenues and expenditures of the General fund and certain special revenue funds (for which none are presently contemplated for New York City) include a comparison with a formal budget. Despite these minimum requirements, it is recommended that, after implementation of the proposed new fund structure of the City, 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. However, if the individual fund statements are not needed, and 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, homogenous funds within the same type may be consolidated in a single balance sheet; however, it is not appropriate to consolidate funds of different types or to consolidate account groups. Homogenous funds are funds of like nature and purpose. For example, the balance sheets of all of the City's debt service funds could be consolidated into a single balance sheet for presentation in conformity with generally accepted accounting principles. A consolidation of this sort may provide 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 individual 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 Required**

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 accounts 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, as follows:

"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 qualification 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 cannot be presented in a separate schedule. In such situations, the separate schedules should be incorporated into the basic financial statements by reference either in the text of the statements or in a related footnote.
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.
Accounting Principles Applicable to Recording and Reporting of Financial Transactions

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 and professional pronouncements by interested governmental organizations and professional accounting bodies that over the years have prescribed such principles for governmental units to adopt and follow in the conduct of their financial operations. Among these professional bodies whose publications and pronouncements constitute generally accepted

¹ Governmental Accounting, Auditing and Financial Reporting, page 3
accounting principles applicable to governmental units are the following:

- 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);


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

In the interest of simplicity of presentation, the accounting principles hereinafter set forth include 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 are delineated in logical sequence as follows:

Fund Accounting

The application of fund accounting to the financial transactions of the City and the individual funds recommended to be established on or before July 1, 1977 were outlined in detail in Accounting Systems Directive No. 5, now incorporated herein by reference.

With respect to the detailed principles which 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 directive.

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 are set forth in the following paragraphs:

1. 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. An example would be
a contribution in lieu of property taxes to the City's general fund from an enterprise fund, such as its water utility fund. Other examples include 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.

2. 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.

3. The third category is comprised of recurring transfers between two or more budgetary funds for the purpose of shifting resources from the fund legally
required to receive the revenue to the fund authorized to expend the revenue, which should be segregated from normal revenues or expenditures. The statutes or City Charter may not permit a direct allocation of a revenue source between two funds. Accordingly, it is necessary to have an annual transfer from the fund legally required to receive the revenue to a fund authorized to expend all or some portion of the revenue. An example might be an annual transfer from the City's general fund to its debt service funds. Such transfers would not represent true revenues and expenditures of the respective funds. However, the total transfers received and the total transfers disbursed should be included as separate items in each fund's statement of revenues and expenditures or equivalent financial statement.

4. The last 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 would 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 (a)
to show that all applicable legal provisions have been complied
with; and (b) 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.

In application 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>1. City Charter</td>
<td></td>
</tr>
<tr>
<td>a. Tax deficiency account (Sec. 127a.)</td>
<td>Reserve Account in General Fund</td>
</tr>
<tr>
<td>b. Tax appropriation and general fund stabilization reserve fund (Sec. 128a.)</td>
<td>&quot; &quot;</td>
</tr>
<tr>
<td>c. Real property fund (Sec. 251)</td>
<td>Revenue Account in General Fund</td>
</tr>
<tr>
<td>d. Assessable improvement funds (Sec. 300) (in liquidation; all bonds retired)</td>
<td>Fund Balance Account in General Fund</td>
</tr>
<tr>
<td>e. Traffic improvement fund (Sec. 2103.1.m)</td>
<td>Revenue and Expenditure Accounts in General Fund</td>
</tr>
<tr>
<td>2. General Municipal Law</td>
<td></td>
</tr>
<tr>
<td>a. Tax stabilization reserve fund (Sec. 6-e.)</td>
<td>Reserve Account in General Fund</td>
</tr>
<tr>
<td>b. Workmen's compensation reserve fund (Sec. 6-j.)</td>
<td>Not currently active</td>
</tr>
<tr>
<td>c. Reserve fund for proceeds of sale of capital improvements on which there is outstanding indebtedness (Sec. 6-1.)</td>
<td>Reserve Account in applicable debt service fund</td>
</tr>
<tr>
<td>3. Local Finance Law</td>
<td></td>
</tr>
<tr>
<td>a. 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>
<tr>
<td>b. Special bank account for revenues against which RANs have been issued, when amount of RANs issued equals anticipated revenue (Sec. 25.00)</td>
<td>&quot; &quot;</td>
</tr>
<tr>
<td>c. Special fund for revenues from an enterprise whose debt is excluded in computing debt limit (Sec. 123.00 and 124.10)</td>
<td>Enterprise Fund</td>
</tr>
<tr>
<td>4. Education Law</td>
<td></td>
</tr>
<tr>
<td>a. Public library fund (Sec. 259)</td>
<td>Not applicable to City</td>
</tr>
</tbody>
</table>
5. Social Services Law
   a. Separate account for funds received as guardians of a minor (Sec. 87.3)  
      | Trust and Agency Fund  

6. MAC Act
   a. Moneys MAC pays to City for debt service Various accounts or operating expenses shall be held in trust for the specified purpose (S-c. 3037)  
      | in general fund and debt service fund; memorandum entries in general long-term debt group of accounts

While the recommendations set forth above will assure accountability, it would be desirable for the City to obtain an opinion from Corporation Counsel as to legal compliance.
However, this 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. Therefore, authoritative literature now 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, with respect to recording and reporting on financial transactions for the City, the following guidelines are applicable: If a given transaction is required to be recorded in a manner which would be in conflict with generally accepted accounting principles for financial reporting purposes, it must nevertheless be recorded in compliance with the applicable legal requirement. At fiscal year-end, in the process of closing the books and preparation of 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 under the caption of "Financial Reporting" for further guidance in reporting on matters relating to compliance with legal requirements.

**Base of Accounting**

The basis of accounting upon 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, namely, the accrual basis and modified accrual basis. Each of these bases is separately defined as follows:

**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

**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." ²

¹Governmental Accounting, Auditing and Financial Reporting, page 151
²Ibid, page 164
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 Utility Fund
          b. Sewer Fund
          c. 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; in which instance 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 therefore, such as sales taxes, income taxes, or gross receipts taxes. There are certain technical exceptions to use of 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.

Apart from the limited exceptions noted above, all revenues and expenditures (or expenses) in the above funds should be recorded strictly on the accrual basis, as previously defined.
In application of the accrual method to accounting for expenditures in a capital projects fund, it is incompatible therewith to encumber total contract commitments or portions thereof representing work completed or uncompleted. 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 the common practice for such billings 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. Other than as described in ASD No. 1, dealing with Federal and State aid, there ordinarily 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 is as follows:

1. Revenues shall be recorded as received in cash except for (a) revenues susceptible to accrual, and (b) 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.

   a. Revenues susceptible to accrual. Generally revenues shall be recorded on the accrual basis only if they are susceptible to accrual. Being susceptible to accrual implies more than being measurable. 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 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, which are requisite to being considered susceptible to accrual.

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 tax, 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 as of the time refund claims are filed with the City. Under generally accepted accounting principles, the revenues in the City's proposed budgetary funds that are considered susceptible to accrual are set forth below. All other revenues in these funds are not considered susceptible to accrual and therefore should be recorded as collected.

<table>
<thead>
<tr>
<th>Source of Revenue</th>
<th>Explanation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Sales Taxes</td>
<td>Subject to the provisions of Accounting Systems Directive No.1</td>
</tr>
<tr>
<td>2. State and Federal categorical grants</td>
<td></td>
</tr>
<tr>
<td>3. Interest on investments</td>
<td></td>
</tr>
</tbody>
</table>
The calendar for remittance to political subdivisions for quarterly remitters of sales tax collected by New York State 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% of their respective shares. The balance is remitted normally 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 normally received by June 28 would be accruable as of June 30 if not received by year-end. The amount normally received by July 12 would also be accruable. All delinquent sales tax received by the State through July 31 in delinquent remittances from merchants for the quarter ended May 31 or prior periods may be accrued provided the total thereof can be identified and the City notified in writing by August 31 each year.
In addition to quarterly remittances of State-collected sales tax, as described above, the State Department of Taxation and Finance will begin effective March 1, 1976 to require the following:

of

1. The filing/a monthly sales and use tax return by every vendor having taxable receipts, amusement charges and rents of $300,000 or more in the quarter ended May 31, 1975, August 31, 1975, November 30, 1975, or February 29, 1976. The March return is due on or before April 15, 1976 and each subsequent monthly return shall be filed within fifteen days after the close of each month. Thus, the returns from such merchants for the month of June in each year thereafter shall be filed on or before July 15, each year.

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.

2. The filing of an estimated monthly sales and use tax return by every vendor having total taxable receipts, amusement charges and rents of $300,000 or more for the quarter ended November 30, 1975. In the initial return total sales and use taxes estimated to be payable for March 1976 must be reported and paid on or before March 20, 1976. To avoid penalty and interest charges on underpayment, at least 90% of the actual tax liability for March must be remitted with the timely filed estimated return.
Any difference between the estimated tax paid and the actual tax due for the month of March must be reported and paid in the regular monthly return due April 15, 1976. Similar adjustments for differences in amounts due and paid in successive months shall be reflected in the regular monthly returns to be filed on or before the 15th of each month. Thus, the adjustment for any amounts due but not paid in the monthly estimated returns for the month of June of each year should be included in the regular returns for each month to be filed on or before July 15 each year.

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 a City whose fiscal year ended June 30. This would clearly permit New York City to accrue sales and use taxes included in monthly estimated returns fixed by vendors with the State Department of Taxation and Finance by June 20 each year. It is assumed a remittance to the City from such returns will be made during the month of July each year.

While technically the deficiency payments in such estimated returns by vendors for the month of June each year will not be in the hands of the State until after June 30 each year, such amounts are construed to be adjustments to the said estimated payments and essentially a part of the sales and use taxes for the month of June each year. Accordingly, it has been concluded that the full amount of applicable sales and use taxes remitted by vendors (required to file monthly regular and estimated returns) in their regular returns to the State on or before July 15 each
year would be accruable by the City as of June 30 each year. It is assumed such amounts will be remitted to the City on or before July 31 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.
b. 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. For example, if material property tax revenues should have been received prior to the year-end but are delayed until after the year-end, the amount should be accrued.

Material revenues received prior to normal 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.

Property Taxes Collected in Advance

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."

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.

Expenditures

2. Expenditures in budgetary funds are recorded on the accrual basis, except in the instances discussed below:
a. Disbursements for inventory type items may be considered as expenditures at the time of purchase or at the time the items are used.

b. 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 normally are carried as a receivable from the person to whom advanced until settlement is made by way of an expense report and return of unused cash, if any.
c. Interest on long-term debt, to be 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.

d. The encumbrance method of accounting for expenditures for budgetary funds is recommended to be adopted in the City's general fund, representing 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. 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 executed contract but to 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 recorded 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 Home Rule 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:

1) segregated by appropriate funds upon adoption, or
2) adopted initially in the form of a budget for each of the respective funds.

Normally, the second course would be followed. Therefore, subject to appropriate legal approval, it is recommended that a budget be adopted for each of the following funds (those funds prescribed for 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>Type 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</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>
<tr>
<td><strong>Enterprise Funds:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Water Utility Fund</td>
<td>Annual</td>
<td>Management budget, in memorandum form</td>
</tr>
<tr>
<td>Sewer Fund</td>
<td>Annual</td>
<td>Management budget, in memorandum form</td>
</tr>
<tr>
<td>Mitchell Lama Housing and Municipal Loan Programs</td>
<td>Annual</td>
<td>Management budget, in memorandum form</td>
</tr>
<tr>
<td><strong>Intragovernmental Service Fund:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Municipal Services Administration</td>
<td>Annual</td>
<td>Management budget, in memorandum form</td>
</tr>
</tbody>
</table>

For enterprise and intragovernmental service funds, preparation of a management budget in memorandum form is recommended, in lieu of a formal rigidly controlled type of budget applicable to the City's general fund. An explanation of and rationale for use of such type of budget for enterprise funds is well stated in the excerpt below from "Governmental Accounting, Auditing, and Financial Reporting," (GAAFR) page 51. This budgetary approach is also considered appropriate for application to intragovernmental service funds.
"While the preparation and adoption of a comprehensive budget is essential for good management, this does not mean that the same degree of budgetary control must be exercised in executing an enterprise budget, or that there be a formal system of budgetary accounting such as that required for the General and Special Revenue Funds. On the contrary, since a utility or other enterprise is a self-supporting operation of a commercial nature, its expenditures should not be controlled by means of detailed and rigid appropriations. These expenditures will vary with the timing and level of demand for service, and if rigidly controlled may delay necessary expansion of activities or impede satisfactory performance. In the interests of managerial flexibility and practicality, therefore, it is recommended that no formal system of budgetary accounting and control be employed for enterprise funds, but that, instead, the budgetary estimates upon which the legally adopted budget is based be retained in memorandum form and utilized in the preparation of comparative operating statements." Examples of such statements are to be found in Chapter VI, pages 65 and 67 of GAAFR.

**Budgetary Control**

It is assumed that the structure of the general fund budget will follow organizational lines, based on department, agency, function, activity, and sub-activity levels, in order to achieve budget control through individuals with administrative responsibility at those organizational levels. If desired, of course, program budgeting can be continued to the extent now followed or expanded by simply including program cost codes in the general fund expenditure account codes planned for 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, subsidiary appropriation ledgers to control expenditure comparisons should, as a minimum, 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, is as follows:

**Enterprise, Intragovermental 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 Utility fund, Sewer fund, and its Municipal Services Administration 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 current 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 Utility or Sewer funds 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 Fund and the 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. The accounting treatment for such assets is set forth under the caption below.

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: (1) tangible nature; (2) a life lasting longer than one year; and (3) a significant value. The latter is a matter of judgment, based on the size of the City and other relevant circumstances.
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 unmaturred 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.

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 the financial statements by June 30, 1978 in conformity with such
Financial Statements Required in City Comptroller's Annual Report Effective for the Year Ended June 30, 1978

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 summary of the financial statements expected to be required of the City, based on the fund structure proposed and the applicable accounting principles enumerated in this directive, is set forth below.

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

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

Capital Projects Fund

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

Enterprise Funds (Water Utility, Sewer, and Mitchell Lama Housing and Municipal Loan Program Funds)

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

Reporting Budgetary Comparisons

For financial reporting purposes generally accepted accounting principles require that the statement of revenues and expenditures of the General fund and certain special revenue funds (for which none are presently contemplated for New York City) include a comparison with a formal budget. Despite these minimum requirements, it is recommended that, after implementation of the proposed new fund structure of the City, 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 aggregate 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/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 debt service 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, as follows:

"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.
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.
February 27, 1977
(Revised)

STATE OF NEW YORK
DEPARTMENT OF AUDIT AND CONTROL
DIVISION OF AUDITS AND ACCOUNTS

ACCOUNTING SYSTEMS DIRECTIVE FOR NEW YORK CITY

Accounting Systems Directive No. 7

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 capita 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.

The purpose of this directive is to furnish guidance and supporting rationale for specific accounting treatment of a variety
of known and expected types of recurring transactions. Specific examples are delineated later in this document.

Accounting Premises for Reflecting Transactions of MAC on City Records

Some of the financial transactions of MAC will directly involve counterpart transactions with the City, as illustrated in the attachment to this directive. Others will consist of financing or refinancing City note-type debts (which in an accounting sense are usually 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, most financial transactions of MAC 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 current note-type debt. Over the years normal City revenue sources will be preempted by MAC, but only for debt service and related administrative expenses, to repay MAC bonds or forms of MAC debt. 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, under generally accepted accounting principles, fair presentation of the financial position of the various funds and account groups of the City and results of operations of its individual funds, together with the obligation for full disclosure of its debt transactions, 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 9, Section 2) authorizes cities to contract indebtedness for lawful city purposes. Such indebtedness shall not be contracted for 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 the 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) and revenue anticipation notes (RANs). 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 full faith and credit debt.

TANs and RANs have been historically recorded as liabilities in accounts on the City's books that would, under the revised accounting system, be incorporated into its new general fund. BANs would be recorded, under the revised accounting system, as a liability in the Limited Profit Housing and Municipal Loan Programs Fund, Capital Projects, or other constituent fund pending their conversion to funded debt through 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 (a) amortization and redemption of term bonds, sinking fund bonds, and serial bonds, (b) the 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 (c) the 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 after their date of original issue. 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 as aforesaid at the suit of any holder of obligations issued for any such indebtedness.

Interest due at the respective maturity dates of RANs and TANs is currently budgeted for in the City's annual expense budget, separate and apart from interest and principal installments on serial bonds, additions to sinking funds, or redemptions of term bonds. 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 RANs would be budgeted and accounted for as an expense of the fund in which the liability is carried. (1)

Redemption of RANs, RANs and TANs at their respective maturity dates has not historically been provided for in the expense budget of the City. Similarly, under the revised accounting system, redemption of RANs and TANs would not be budgeted in the

(1) Since the City Charter requires the appropriations to be in the "expense budget," such budget would need to be reclassified under the proposed accounting system to the appropriate fund in accordance with ASD No. 5.
general fund; rather, they would be redeemed out of cash collected from the taxes or other receivables on which the borrowings were based. Bonds 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 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 of receipt of such revenue."

In clarification of the foregoing, 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. It should be noted, in support of this view, that Section 39.00 of the Local Finance Law requires the 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. 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, to which reference has previously been made.

Thus, the above sections of the Local Finance Law place a legal limit on the ultimate terms from date of original issue to redemption, including all renewals, of not to exceed five years for tax anticipation notes and three years for revenue anticipation notes. As noted in the preceding excerpts from 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 as follows:

§ 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 tax anticipation notes to five years and revenue anticipation notes 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.

Accordingly, the legal impact of successive renewals beyond five years from date of original issue of such notes would be to subject them to the force of Article 8, Section 2 of the State Constitution and to terminate their tax limit exclusion either because the revenues which formed the basis of their issuance are no longer available for their redemption or have not been received and therefore require such debt to be treated as funded debt. However, it would appear that such change in status would be limited to one year, because of the requirement for redemption in the sixth year.
However, 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 contained a definition of "short-term obligations," which it defined to mean "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 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.

Also, a similar situation may 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**

Obligations of Municipal Assistance Corporation for the City of New York (MAC) 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 3616 of the Public Authorities Law, which provides 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 not payable out of any funds other than those of MAC. A detailed statutory structure has been created which diverts certain revenue sources formerly available to the City for the period during which MAC obligations are outstanding, transfers them to certain State funds, and provides for their payment to MAC, subject to State appropriation, at which point they become funds of MAC, out of which MAC debt and expenses are to be paid.

Even though the bonds or other long-term obligations issued by MAC do not legally come within the City's debt limit and the City has no legal obligation to make any budgetary
appropriations with respect thereto, the practical effect, from an accounting viewpoint, is to eliminate note-type (short-term) debt and to substitute it with 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 City Relating Financing Transactions

Normally, for accounting purposes, New York City note-type debt consists of obligations with maturity dates of one year or less. Funded debt consists of obligations with maturity dates in excess of one year. Under the applicable provisions of the New York State Constitution and the Local Finance Law, tax anticipation notes and revenue anticipation notes, through failure to effect a redemption within five years, become subject to redemption pursuant to the State Constitution and must be treated accordingly for accounting purposes.

Bond anticipation notes comprise a debt category separate and apart from other forms of note-type or funded debt of the City. Basically, BANs represent a form of indebtedness which is within the constitutional debt limit of the City unless they are issued for a purpose which may be specifically excluded in 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 36 of the
State Constitution or related sections of the Local Finance Law.
Housing projects qualifying under this section constitute one
example thereof. Under the Local Finance Law, the term of bond
anticipation notes may not exceed one year and each renewal,
as provided for in the law, may not exceed a term of one year.

Since bond anticipation notes are issued for temporary
financing purposes and in the expectation of the issuance of
long-term bonds in substitution thereof, the City has historically
classified BANs 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 BANs uniformly have maturity dates not to exceed one year,
the treatment accorded these obligations conforms to the account-
ing classification relating to short-term debt; i.e., an obli-
gation 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 on City Records of City-Related Transactions of MAC and of Note-Type Debt 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.

Obligations of Municipal Assistance Corporation 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 long-term debt group of accounts, offset by memorandum accounts entitled "amount available in debt service fund" and "amount to be provided from future revenue for payment of MAC bonds" or other applicable account title.

Where proceeds of long-term bonds issued by MAC are used to redeem City note-type debt (and all other MAC transactions producing an equivalent effect), the accounting result would be to eliminate a liability for notes (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, it would likewise eliminate a liability for such notes (TANs and RANs) from the City's general fund and to record the substitute debt 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: 1) fund balance (deficit), and 2) credits arising from a) MAC liquidation of City note-type debt; b) conversion of City note-type debt to long-term debt through issuance of City bonds for notes; and c) 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 appearing later in this directive.

Also illustrated later is 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. It is contemplated that several of the statements and summaries of details of City funded debt appearing in prior published reports would be presented in the form of supplemental schedules in future annual reports.
Examples of Transactions by M&G 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, BARs and/or BARs, 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 (short-term) debt. Under the revised accounting system these would be budgeted and accounted for as follows:

   a. Interest on maturing TANS and BARs 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 BARs is not illustrated in the sample entries. No budget provision for redemption of TANS and BARs would be appropriate as the liability therefore would be shown in the general fund. Interest on BARs 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 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 should be established. In the event long-term debt is created by extension of the terms of city note-type debt, such long-term 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 Act.
City General Long-Term Debt Group

Terms:
- Date interest payments are due:
- Payment frequency:
- Amount to be provided for payment:
- Account:
- Interest:
- Principal:
- City General Long-Term Debt Group

Notes payable:
- Date of note:
- Maturity date:
- Amount:
- Interest rate:
- Maturity date:
- Amount:
- Interest rate:
- Maturity date:
- Amount:
- Interest rate:
- Maturity date:
- Amount:
- Interest rate:
- Maturity date:

General Fund:

Description of Transactions
<table>
<thead>
<tr>
<th>xxx</th>
<th>Notes payable (maturing after 1 year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>xxx</td>
<td>City General Long-Term Debt</td>
</tr>
<tr>
<td>xxx</td>
<td>Proceeds from sale of bonds</td>
</tr>
<tr>
<td>xxx</td>
<td>Proceeds from issuance of bonds</td>
</tr>
<tr>
<td>xxx</td>
<td>Proceeds from issuance of bonds</td>
</tr>
</tbody>
</table>

**Description of Transactions**

**Examples**

- By bond sinking fund (not available to the City)
  
- By bond sinking fund (not available to the City)
  
- By bond sinking fund (not available to the City)
  
- By bond sinking fund (not available to the City)

**Notes**

- City bond sinking fund notes not held
- City bond sinking fund notes not held
- City bond sinking fund notes not held
- City bond sinking fund notes not held


\textbf{10.} XNC debits sales taxes to cover loss

\textbf{9.} XNC debits sales taxes in amounts

\textbf{8.} XNC debits interest and principal

\textbf{7.} XNC debits \\

\textbf{6.} XNC debits interest, and pays next installments on the bonds, using

\textbf{5.} XNC debits interest and principal

\textbf{4.} XNC debits interest and principal

\textbf{3.} XNC debits interest and principal

\textbf{2.} XNC debits interest and principal

\textbf{1.} XNC debits interest and principal

\textbf{0.} XNC debits interest and principal
11. City Receivables Cash Advances from City's Advocacy

12. Cash

13. NNC Revenues from Transactions

AHD 47
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:

<table>
<thead>
<tr>
<th>Fund Balance:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fund balance (deficit)</td>
</tr>
<tr>
<td>Less credits arising from:</td>
</tr>
<tr>
<td>MAC liquidation of City note-type debt</td>
</tr>
<tr>
<td>Conversion of City note-type debt to long-term debt through issuance of City Bonds for notes</td>
</tr>
<tr>
<td>Conversion of City note-type debt to long-term debt through extended payment terms</td>
</tr>
</tbody>
</table>

(XXXX) (XXX) (XXX) (XXX)

Fund Balance (deficit)-net (XXXX)

The initial line in the foregoing statement would represent the normal year-end balance of the fund balance account in any year. There may be qualifying debits or credits to such account during any year; if so, such entries would be reflected in the required Statement of Changes in Fund Balance 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 Lien 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>Obligations of Municipal Funds</th>
<th>City Assistance Funded Corporation Debt</th>
<th>(Note)</th>
<th>Combined</th>
</tr>
</thead>
<tbody>
<tr>
<td>City Funded Debts</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Corporate Stock</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Amount available in sinking funds</td>
<td>XXX</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>
<td>XXX</td>
</tr>
<tr>
<td>Total</td>
<td>XXX</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 | XX                        | XXX                                      | XVI    | XX       |
| Amount to be provided from future taxes | XXX                      | XXX                                      | XXX    | XXX      |
| Total                                | XXX                        | XXX                                      | XXX    | 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                        | XXX                                      | XXX    | XXX      |

**Total** **Amount Available and to be Provided for Payment of City Funded Debt**

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

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

| **Grand Total**                             | XXX                      | XXX                                     | XXX    | XXX      |
General Long-Term Debt

City Funded Debt:
- Corporate stock redeemable from sinking funds
- and other
- Serial/bonds redeemable from current appropriations in debt service funds

<table>
<thead>
<tr>
<th>City Funded Debt</th>
<th>Obligations of Municipal Assistance Corporation (Note)</th>
<th>Combined</th>
</tr>
</thead>
<tbody>
<tr>
<td>XXX</td>
<td>-</td>
<td>XXX</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)

<p>| | | |</p>
<table>
<thead>
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<td>XXXXX</td>
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</table>

Grand Total

<p>| | | |</p>
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<th></th>
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</thead>
<tbody>
<tr>
<td>XXXXX</td>
<td>XXXXX</td>
<td>XXXXX</td>
</tr>
</tbody>
</table>

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 items among these two columns. If a combined balance sheet of the City's various issues 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.
REVISED DRAFT

STATE OF NEW YORK
DEPARTMENT OF AUDIT AND CONTROL
DIVISION OF AUDITS AND ACCOUNTS

ACCOUNTING SYSTEMS DIRECTIVE FOR NEW YORK CITY

Accounting Systems Directive No. 7

Accounting for Financing and Debt Service Transactions on Behalf of New York City by Municipal Assistance Corporation and from Application of New York State Moratorium Act

Introduction

The debt refinancing programs authorized or mandated in legislation creating the Municipal Assistance Corporation (MAC) and the Emergency Financial Control Board (EFCB), and in the New York State Moratorium Act for the City of New York, 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 capita 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.

The purpose of this directive is to furnish guidelines and supporting rationale for specific accounting treatment of a variety
of known and expected types of recurring transactions. Specific examples are delineated later in this document.

Accounting Premises for Reflecting Transactions of MAC on City Records

Some of the financial transactions of MAC will directly involve counterpart transactions with the City, as illustrated in the attachment to this directive. Others will consist of financing or refinancing City note-type debts (which in an accounting sense are usually short-term; i.e., due in less than one year). Such or may financing may/not involve receipt of or exchange of cash between MAC and the City. Nonetheless, in performing its legislative and administrative functions, most financial transactions of MAC 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 current note-type debt. Over the years normal City revenue sources will be pre-empted by MAC, but only for debt service and related administrative expenses, to repay MAC bonds or other forms of MAC debt. Thus, certain debts of MAC, in effect, will 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, under generally accepted accounting principles, fair presentation of the financial position of the various funds and account groups of the City and results of operations of its individual funds, together with the obligation for full disclosure of its debt transactions, 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 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 the interest thereon. This type of debt, historically described by the City as funded debt, consists of bonds or other obligations which 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) and revenue anticipation notes (RANS). 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 full
faith and credit debt.

TANs and BANs have been historically recorded as a liability
in those accounts on the City's books that would, under the
revised accounting system, be incorporated into its new general
fund. BANs would be recorded, under the revised accounting system,
as a liability in the Mitchell-Lama Housing Fund, Capital Projects,
or other constituent fund pending their conversion to funded debt
through 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 (a) amortization and
redemption of term bonds, sinking fund bonds, and serial
bonds, (b) the 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 (c) the 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 after their date of original issue. 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 as aforesaid at the suit of any holder of obligations issued for any such indebtedness.

Interest due at the respective maturity dates of RANs and TANs is currently budgeted for in the City's annual expense budget, separate and apart from interest and principal installments on serial bonds, additions to sinking funds, or redemptions of term bonds. 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)

Redemption of BANs, RANs and TANs at their respective maturity dates has not historically been provided for in the expense budget of the City. Similarly, under the revised accounting system, redemption of RANs and TANs would not be budgeted in the expense budget.

(1) Since the City Charter requires the appropriations to be in the "expense budget," such budget would need to be reclassified under the proposed accounting system to the appropriate fund in accordance with ASD No. 5.
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 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 of receipt of such revenue."

In clarification of the foregoing, 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. It should be noted, in support of this view, that Section 39.00 of the Local Finance Law requires the 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. 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, to which reference has previously been made.

Thus, the above sections of the Local Finance Law place a legal limit on the ultimate terms from date of original issue to redemption, including all renewals, of not to exceed five years for tax anticipation notes and three years for revenue anticipation notes. As noted in the preceding excerpts from 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 as follows:

§ 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. (underscoring 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 tax anticipation notes to five years and revenue anticipation notes 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.

Accordingly, the legal impact of successive renewals beyond five years from date of original issue of such notes would be to subject them to the force of Article 8, Section 2 of the State Constitution and to terminate their tax limit exclusion either because the revenues which formed the basis of their issuance are no longer available for their redemption or have not been received and therefore require such debt to be treated as funded debt. However, it would appear that such change in status would be limited to one year, because of the requirement for redemption in the sixth year.
However, during the recent 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 contained a definition of "short-term obligations," which it defined to mean "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.

Thus, if the constitutionality of the Moratorium Act is sustained in the appeal courts, it is possible that a TAN which has already been renewed for several years may, during the moratorium period, reach a point where its total term exceeds the five year period specified in Article 8, Section 5 of the State Constitution and thus be propelled into the City's debt limit. It also comes within the purview of Article 8, Section 2 of the State Constitution, which requires that an appropriation must be made by the City to redeem such a TAN. Presumably, the same problem would apply to a RAN, particularly if the moratorium were subsequently extended beyond three years.

Impact of MAC Legislation and Transactions on New York City Debt

Obligations of Municipal Assistance Corporation for the City of New York (MAC) 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, which provides 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 not payable out of any funds other than those of MAC. A detailed statutory structure has been created which diverts certain revenue sources formerly available to the City for the period during which MAC obligations are outstanding, transfers them to certain State funds, and provides for their payment to MAC, subject to State appropriation, at which point they become funds of MAC, out of which MAC debt and expenses are to be paid.

Even though the bonds or other long-term obligations issued by MAC do not legally come within the City's debt limit and the City has no legal obligation to make any budgetary
appropriations with respect thereto, the practical effect, from an accounting viewpoint, is to eliminate note-type (short-term) debt and to substitute it with 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 City Related Financing Transactions

Normally, for accounting purposes, New York City note-type debt consists of obligations with maturity dates of one year or less. Funded debt consists of obligations with maturity dates in excess of one year. Under the applicable provisions of the New York State Constitution, the Local Finance Law, and the New York State Moratorium Act for the City of New York, tax anticipation notes and revenue anticipation notes, through application of the Moratorium Act or through failure to effect a redemption within five years, become subject to redemption pursuant to the State Constitution and must be treated accordingly for accounting purposes.

Bond anticipation notes comprise a debt category separate and apart from other forms of note-type or funded debt of the City. Basically, BANs represent a form of indebtedness which is within the constitutional debt limit of the City unless they are issued for a purpose which may be specifically excluded in 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. Under the Local Finance Law the term of bond anticipation notes may not exceed one year and each renewal, as provided for in the law, may not exceed a term of one year.

Since bond anticipation notes are issued for temporary financing purposes and in the expectation of the issuance of long-term bonds in substitution thereof, the City has historically classified BANs 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 BANs uniformly have maturity dates not to exceed one year, the treatment accorded these obligations 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 and funded debt as long-term debt.
Accounting Treatment on City Records of City-Related Transactions of MAC and of Bonds Subject to Moratorium

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.

Obligations of Municipal Assistance Corporation 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 long-term debt group of accounts, offset by memorandum accounts entitled "amount available in debt service fund" and "amount to be provided from future revenue for payment of MAC bonds" or other applicable account title.

Because of application of the Moratorium Act or where the proceeds of long-term bonds issued by MAC are used to redeem City note-type debt (and all other transactions producing an equivalent effect), the accounting result will be to eliminate a liability for notes (RANs and TANs) from the City's general fund and to record the substitute debt in the memorandum long-term debt group of accounts. This will leave an unapplied credit in the general fund arising from such note redemption. Under generally accepted accounting principles, the amount arising
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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: 1) Fund balance (deficit),
and 2) credits arising from a) MAC liquidation of City note-type
debt; b) conversion of City note-type debt to long-term debt through
Moratorium; and c) conversion of City note-type debt to long-term
debt through issuance of City bonds for notes. 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 appropri-
ate 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 appearing later in this directive.

Also illustrated later is a Statement of General Long-Term
Debt, including City funded debt and obligations of Municipal
Assistance Corporation, prepared in a format considered appropri-
ate for inclusion in the City Comptroller's Annual Financial
Report. It is contemplated that several of the statements and
summaries of details of City funded debt appearing in prior
published reports 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 (short-term) 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 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 groups of accounts for City related outstanding debt of MAC should be established. Long-term debt created by application of the Moratorium Act 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 Act.
<table>
<thead>
<tr>
<th>Description of Transactions</th>
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</thead>
<tbody>
<tr>
<td>1. City receives cash from MAC to repay short-term notes.</td>
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<td></td>
</tr>
<tr>
<td>2. City receives cash from MAC to repay state and city agencies.</td>
<td></td>
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<td></td>
</tr>
</tbody>
</table>

- By MAC
- Long-term bonds
  - Amount to be provided from:
    - General Fund
  - Notes Payable
  - City short-term dept.
  - From MAC long-term notes issued
  - Cash

- NC Long-term dept. of MAC bonds
  - Amount to be provided from:
    - General Fund
  - Notes Payable
  - City short-term dept.
  - From MAC long-term notes issued
  - Cash

- NC Long-term dept. of MAC bonds
  - Amount to be provided from:
    - General Fund
  - Notes Payable
  - City short-term dept.
  - From MAC long-term notes issued
  - Cash
Description of Transactions

4. City's TANs and RANs became subject to the three year moratorium provided for in the New York State Moratorium Act for the City of New York (see explanation in directive respecting 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 moratorium is less than five years:
Notes payable (maturities affected) XXX
Notes payable (maturities affected) XXX

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

City General Long-Term Debt Group of Accounts:
Amount to be provided for payment of City Notes extended through Moratorium XXX
Long-Term City Notes payable XXX

General Fund:
Notes Payable XXX
Fund balance-credits arising from conversion to long-term debt through Moratorium XXX

City General Long-Term Debt Group of Accounts:
Amount to be provided for payment of City Notes extended through Moratorium XXX
Long-Term City Notes payable XXX

5. City or State pension funds and various banks holding City notes become subject to a moratorium date of July 1, 1986 on certain short-term notes they now hold.
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 Limited Profit Housing and Municipal Loan Programs 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) Limited Profit Housing and Municipal Loan Programs 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 City bonds (a revenue account) XXX

City General/Long-Term Debt Group of Accounts:
Amount to be provided for payment of serial bonds
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 administration 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

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.

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
### 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 disburse amounts 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.

### Illustrative Journal Entries

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

| Expenditures | XXX |
| Cash         | XXX |

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

<table>
<thead>
<tr>
<th>Fund Balance:</th>
<th>(XXXX)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fund balance (deficit)</td>
<td></td>
</tr>
</tbody>
</table>

Less credits arising from:
- MAC liquidation of City note-type debt XXX
- Conversion of City note-type debt to long-term debt through Moratorium XXX
- Conversion of City note-type debt to long-term debt through issuance of City bonds for notes XXX XXX

Fund Balance (deficit)-net (XXXX)

The initial line in the foregoing statement would represent the normal year-end balance of the fund balance account in any year. There may be qualifying debits or credits to such account during any year; if so, such entries would be reflected in the required Statement of Changes in Fund Balance in the City Comptroller's Annual Report.

The debt related credits to the General Fund 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 and Moratorium or other City-related debt. 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>City Funded Debt</th>
<th>Obligations of Municipal Corporation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate Stock:</td>
<td>City Assistance Funded Debt (Note)</td>
</tr>
<tr>
<td>Amount available in sinking funds</td>
<td>Total</td>
</tr>
<tr>
<td>XXX</td>
<td>-</td>
</tr>
<tr>
<td>XXX</td>
<td>-</td>
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<td>XXX</td>
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</table>

General Obligation Serial and Other Bonds:
| Amount available in debt service funds | Total | Combined |
| XXXXX | - | XXXXX |
| XXXXX | - | XXXXX |

Short-term Notes Subject to Emergency Moratorium Act with Maturities Beyond Five Years from date of Original Issue:
| Amount to be provided from future taxes | Total Amount Available and to be Provided for Payment of City Funded Debt | Combined |
| XXXXX | - | XXXXX |

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 | MAC revenue | Total |
| XXXXX | - | XXXXX |

Grand Total

XXX

XXX:XX

XX

XXX

XXX:XX

XXXXX

XXXXX

XXXXX
### General Long-Term Debt

<table>
<thead>
<tr>
<th>City Funded Debt</th>
<th>Obligations of Municipal Assistance Corporation (Note)</th>
<th>Combined</th>
</tr>
</thead>
<tbody>
<tr>
<td>XXX</td>
<td>-</td>
<td>XXXX</td>
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<td>XXXXX</td>
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<td>XXXXX</td>
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<td>XXXXX</td>
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### Obligations of Municipal Assistance Corporation Issued in Exchange for or in Lieu of City Note-Type Debt (not a legal obligation of City)

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### Grand Total

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</table>

### 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 columns. 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.
STATE OF NEW YORK
DEPARTMENT OF AUDIT AND CONTROL
DIVISION OF AUDITS AND ACCOUNTS

ACCOUNTING SYSTEMS DIRECTIVE FOR NEW YORK CITY

Accounting Systems Directive No. 7

Accounting for Financing and Debt Service Transactions on Behalf of New York City by Municipal Assistance Corporation and from Application of New York State Moratorium Act

Introduction

The debt refinancing programs authorized or mandated in legislation creating the Municipal Assistance Corporation (MAC) and the Emergency Financial Control Board (EFCB), and in the New York State Moratorium Act for the City of New York, will pose some unusual accounting and financial reporting problems for New York City. The purpose of this directive is to furnish guidelines and supporting rationale for specific accounting treatment of a variety of known and expected types of recurring transactions. Specific examples are delineated later in this document.

Accounting Premises for Reflecting Transactions of MAC on City Records

Some of the financial transactions of MAC will directly involve counterpart transactions with the City. Others will consist of financing or refinancing City short-term debts which involve no receipt of or exchange of cash between MAC and the City. Nonetheless, all financial transactions of MAC are considered to be conducted on behalf of and for the benefit of the City. In substance, the legislative and administrative functions of MAC are to serve as a substitute organization for the City in the debt financing area of its overall operations.
Through issuance of its own long-term bonds MAC will be refinancing substantial portions of the City's current short-term debt. Over the years MAC will be drawing on normal City revenue sources (pre-empted only for debt service and related administrative expenses) to repay its own bonds or other forms of debt. Thus debts of MAC, in effect, will represent substitutions of existing City debt to be repaid from future City revenues. Accordingly, since MAC's financial transactions are for the direct benefit of the City, for accounting purposes, they are considered virtually equivalent to City transactions.

Based on the foregoing, it has been concluded that, under generally accepted accounting principles, fair presentation of the financial position of the various funds and account groups of the City and results of operations of its individual funds, together with the obligation for full disclosure of its debt transactions, requires that the effect on the City of all 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 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 the interest thereon. This type of debt, generally consisting of long-term bonds, is commonly described as funded debt.

In addition to its funded debt, the city is authorized to issue tax anticipation notes (TANs) and revenue anticipation notes (RANs). Such notes at point of issue do not come within the general debt incurring power or limit of the City. The City may also issue bond anticipation notes (BANs), which do come within the general debt limit of the City. All three types of notes are commonly referred to as "short-term debt" and historically have been recorded as a liability in those accounts on the City's books that would, under the revised accounting system, be incorporated into its new general fund.
Provision for Payment of Interest On and Redemption of Indebtedness

Provision shall be made annually by appropriation for by every city/the payment of interest on all indebtedness and for the amounts required for (a) amortization and redemption of term bonds, sinking fund bonds, and serial bonds, (b) the 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 (c) the 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 after their date of original issue. 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 as aforesaid at the suit of any holder of obligations issued for any such indebtedness.

Interest due at the respective maturity dates of BANs, RANs and TANs is currently budgeted for in the City's annual expense budget, separate and apart from interest and principal installments on serial bonds, additions to sinking funds, or redemptions of term bonds. Under the revised accounting system, interest due annually on these short-term notes would be budgeted as a line item expenditure in the general fund.

Redemption of BANs, RANs and TANs at their respective maturity dates has not historically been provided for in the expense budget of the City. Similarly, 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 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 of receipt of such revenue."
In clarification of the foregoing, 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. It should be noted, in support of this view, that Section 39.00 of the Local Finance Law requires the 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. 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, to which reference has previously been made.

Thus, the above sections of the Local Finance Law place a legal limit on the ultimate terms from date of original issue to redemption, including all renewals, of not to exceed five years for tax anticipation notes and three years for revenue anticipation notes.

However, Article 8, Section 5 of the New York State Constitution, in describing certain types of indebtedness commonly considered as short-term debt, states as follows:
§ 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. (underscoring supplied)

Conversion of Short-Term Notes Into Funded Debt

Thus, even though Sections 24.00 (a) (6) and 25.00 (f) of the Local Finance Law restrict the maximum legal terms of tax anticipation notes to five years and revenue anticipation notes 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.
Accordingly, the legal impact of successive renewals beyond five years from date of original issue of such notes would be to convert short-term debt to funded debt. However, it would appear that such change in status would be limited to one year, because of the requirement for redemption in the sixth year.

However, during the recent 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 contained a definition of "short-term obligations," which it defined to mean "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 short-term obligations.

Thus, if the constitutionality of the Moratorium Act is sustained in the appeal Courts, it is possible that a TAN which has already been renewed by roll-over for several years may, during the moratorium period, reach a point where its total term exceeds the five year period specified in Article 8, Section 5 of the State Constitution and thus be propelled into the City's debt limit. At that point in time, however, it also comes within the purview of Article 8, Section 2, of the State Constitution, which requires that an appropriation must be made by the City to redeem such a TAN. Presumably, the same would be true of a RAN, particularly if the moratorium were subsequently extended beyond three years.
Consequently, with respect to both TANs and RANs, either through application of the Moratorium Act or through failure to effect a timely redemption of such notes, the effect thereof at the end of the five year period would in either event be to convert City short-term debt into funded or long-term debt.

Impact of MAC Legislation and Transactions on New York City Debt

Debt incurred by Municipal Assistance Corporation for the City of New York (MAC) is not within the City's debt limit, nor does the City or MAC 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, which provides 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."

Even though the bonds or other long-term obligations issued by MAC do not legally come within the City's debt limit and the City has no legal obligation to make any budgetary appropriations with respect thereto, the practical effect, from an accounting viewpoint, is to convert short-term debt to long-term debt where the proceeds of MAC bonds are used to redeem City short-term notes.
While the legal premises and rationale set forth herein and the conclusions drawn therefrom appear applicable, it would be desirable for the City to obtain an opinion thereon from Corporation Counsel.

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

Normally, for accounting purposes, short-term debt consists of obligations with maturity dates of one year or less. Long-term debt consists of obligations with maturity dates in excess of one year. Under the applicable provisions of the New York State Constitution, the Local Finance Law, and the New York State Moratorium Act for the City of New York, tax anticipation notes and revenue anticipation notes, through application of the Moratorium Act or through failure to effect a redemption within five years, undergo a conversion from short-term debt to long-term debt, both legally and for accounting purposes. Bond anticipation notes, which come within the City's legal debt limit and are therefore considered a part of its funded debt, nonetheless qualify as short-term debt by reason of one year maturity dates throughout their legal existence.

Accordingly, 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 short-term and long-term debt. In each case, a City obligation with a maturity date of one year or less is a short-term debt; an obligation with a maturity date in excess of one year is a long-term debt.
Under generally accepted accounting principles, the accounting treatment for short-term debt differs materially from the accounting treatment for long-term debt. New York City short-term 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.

Long-term debt will appear in a newly established long-term debt group of accounts, offset by memorandum accounts entitled "amount to be provided from taxation for payment of general obligation bonds," "amount to be provided from future revenue for payment of MAC bonds" or other applicable account title.

Because of application of the Moratorium Act or where the proceeds of long-term bonds issued by MAC are used to redeem City short-term notes (and all other transactions producing an equivalent effect), the accounting result will be to eliminate a liability for short-term debt from the City's general fund and to record the substitute long-term debt in the memorandum long-term debt group of accounts. This will leave an unapplied credit in the general fund arising from such conversion. 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, it is appropriate to segregate the fund balance of the general fund into its component elements. Therefore, the debt transactions arising from application of the Moratorium Act or by MAC on behalf of the City 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 appearing later in this directive.
Examples of Transactions by MAC and Various City Funds Affecting City's Short and Long Term 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 to TANs, RANs and/or BANs.

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

   a. Interest on maturing short term notes would be 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 short-term notes is not illustrated in the sample entries. No budget provision for redemption of short-term notes would be appropriate.

   b. Payments of interest on all funded debt, and the amounts required for amortization or redemption of term bonds, sinking fund bonds and serial bonds would be budgeted and accounted for in appropriate debt service funds.

A separate debt service fund to budget and account for all MAC debt transactions should be established. Similarly, a separate long-term debt group of accounts for MAC outstanding debt and for long-term debt created by application of the Moratorium Act should be set up on the City records.
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 Act.
Description of Transactions

1. City receives cash from MAC to liquidate existing short-term notes 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 short-term notes, 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 under MAC's exchange offer.

Illustrative Journal Entries

<table>
<thead>
<tr>
<th>General Fund:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash XXX</td>
</tr>
<tr>
<td>Notes Payable XXX</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>General Fund:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash XXX</td>
</tr>
<tr>
<td>Fund balance-credits arising from MAC liquidation of City short-term debt XXX</td>
</tr>
<tr>
<td>Notes Payable XXX</td>
</tr>
<tr>
<td>Cash XXX</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>MAC Long-Term Debt Group of Accounts:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount to be provided from future revenue for payment of MAC bonds XXX</td>
</tr>
<tr>
<td>Long-Term bonds issued by MAC XXX</td>
</tr>
</tbody>
</table>

<table>
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<tr>
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<tr>
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<td>Amount to be provided from future revenue for payment of MAC bonds XXX</td>
</tr>
<tr>
<td>Long-Term bonds issued by MAC XXX</td>
</tr>
</tbody>
</table>
### Description of Transactions

4. City's short-term notes became subject to the three year moratorium provided for in the New York State Moratorium Act for the City of New York (see explanation in directive respecting the conversion to long-term debt after five years from original date of issue of short-term notes).

5. City or State pension funds and various banks holding City notes become subject to a moratorium date of July 1, 1986 on certain short-term notes they now hold.

### Illustrative Journal Entries

<table>
<thead>
<tr>
<th>General Fund:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Where period from original issue through moratorium is less than five years:</td>
</tr>
<tr>
<td>Notes payable (maturities affected) XXX</td>
</tr>
<tr>
<td>Notes payable (maturities affected) XXX</td>
</tr>
</tbody>
</table>

| Where period from original issue through moratorium is greater than five years: |
| Notes payable XXX |
| Fund balance-credits arising from conversion to long-term debt through Moratorium XXX |

| Moratorium Long-Term Debt Group of Accounts: |
| Amount to be provided from future revenue for payment of City notes XXX |
| Long-Term City Notes payable XXX |

<table>
<thead>
<tr>
<th>General Fund:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Notes Payable XXX</td>
</tr>
<tr>
<td>Fund balance-credits arising from conversion to long-term debt through Moratorium XXX</td>
</tr>
</tbody>
</table>

| Moratorium Long-Term Debt Group of Accounts: |
| Amount to be provided from future revenue for payment of City notes XXX |
| Long-Term City Notes payable XXX |
Description of Transactions

6. City sinking funds, containing funds to be applied to the amortization of outstanding term bonds of the City, purchase new bonds issued by the City upon payment of certain City bond anticipation notes now held by such sinking funds.

Illustrative Journal Entries

General Fund (assuming cash is exchanged between sinking funds and general fund):

<table>
<thead>
<tr>
<th>Description</th>
<th>XXX</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td></td>
</tr>
<tr>
<td>Fund balance-credits arising from conversion to long-term debt through issuance of bonds for notes</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Description</th>
<th>XXX</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bond Anticipation Notes payable</td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td></td>
</tr>
</tbody>
</table>

General Fund (assuming no cash is exchanged between sinking funds and general fund):

<table>
<thead>
<tr>
<th>Description</th>
<th>XXX</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bond Anticipation Notes payable</td>
<td></td>
</tr>
<tr>
<td>Fund balance-credits arising from conversion to long-term debt through issuance of bonds for notes</td>
<td></td>
</tr>
</tbody>
</table>

Long-Term Debt Group of Accounts:
Amount to be provided from taxation for payment of general obligation bonds

<table>
<thead>
<tr>
<th>Description</th>
<th>XXX</th>
</tr>
</thead>
<tbody>
<tr>
<td>General obligation bonds payable</td>
<td></td>
</tr>
</tbody>
</table>

General Fund:

<table>
<thead>
<tr>
<th>Description</th>
<th>XXX</th>
</tr>
</thead>
<tbody>
<tr>
<td>Notes payable (maturities affected)</td>
<td></td>
</tr>
<tr>
<td>Notes payable (maturities affected)</td>
<td></td>
</tr>
</tbody>
</table>

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.
9. MAC Retains Sales Taxes in Amounts Required for Annual Additions to MAC Bond Reserves.

10. MAC Retains Sales Taxes to Cover This Program.

Office for Service Rendered on Billings from State Comptroller, Including Administration Expenses, Including

MAC Debt Service Fund:

MAC
Sales Taxes Allocated to
Administration Expenses of MAC
MAC Debt Service Fund:

Retirement Reserve for MAC Bond
Retirement Provision for MAC Bond

Sales Taxes Allocated to MAC Reserve Account
Amounts Held by MAC Bond
MAC Debt Service Fund:

MAC bonds of MAC bonds
Future Revenue for Payment
Amount to be Provided from Long-Term Bonds Issued by MAC
MAC General Long-Term Debt Group of

(Required)
Allocated to MAC

Taxes to City

Amounts from Reimbursements of Such Taxes to Exempt Necessary (in Equal Sales Tax (and/or Stock Transfer
Interest on MAC Bonds
MAC Debt Service Fund:

Illustrative Journal Entries

Description of Transactions

18
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. From these factors have resulted 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 employees 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 and 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 cause distortion of 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 its 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, which is concerned with the determination of the amount of pension cost for accounting purposes, is applicable to the cost of pension plans of 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, including government) has underway a current 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 currently makes annual contributions to five separate retirement systems. These contributions are presently funded in the City's annual expense budget; under the proposed new fund structure, as set forth in Accounting Systems Directive No. 5, they would be included in the annual budget of the general fund. The retirement systems are as follows:

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

In terms of applicable accounting principles it is important to distinguish between the "provision for pension cost," 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 of major consideration in this directive. The latter is a financial management decision and is not within the purview of this directive.

Basic Accounting Method

The specific elements of generally accepted accounting principles applicable to accounting for the City's annual "provision for pension cost" pertaining to the respective retirement systems are as follows:
1. In the absence of convincing evidence that the City would ever reduce or discontinue the benefits called for in its various pension plans, the cost of the plan should be accounted for on the assumption that the City will continue to provide such benefits. This assumption implies a long-term undertaking, the cost of which should be recognized annually whether or not funded. Therefore, accounting for pension cost should not be discretionary.

2. The entire cost of benefit payments to be ultimately made (derived primarily from annual City contributions) should be expensed subsequent to 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.

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

4. 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 later in this directive. The accounting method and the actuarial cost method should be consistently applied from year to year.

**Actuarial Cost Methods**

**Actuarial Valuations**

An actuarial valuation of a pension plan is the process used by actuaries for determining the amounts an employer is to contribute under a pension plan. A valuation is made 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 on the valuation date of benefits to be paid over varying periods of time in the future to employees after retirement. An actuarial cost method is then applied to this present value to determine the contributions to be made by the employer.

The resulting annual cost determinations are estimates, since in making a valuation a number of significant uncertainties concerning future events must be made by making several actuarial assumptions, such as:

1. interest, i.e., return on funds invested
2. expenses of administration, and
3. 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 method 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 service earned during the year.
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, however, 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

As explained above, 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 done in a manner not directly related to the periods during which the service on which the benefits are based has been or will be rendered. The principal projected benefit cost methods are discussed briefly below.

1. Entry Age Normal Method

Under the entry age normal method, the normal costs are computed on the assumption (1) that 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) that 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 company 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 (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.

2. 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 his entry into the plan, if later) to his 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.

3. 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 (discussed below).

4. 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 contribution 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 therefore to reflect actual experience, and from time to time to revise the actuarial assumptions to be used in the future. These adjustments constitute actuarial gains and losses and are factors to be considered in the use of any actuarial method, as heretofore described. They 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 in use: immediate-recognition, spreading and averaging. Under the immediate-recognition method recognition (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 (through substantial additions to or deletions from employee groups, for example), 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 Respecting Accounting and Actuarial Methods Applicable to City's Retirement Systems**

As stated earlier, generally accepted accounting principles require that the annual provision for pension cost of a contributing governmental unit, such as New York City, should be:

1. recognized annually whether funded or not;
2. expensed in the general fund of the City;
3. accounted for on the accrual basis, and
4. 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 now described hereafter:
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) if indicated in the following sentence, a provision for vested benefits. 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 per cent 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 per cent 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 cost, (2) 10 per cent of the past service cost (until fully amortized), (3) 10 per cent 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 which has been charged against income and the amount which has been 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 item (4) above, any of the actuarial cost methods described on pages 5 through 10 of this directive qualify as acceptable.

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, in a manner consistent with the conclusions of this paragraph, 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, as described later in this directive.

**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:

1. A statement that such plans exist, identifying or describing the employee groups covered.

2. A statement of the City's accounting and funding policies.

3. The provision for pension cost for the period.

4. 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.

5. 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, cited above, 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 current 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 into the various retirement systems are to be paid. In order to compensate for the lag in payment, interest at the valuation rate has been added to the amount of the contributions that were otherwise payable. It is understood that the total amount of these delayed payments is still subject to final determination.

Technically, under the transition rules of APB Opinion 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 referred to above, 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 would require a substantial amount of staff time 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 an immaterial amount.
In the absence of definitive data on the correct amount to be excluded therefrom, it represents a reasonable approach to conclude that the amount of these two years of unpaid contributions should be accrued and reflected as a liability in the City's general fund balance sheet at its next ensuing annual statement date.

It would appear that the recording of such liability would, in substance, represent 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 would be charged to the fund balance account of the general fund.

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 merely disclose that the amount thereof had been charged to the fund balance account. Financial statements of subsequent periods need not repeat the disclosures.
Inasmuch as the Task Force study indicates the likelihood of a change in actuarial cost method, 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. However, this conclusion is made subject to the ultimate findings and recommendations of the pension study Task Force.

Glossary

Because this directive contains considerable technical material and uncommon terms, it has been considered desirable to include a glossary of the significant terms referred to herein. This glossary therefore appears as Exhibit A to this directive.
GLOSSARY

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 (1) the amount in the pension fund and (2) 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.
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. From these factors have resulted 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 employees 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 and 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 cause distortion of 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 its 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, which is concerned with the determination of the amount of pension cost for accounting purposes, is applicable to the cost of pension plans of 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, including government) has underway a current 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 currently makes annual contributions to five separate retirement systems. These contributions are presently funded in the City's annual expense budget; under the proposed new fund structure, as set forth in Accounting Systems Directive No. 5, they would be included in the annual budget of the general fund. The retirement systems are as follows:

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

In terms of applicable accounting principles it is important to distinguish between the "provision for pension cost," 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 of major consideration in this directive. The latter is a financial management decision and is not within the purview of this directive.

Basic Accounting Method

The specific elements of generally accepted accounting principles applicable to accounting for the City's annual "provision for pension cost" pertaining to the respective retirement systems are as follows:
1. In the absence of convincing evidence that the City would ever reduce or discontinue the benefits called for in its various pension plans, the cost of the plan should be accounted for on the assumption that the City will continue to provide such benefits. This assumption implies a long-term undertaking, the cost of which should be recognized annually whether or not funded. Therefore, accounting for pension cost should not be discretionary.

2. The entire cost of benefit payments to be ultimately made (derived primarily from annual City contributions) should be expensed subsequent to 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.

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

4. 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 later in this directive. The accounting method and the actuarial cost method should be consistently applied from year to year.

**Actuarial Cost Methods**

**Actuarial Valuations**

An actuarial valuation of a pension plan is the process used by actuaries for determining the amounts an employer is to contribute under a pension plan. A valuation is made 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 on the valuation date of benefits to be paid over varying periods of time in the future to employees after retirement. An actuarial cost method is then applied to this present value to determine the contributions to be made by the employer.

The resulting determinations are estimates, since in making a valuation a number of significant uncertainties concerning future events must be made by making several actuarial assumptions, such as:

1. interest, i.e., return on funds invested
2. expenses of administration, and
3. amounts and timing of benefits to be paid with respect to presently retired employees, former employees whose benefits have vested, and present employers.

**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 method 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 consists of (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 some plans, the retirement benefits are related to salary levels, which usually increase during the years. As to the employees collectively, however, 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

As explained above, 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 done in a manner not directly related to the periods during which the service on which the benefits are based has been or will be rendered. 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: (1) that 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) that 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 company 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 rate of 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 (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.

**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 his entry into the plan, if later) to his retirement date. Thus, past service cost is
not determined separately but is included in normal cost.

The individual level prepayment 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 prepayment 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 retiree lives of employees, thus avoiding the very short initial contribution period 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 unit credit 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 (discussed below).

**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 contribution 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. Heightened events related specifically with events will alter also, of conditions change, the assumptions concerning the future may become invalid. Adjustments may be needed annually therefore to reflect actual experience, and from time to time to revise the actuarial assumptions to be used in the future. These objections can which actuarial gains and losses and are factors to be considered in the use of any actuarial method, as heretofore described. They 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, 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 in use: 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 past service cost (or prior service cost on amendment). 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 reduction 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 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 computations or in reducing 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 Respecting Accounting and Actuarial Methods Applicable to City's Retirement System:

 As stated earlier, generally accepted accounting principles require that the annual provision for pension cost of a contributing governmental unit, such as New York City, should be:

 1. recognized annually whether funded or not;

 2. expensed in the general fund of the City;

 3. accounted for on the accrual basis, and

 4. 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 now described hereafter:
The annual provision for pension cost should be less than the total of (1) normal cost, (2) an amount equivalent to interest on any unfunded prior service cost, and (3) if indicated in the following analysis, a provision for vested benefits. 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 per cent 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 per cent 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.

The annual provision for pension cost should not be greater than the total of (1) normal cost, (2) 10 per cent of the past service cost (until fully amortized), (3) 10 per cent 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.
equivalents on the difference between provisions and amounts funded.

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 accrued or prepaid pension cost. Except to the extent indicated in the preceding sentence 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 item (d) above, any of the actuarial cost method described on pages 5 through 10 of this directive qualify as acceptable.

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, in a manner consistent with the change in method, and the change in method and its effect should be disclosed in a note to the financial statements, as described later in this directive.

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:

1. A statement that such plans exist, identifying or describing the plans.

2. A statement of the City's accounting and funding policies.

3. The provision for pension cost for the period.

4. 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.
Accrual of Prior Years' Contributions

According to a current City Pension System Task Force Study, there has been a lag of many years in two-year lag in payment of the contributions made under the City when the City's payroll was divided into various smaller social systems. In order to compensate for the lag in payment, interest at the valuation rate has been added to the amount of the contributions that were otherwise payable. It is estimated that the total amount of these delayed payments is still subject to final determination.

Under generally accepted accounting principles, the amount of these two years of unpaid contributions should be accrued and reflected as a liability in the City's general fund balance sheet at its next ensuing annual statement date.

It would appear that the recording of such liability would, in substance, represent 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 would be charged to the fund balance account of the general fund.

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 merely disclose that the amount thereof which the plan is expected to receive in the years represented in the books is not actually expected to be the amount which it is presently expected to be.

Inasmuch as the task force study indicates the likelihood of a change in actuarial cost method, it would seem appropriate to be prevailed on the task force to be in formulating the new actuarial assumptions under any proposed change to a new actuarial cost method. However, this conclusion is made subject to the ultimate findings and recommendations of the pension study task force.

Glossary

Because this directive contains considerable technical material and uncommon terms, it has been considered desirable to include a glossary of the significant terms referred to herein. This glossary therefore appears as Exhibit A to this directive.
GLOSSARY

Actuarial Assumptions - Factors which actuaries use in tentatively resolving uncertainties concerning future events affecting pension costs for example, mortality rate, employees turnover, rates of withdrawals, etc.

Actuarial Funding Method - A method generally 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 Gain (Loss) - 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 (1) the amount in the pension fund and (2) 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.

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
be paid.

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.

Prior Service Cost - The annual 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-Adjusted 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 valuation or determination. Years of service 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 date become current 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 actuarial interest earned on the investment of the
funds. The method of valuation should be reviewed by
qualified actuaries and the results verified by an independent
auditor to ensure the reliability of the results.

The plan's funding status is affected by various conditions, such as inadequacy of the pension fund, which may
prevent the employee from receiving the vested benefits.

Withholding - The removal of an employer from economy
under a pension plan for a reason other than death or
tirement. See turnover.
STATE OF NEW YORK
DEPARTMENT OF AUDIT AND CONTROL
DIVISION OF AUDITS AND ACCOUNTS

Accounting Systems Directive for New York City

Accounting Systems Directive No. 9

Recommendations Respecting Miscellaneous Accounting Practices

Introduction

In order to assure that City financial transactions are recorded and reported upon 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. For this purpose, it is recommended that certain current practices be discontinued and substituted by sound accounting practices and policies. Certain past practices recommended to be discontinued and new accounting practices to be substituted therefor are delineated as follows:

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 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 Financial Report, which is apparently 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/deficiency in revenues over expenditures in the expense budget therefore has not been reflected in the City Comptroller's Annual Financial Report.

It is understood that the City Comptroller's Office has plans underway to consolidate all accounts designated in Accounting Systems Directive No. 5 to be includible in a general fund of the City into such a fund as of June 30, 1976. In addition, accounts designated in ASD No. 5 to be properly includible in a Water and Sewer fund (enterprise funds) and the Municipal Services Administration fund (intragovernmental service fund) are to be temporarily included in such general fund pending completion of system changes and development of related asset values essential to establishment of an appropriate enterprise and intragovernmental service fund, respectively.

The above action is very desirable and it is recommended that, effective as of June 30, 1976, the prior year practices, as heretofore described, be discontinued and substituted (to the extent practicable as of the close of the current year) by the following year-end practices and procedures:

1. Permit charges against unexpended appropriation balances in expense budget accounts beyond June 30 only to the extent of
2) properly accrualable items, such as purchases of supplies or equipment on which delivery had been made or title had otherwise passed to the City, and 2) 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 ASD No. 6. 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 revenues in the expense budget in the current year and in the general fund being established as of June 30, 1976 when collected in cash except those sources considered susceptible to accrual, as set forth in ASD No. 6, as follows:

<table>
<thead>
<tr>
<th>Source of Revenue</th>
<th>Explanation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Sales taxes</td>
<td>Subject to the provisions of ASD No. 6</td>
</tr>
<tr>
<td>2. State and Federal categorical grants</td>
<td>Subject to the provisions of ASD No. 1</td>
</tr>
<tr>
<td>3. Investment income</td>
<td>If temporarily included in General Fund</td>
</tr>
<tr>
<td>4. Water sales and sewer service charges</td>
<td>If temporarily included in General Fund</td>
</tr>
<tr>
<td>5. Charges to departments by Municipal Services Administration</td>
<td></td>
</tr>
</tbody>
</table>

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 for the year ended June 30, 1976 and future years, as set forth in Accounting Systems Directive No. 6. As indicated above, 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) above in the statement of revenues and expenditures and supporting schedule of expenditures classified by function in the City Comptroller's Annual Financial 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>

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 ASD No. 2 designates that real estate taxes are to be recorded as revenue in the fiscal year in which collected, the use of a reserve for uncollectible taxes or its equivalent 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 TAD 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.