

	<b>Montana Operations Manual</b>  <b>Policy</b>	Category	Accounting
		Effective Date	09/01/2004
		Last Revised	Not Approved Yet
Issuing Authority	Department of Administration State Financial Services Division		
<b>311 Fund Equity</b>			

**I. Purpose**

~~Policy 311~~ This policy defines fund equity as it applies to all governmental state agencies and component units.

**II. Scope**

This policy applies to all state agencies and component units, excluding community colleges.

**III. ~~Policy – 311 Fund Equity~~ Overview**

~~III-~~ This policy defines fund equity classifications as outlined in GASB Statement No. 54, GASB Statement No. 63, and GASB Concept Statement No. 4. The policy also discusses stipulations on minimum General Fund balance, fund balance spending, and related accounting disclosures. A governmental fund balance decision tree is provided in Appendix A to assist agencies with determination of fund balance classification.

**IV. Governmental Funds – Fund Balance**

Fund balance is the difference between (a) assets and deferred outflows of resources and (b) liabilities and deferred inflows of resources using the current financial resources measurement focus and the modified accrual basis of accounting (Actuals Ledger for governmental funds). Governmental funds include the General Fund (01100), state special revenue funds (02xxx and 08xxx-08499), federal special revenue funds (03xxx), debt service funds (04xxx), capital project funds (05xxx), and permanent funds (09xxx-09499).

~~GASB Statement No. 54, Fund Balance Reporting and Governmental Fund Type Definitions, establishes accounting and financial reporting standards for governmental funds by providing criteria for classifying fund balances. The objective of this Statement is to improve the usefulness, and understandability, of governmental fund balance information by providing more clearly defined categories making the nature and extent of the constraints placed on governmental funds more transparent.~~

~~According to GASB Statement No. 54, f~~ Fund balance of governmental funds is required to be reported in classifications that comprise a hierarchy based primarily on the extent to which the government is bound to honor constraints on the specific purposes for which amounts in those funds can be spent. These classifications and the criteria for determining the correct classification for the fund balance of governmental funds are included in GASB Statement No. 54. The five fund balance classifications, in order of constraint level, are Nonspendable, Restricted, Committed, Assigned, and Unassigned. Nonspendable, as discussed below, can both represent a constraint or an asset that is not in spendable form, such as inventory or prepaid expenses.

~~V-~~ **A. Nonspendable Fund Balance**

Nonspendable fund balance classification includes amounts that cannot be spent because they are either:

- Not in a spendable form, or not expected to be converted to cash, such as inventory and prepaid amounts.

- Legally or contractually required to remain intact, such as the corpus or principle of a permanent fund; ~~T~~The interest earned on the corpus or principle of a permanent fund may or may not be nNonspendable, depending on the trust agreement; an exception to this requirement is a permanent fund that is defined as nonspendable only in statute and which may not meet the definition of nonspendable in GASB Statement No. 54.
- Long-term amounts of loans and notes receivable, if use of the proceeds from collection is not otherwise constrained, and **only** if the fund balance is otherwise classified as unassigned, or in the gGeneral fFund.
- Property acquired for resale, if use of the proceeds from sale is not otherwise constrained, and **only** if the fund balance is otherwise classified as unassigned, or in the gGeneral fFund.

#### **VI. B. Restricted Fund Balance**

Fund balance should be reported as restricted for amounts that can only be spent or used for specific purposes and the constraints placed on the use of resources are either:

- Externally imposed by creditors, grantors, contributors, or laws and/or regulations of other governments.
- Imposed by law through constitutional provisions.
- Imposed by enabling legislation that is legally enforceable by an external party. If the enabling legislation can be changed by the same action of the government's highest level of authority that established it, the related constraint results in a Committed fund balance, not Restricted. This is discussed under Committed Fund Balance below.

Enabling legislation authorizes the government to assess, levy, charge, or otherwise mandate payment of resources from external providers and *includes a legally enforceable requirement* that those resources be used only for the specific purposes stipulated in the legislation. Legally enforceable means that a government can be compelled by an external party, such as citizens, public interest groups or the judiciary, to use resources created by enabling legislation only for the purposes specified by legislation.

#### **VII. C. Committed Fund Balance**

- Fund balance should be reported as committed for amounts that can only be used for specific purposes when constraints placed on the use of resources are either:
  - Imposed by formal action of the government's highest level of decision-making authority; for the State of Montana the highest level of authority is our legislature.
  - Amounts that cannot be used for any other purpose unless the constraint is changed by an action similar to the action that initially constrained the fund.
  - Amounts that are contractual obligations to the extent the **existing** resources in the fund have been specifically committed for use in satisfying those contractual requirements.

Note: the Committing action must be taken prior to year-end, but the amount may be determined in a subsequent period.

In contrast to fund balance that is Restricted by enabling legislation (previously discussed), amounts classified as Committed fund balance due to enabling legislation may be used for other purposes with the appropriate due process. For example, if fund balance is set aside for a specific purpose by the legislature (normally considered enabling legislation), but the constraint and/or purpose originally placed on the funds can be removed or changed by the same group (legislature in this example) using an action similar to the one that initially constrained the funds, the fund balance classification should be reported as committed rather than Restricted.

#### **VIII. D. Assigned Fund Balance**

Fund balance should be reported as assigned when constraints placed on the resources are:

- Amounts that are constrained by the government's intent to be used for a specific purpose and the intent to spend down fund balance to fund the next

year's projected deficit spending if this exists (discussed further under budgetary appropriation below).

- Neither ~~N~~onspendable, ~~R~~estricted nor ~~C~~ommitted.

Intent should be expressed by either the governing body itself or by a body (budget or finance committee for example) or official the governing body has delegated the authority to assign amounts to be used for a specific purpose. The expression of intent does not have to be made prior to year-end as with commitments.

Assigned fund balance should include fund balance in the ~~G~~eneral ~~f~~und intended for a specific use that is narrower than general purpose of the government.

#### ~~IX.~~ **E. Unassigned Fund Balance**

This classification represents spendable amounts that have not been ~~r~~estricted, ~~c~~ommitted or ~~A~~ssigned to a specific purpose within the ~~G~~eneral ~~f~~und; thus the only fund with a positive ~~u~~nassigned fund balance classification amount will be the General Fund.

Unassigned fund balance will also include fund balance deficits in major categories, however this portion of fund balance classification will be completed by Department of Administration (DOA) State Financial Services Division State Accounting Bureau (SAB) for Comprehensive Annual Financial Report (CAFR) reporting Reporting purposes only.

#### ~~X.~~ **F. Fund Balance Accounts**

Governmental fund balance accounts are defined in SABHRS as follows:

- 4120 \_\_\_\_\_ Nonspendable
- 4121 \_\_\_\_\_ Inventory
- 4122 \_\_\_\_\_ Prepays
- 4123 \_\_\_\_\_ LT Notes Receivable
- 4125 \_\_\_\_\_ Restricted
- 4130 \_\_\_\_\_ Committed
- 4135 \_\_\_\_\_ Assigned
- 4140 \_\_\_\_\_ Unassigned

#### ~~XI.~~ **G. Encumbrances**

~~GASB 54 states e~~ncumbering amounts for specific purposes for which resources already have been ~~r~~estricted, ~~C~~ommitted, or ~~A~~ssigned should not result in separate display of \_\_\_\_\_encumbered amounts within those classifications. Encumbered amounts should be \_\_\_\_\_included within the fund balance's original classification.

#### ~~XII.~~ **H. Budgetary Appropriations**

An adopted budget appropriation law generally does not impact the fund balance classification. Budget appropriation laws authorize an agency to spend budgeted revenues of that fiscal year but do not impose constraints on existing fund balances. However, a specific appropriation of existing fund balance to eliminate a projected budgetary deficit included as a budgetary resource in the subsequent year's budget requires ~~A~~ssigned fund balance classification. This assigned amount cannot exceed projected excess of expected expenditures over expected revenues. Fund balances created as a result of the transfer process, included in an appropriation bill, result in an assignment of fund balance in the related fund because the appropriations bill is not substantive law and does not represent the highest level of decision making authority for the Legislature.

#### ~~XIII.~~ **I. Stabilization Arrangements**

Stabilization is used to refer to economic, revenue, budgetary or other similarly intended arrangements. These are amounts that are formally set aside for use in an emergency situation or when revenue shortages or budgetary imbalances arise. The circumstances when these amounts can be used are dictated by controls set by the government and generally determined by statute, ordinances, resolutions, charter or constitution. Stabilization amounts can only be expended when certain specific circumstances exist.

To be considered a stabilization arrangement for GASB Statement No. 54 purposes, both of the following must be met:

- The formal action that imposes parameters for spending should describe specific circumstances under which a need for stabilization arises, and
- The circumstances should not be expected to occur routinely.

Stabilization is considered to be specific purpose for the purposes of classifying fund balance resources, and should be reported as Rrestricted or Ccommitted based on the criteria previously listed.

#### ~~XIV.~~ **J. Minimum General Fund Balance**

The State does not maintain a stabilization fund. However, statute provides a minimum fund balance amount as follows: Section 17-7-140, MCA, defines minimum ending fund balance and specifies the procedures that must be followed to make expenditure reductions if a projected ending fund balance drops below minimum statutory requirements.

If the Budget Director determines that a deficit exists, statute requires reductions that must be made to assure that the projected ending fund balance is in compliance with the minimum ending fund balance of General Fund appropriations for the biennium. Under circumstances when a deficit of this level is projected during a biennium, the Governor may direct reductions from any General Fund expenditure not exempted by Section 17-7-140, MCA, including House Bill (HB) 2 (the State's main appropriation bill), any other appropriation bills, statutory appropriations, or language appropriations. Reductions may not exceed 10% of General Fund appropriations for any single "program," as defined in HB 2. If a program has more than one appropriation, the reduction for one or more of the appropriations may exceed 10% as long as the reduction for the program as a whole does not exceed 10%.

The Legislative and Judicial branches, the Montana School for the Deaf and Blind, principal and interest on state debt, salaries of elected officials, and public school BASE funding are exempt, statutorily, from reductions. These exemptions shield approximately one-third of General Fund appropriations from reduction. Of the remaining expenditures, the Governor may not direct executive agencies headed by elected officials or the Board of Regents to reduce their expenditures by more than the average reduction percentage imposed upon all other executive branch agencies.

~~The state does not maintain a stabilization fund. However, statute provides a minimum fund balance amount as follows: 17-7-140, MCA, defines minimum ending fund balance (i.e. "deficit" of 1% of expenditures) and specifies the procedures that must be followed to make expenditure reductions if a projected ending fund balance drops below minimum statutory requirements.~~

~~The law requires; if the Budget Director determines that a deficit exists, reductions must be made to assure that the projected ending fund balance is at least 1% of general fund appropriations for the biennium. Under circumstances when a deficit is projected during a biennium, the Governor may direct reductions from any general fund expenditure not exempted by 17-7-140, MCA, including HB2 (the state's main appropriation bill), any other appropriation bills, statutory appropriations, or language appropriations. Reductions may not exceed 10% general fund appropriations for any single "program" as defined by HB2. If a program has more than one appropriation, the reduction for one or more of the appropriations may exceed 10% as long as the reduction for the program as a whole does not exceed 10%.~~

#### ~~XV.~~ **K. Default Order for Fund Balance Spending**

The State generally segregates restricted, committed, and assigned resources by account (sub-fund) within the governmental funds, other than the gGeneral fFund. When resources meeting more than one of these spendable classifications are comingled in an account a subfund on the sState's accounting system the assumed order of spending is restricted first, committed second, and finally assigned. State statute requires non-general fund money be spent whenever possible so any related available unassigned balance would be spent last. The remaining balance in the account or subfund will be classified by the

administering agency, in SABHRS, depending on the order for the fund balance spending.

#### ~~XVI.~~ **L. Fund Balance Disclosures**

The following should be disclosed in the notes of the financial statements regarding the fund balance classification policies and procedures (prepared by ~~DOA State Financial Services Division~~ SAB staff):

- Committed fund balance
  - Government's highest level of decision-making authority, and
  - The formal action required to be taken to establish, amend, or rescind a fund balance commitment.;
- Assigned fund balance
  - Body or official authorized to assign amounts to a specific purpose, and
  - Policy established by the governing body pursuant to which assigned authority is given.
- Policies on order of spending fund balance amounts.

Other fund balance disclosures that should be reported in the notes of the financial statements include:

- Any minimum fund balance policies adopted by the government, and
- Detail of fund balance categories if displayed in the aggregate.

#### ~~XVII.~~ **Governmental Fund Balance Classification Decision Tree**

~~The decision tree found on the last page of this policy should be used to assist an agency in determining the appropriate fund balance classification for governmental funds.~~

#### ~~XVIII.~~ **V. Proprietary Funds and Government-wide – Net Pposition**

Net position is the difference between (a) assets and deferred outflows of resources and (b) liabilities and deferred inflows of resources using the economic resources measurement focus and full accrual basis of accounting (Actuals Ledger for proprietary funds and Actuals plus combined with Entitywide Ledger for governmental funds). Proprietary funds include enterprise funds (06xxx-06499) and internal service funds (065xx-06599).

Net position consists of three classifications include;

- Net investment in capital assets
- Restricted
- ~~Unrestricted~~

Agencies are not required to make the entries necessary to classify net position among these categories in SABHRS; however agencies are required to assist ~~DOA's State Financial Services Division~~ SAB in determining the proper classification for CAFR reporting purposes.

#### ~~XIX.~~ **A. Net iInvestment in eCapital aAssets**

This component of net position consists of capital assets including restricted capital assets, net of accumulated depreciation and related debt. Related debt includes the outstanding balances of any bonds, mortgages, notes, capital lease obligations, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. If there are significant unspent related debt proceeds at year-end, the portion of the debt attributable to the unspent proceeds should not be included in the calculation of nNet investment in capital assets. Rather, that portion of the debt should be included in the same net position classification as the unspent proceeds, such as rRestricted for capital projects.

#### ~~XX.~~ **B. Restricted nNet pPosition**

~~Per GASB 34, paragraph 34,~~ nNet position should be reported as restricted when constraints placed on the net position's use are either:

- Externally imposed by creditors, grantors, contributors, or laws and/or regulations of other governments.

- Imposed by law through constitutional provisions.
- Imposed by enabling legislation that is legally enforceable by an external party.

Enabling legislation authorizes the government to assess, levy, charge, or otherwise mandate payment of resources from external providers and *includes a legally enforceable requirement* that those resources be used only for the specific purposes stipulated in the legislation. Legally enforceability means that a government can be compelled by an external party, such as citizens, public interest groups or the judiciary, to use resources created by enabling legislation only for the purposes specified by legislation. Note that the definition of ~~r~~Restricted is the same for net position as it is for fund balance.

For CAFR reporting purposes, each net ~~asset~~ position restriction is to be presented by major category. Restricted net position related to permanent fund principal amounts or permanent endowments should be displayed in two additional components – expendable and nonexpendable. Nonexpendable net position are those that are required to be retained in perpetuity.

#### ~~XXI.~~ **C. Unrestricted Net position**

Unrestricted net position consists of net position that does not meet the definition of “~~N~~et investment in capital assets” or “~~R~~estricted”.

#### ~~XXII.~~VI. **Fiduciary Funds – Net position**

Net position is the difference between (a) assets and deferred outflow of resources and (b) liabilities and deferred inflows of resources using the economic resources measurement focus and full accrual basis of accounting (Actuals Ledger for fiduciary funds). Fiduciary funds include pension trust funds (095xx-09599), investment trust funds (085xx), agency funds (07xxx) and private purpose trust funds (086xx). Agency funds report only assets and liabilities, reporting no net position.

Net position in a fiduciary fund are to be reported in one net position classification titled “held in trust for the benefit of the plan.” Agencies are not required to classify a fiduciary fund’s net position as such in SABHRS, as ~~DOA State Financial Services Division~~ SAB will make this entry for CAFR reporting purposes.

#### ~~XXIII.~~VII. **Fund balance/Net position direct SABHRS entries**

Direct entries to a fund balance/net position account should only be made in the following circumstances:

- Correction of an error from a previous period that occurred at least two fiscal years prior to the current fiscal year
  - An example would be making a correction for a FY~~09~~14 error in FY~~14~~6
  - Corrections related to the previous fiscal year are to be made to the related revenue/expense account rather than a fund balance/net position account using the previous year’s program year
- Change in accounting principle or a change in the application of an accounting principle.
- Retroactive change mandated by the GASB in conjunction with the implementation of a new pronouncement.
- Entries necessary to record or adjust the fund balance/net position classification.
- Fiscal year-end entries to balance inventory and prepaid expense balances to their respective nonspendable fund balance account are required each fiscal year-end. See MOM Policy 375 – Fiscal Year-end, for more detail.

#### ~~XXIV.~~ **A. Example Accounting entry**

Assume a federal special revenue fund purchased ~~2050~~ total desktop computers in FY~~09~~14 and recorded an expenditure for the entire amount. However, only ~~1984~~ desktop computers were received. The error was not discovered until FY~~14~~6 when a refund was requested and received. In this situation the expenditure cannot be abated because the expenditure was not initially recorded in either FY~~14~~6 or FY~~10~~5, thus a direct entry to fund balance should be recorded to account for this correction.

<i>To record the receipt of the refunded cash in FY1<del>16</del><sup>61</sup></i>			
Debit	1104	Cash in Bank	5,000
Credit	4125	Fund Balance - Restricted	5,000

Assume the same as above, except the error you discovered in FY1~~16~~ happened in FY1~~05~~ rather than FY~~09~~<sup>14</sup>. In this situation an expenditure abatement would be created (using a program year of 201~~05~~) rather than a direct entry to a fund balance account.

<i>To record the receipt of the refunded cash in FY1<del>16</del><sup>61</sup></i>			
Debit	1104	Cash in Bank	5,000
Credit	62743	Multi-user computers & terminals	5,000

**Continued on next page**

**Appendix A Decision Tree**

The decision tree found in Appendix A may be used to assist an agency in determining the appropriate fund balance classification for governmental funds (see next page).

XXV.

