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## Guidance Letter 15-001

Date: May XX, 2015

To: County Finance Officers

From: Terry E. Rubald, Deputy Executive Director, Department of Taxation

CC: Committee on Local Government Finance, Marvin Leavitt, Chairman  
Deonne Contine, Executive Director, Department of Taxation  
Kelly Langley, Supervisor, Local Government Finance, Division of Local Government Services

Subject: Special Revenue Funds and Enterprise Funds

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### SUMMARY:

This guidance letter recognizes Governmental Accounting Standards Board ("GASB") Statements, including but not limited to, No. 34, "Basic Accounting Standards and Management's Discussion and Analysis" and No. 54, "Fund Balance Reporting and Governmental Fund Type Definitions" are appropriate standards for the preparation of financial statements for all funds and comply with the requirements of NRS 354.612(2) as generally accepted accounting principles. In addition, this guidance letter discusses the nature and use of special revenue funds and enterprise funds, and provides an example using the Nevada statutory framework for a general improvement district.

### AUTHORITY:

NRS 354.472(1)(d): One of the purposes of the Local Government Budget and Finance Act is to provide for the control of revenues, expenditures and expenses in order to promote prudence and efficiency in the expenditure of public money. NRS 354.612(2) requires fund financial statements and other schedules to be prepared in accordance with generally accepted accounting principles.

### APPLICATION:

The Department finds that Governmental Accounting Standards Board ("GASB") Statements, including but not limited to, No. 34, "Basic Accounting Standards and Management's Discussion and Analysis" and No. 54, "Fund Balance Reporting and Governmental Fund Type Definitions" are appropriate standards for the preparation of financial statements for all funds and comply with the requirements of NRS 354.612(2) as generally accepted accounting principles.

Based on NRS 354.553, 354.570, and GASB No. 34, a special revenue fund is a type of governmental fund, whereas an enterprise fund is a type of proprietary fund.<sup>1</sup> In either case, the level of financial reporting must be based on a determination of whether the special revenue fund or the enterprise fund is a major or non-major fund.<sup>2</sup> The criteria for designation as a major fund is measured by whether the total assets, liabilities, revenues, or expenditures/expenses of the individual special revenue fund or enterprise fund are at least 10 percent of the corresponding total for all funds of that category or type. In addition, the total assets, liabilities, revenues, or expenditures/expenses of the individual special revenue fund or enterprise fund must be at least 5 percent of the corresponding total for all governmental and enterprise funds combined.<sup>3</sup>

When establishing a new fund, it is important to examine the activities that meet the criteria for using a particular kind of fund. For example, a governmental fund, such as a special revenue fund, generally has activities which are financed through taxes, intergovernmental revenues, and other non-exchange revenues. Business-type activities financed in whole or in part by fees charged to external parties for goods or services are usually, but not always, reported in enterprise funds.<sup>4</sup>

GASB No. 34, ¶78 outlines the financial statements required for governmental funds, including a balance sheet and statement of revenues, expenditures, and changes in fund balances. GASB No. 34, ¶91 indicates the required financial statements for a proprietary fund include a statement of net assets or balance sheet; a statement of revenues, expenses, and changes in fund net assets or fund equity; and a statement of cash flows.

### ***Enterprise Funds***

NRS 354.517 defines an enterprise fund as a fund established to account for operations (1) which are financed and conducted in a manner similar to the operations of private business enterprises, where the intent of the governing body is to have the expenses (including depreciation) of providing goods or services on a continuing basis to the general public, financed or recovered primarily through charges to the users; or (2) for which the governing body has decided that a periodic determination of revenues earned, expenses incurred and net income is consistent with public policy and is appropriate for capital maintenance, management control, accountability or other purposes.

Similarly, ¶67 of GASB Statement No. 34 states that an enterprise fund may be used to report any activity for which a fee is charged to external users for goods or services. In addition:

Activities are *required* to be reported as enterprise funds if any one of the following criteria is met. Governments should apply each of these criteria in the context of the activity's *principal revenue sources*.

- a. The activity is financed with debt that is secured solely by a pledge of the net revenues from fees and charges of the activity. Debt that is secured by a pledge of net revenues from fees and charges and the full faith and credit of a related primary government or component unit—even if that government is not expected to make any payments—is not payable solely from fees and charges of the activity. (Some debt may be secured, in part, by a portion of its own proceeds but should be considered as payable “solely” from the revenues of the activity.)

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<sup>1</sup>NRS 354.553, “Proprietary fund” means an internal service fund or enterprise fund; and NRS 354.570, “Special revenue fund” means a fund used to account for specific revenue sources, other than sources for major capital projects, which are restricted by law to expenditure for specified purposes. *See also*, ¶63, ¶64, ¶66, ¶67, GASB Statement No. 34 (June 1999), pp. 25-26.

<sup>2</sup> ¶75, GASB Statement No. 34 (June 1999), p. 28.

<sup>3</sup> ¶76, GASB Statement No. 34 (June, 1999), p. 28.

<sup>4</sup> ¶15, GASB Statement No. 34 (June, 1999), p. 9.

- b. Laws or regulations require that the activity's costs of providing services, including capital costs (such as depreciation debt service), be recovered with fees and charges, rather than with taxes or similar revenues.
- c. The pricing policies of the activity establish fees and charges designed to recover its costs, including capital costs (such as depreciation or debt service).

Footnote 33 to ¶67 states that:

These criteria do not require insignificant activities of governments to be reported as enterprise funds. For example, state law may require a county's small claims court to assess plaintiffs a fee to cover the cost of frivolous claims. However, taxes, not fees, are the principal revenue source of the county's court system, and the fees in question cover only the cost of frivolous small claims court cases. In this case, the county would not be required to remove its court system or the small claims court activity from its general fund and report it in an enterprise fund. Conversely, a state department of environmental protection regulation may require a water utility to recover the costs of operating its water plant, including debt service costs, through charges to its customers—the utility's principal revenue source. Because these charges are the activity's principal revenue source and because the water utility is required to recover its costs, the utility should be reported as an enterprise fund.

In explaining enterprise fund reporting requirements, GASB 34, ¶387 states that:

Perhaps most significantly, this Statement makes clear that enterprise fund reporting should be used for any activity that is financed with *debt secured solely by net revenue* from its fees and charges to external users. Enterprise fund reporting is also required for any activity that operates under *laws or regulations* requiring that its costs of providing services, including capital costs (depreciation or debt service), be recovered with fees and charges. The final criterion—requiring enterprise fund reporting for any activity for which management establishes fees and charges, pursuant to its *pricing policies*, designed to recover its costs of providing services, including capital costs—is similar to the existing criterion. However, it adds an element of objectivity by basing the standard on established policies rather than management's intent. Further, this Statement makes clear that all criteria for required use of enterprise fund reporting should be applied only in the context of an activity's principal revenue sources. For example, paragraph 67a requires an activity to be reported as an enterprise fund if the activity is financed by debt secured solely by a pledge of the net revenue from fees and charges of the activity. To apply the principal revenue source test in relation to this criterion, a government should compare an activity's pledged revenues to its total revenues.

### **Special Revenue Funds**

GASB Statement No. 54, "Fund Balance Reporting and Governmental Fund Type Definitions" abandons the reserved and unreserved classifications of fund balance and replaces them with five new classifications: non-spendable, restricted, committed, assigned and unassigned. These classifications will indicate the level of constraints placed upon how resources can be spent and identify the sources of those constraints.

In addition, Statement No. 54 updates the definitions of governmental fund types, with the most significant changes related to special revenue funds. The nature of a special revenue fund is discussed at Paragraph 30:

30. Special revenue funds are used to account for and report the proceeds of specific revenue sources that are restricted or committed to expenditure for specified purposes other than debt service or capital projects. The term *proceeds of specific revenue sources* establishes that one or more specific restricted or committed revenues should be the foundation for a special revenue fund. Those specific restricted or committed revenues may be initially received in another fund and subsequently distributed to a special revenue fund. Those amounts should not be recognized as revenue in the fund initially receiving them; however, those inflows should be recognized as revenue in the special revenue fund in which they will be expended in accordance with specified purposes. Special revenue funds should not be used to account for resources held in trust for individuals, private organizations, or other governments.

In the past, special revenue funds were reported in instances where there was a specific spending purpose, but not necessarily a specific revenue source. The new definition of a special revenue fund means that local governments need to evaluate resources received to determine if they qualify for reporting in a special revenue fund. An activity may no longer be reported as a special revenue fund based only on management's desire to account for it separately. For all major special revenue funds reported, local governments will need to disclose the purpose of the fund and the revenues and other resources reported in the funds in the notes to the financial statements.

***Please note that the change in classifications of fund balance and special revenue fund reporting requirements detailed in Statement No. 54 does not require changes in the way a local government budgets and internally accounts for special revenue funds; and the Department has not changed the budget reporting forms to reflect the new classifications.***

In addition, GASB Statement No. 54 states at Paragraph 31:

The restricted or committed proceeds of specific revenue sources should be expected to continue to comprise a *substantial portion* of the inflows reported in the fund. Other resources (investment earnings and transfers from other funds, for example) also may be reported in the fund if those resources are restricted, committed, or assigned to the specified purpose of the fund. Governments should discontinue reporting a special revenue fund, and instead report the fund's remaining resources in the general fund, if the government no longer expects that a substantial portion of the inflows will derive from restricted or committed revenue sources.

Local governments may use the following calculation to determine whether an activity would qualify for reporting as a special revenue fund:

$$\text{Substantial portion of inflows} = \frac{\text{(restricted revenues + committed revenues)}}{\text{Total Inflows reported in the fund}}$$

In the calculation, restricted revenues are defined as resources externally restricted or having restrictions imposed by internal enabling legislation (same definition as restricted net assets used in government-wide reporting). The committed revenues are resources with constraints imposed by the highest level of the government, where the constraints can be removed only by a similar action of the same governing body. Total Inflows are defined as the inflows of all financial resources. Total inflows will include transfers and other financing sources such as debt issuances.<sup>5</sup>

"Substantial portion" of inflows is not defined in Statement No. 54, however, the Government Finance Officers Association has indicated "around 20 percent" is reasonable for justifying a special revenue fund; and it is a commonly used threshold. Local governments also need to consider factors such as

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<sup>5</sup> Washington State Auditor's Office, "GASB Statement 54 – Focusing on Special Revenue Funds," page 37, accessed 4-17-15 at <http://digitalarchives.wa.gov/WA.Media/do/BE1679E72F5484784D2834ACA64AE00E.pdf>

past resource history, future resource expectations and unusual current year inflows such as debt proceeds.<sup>6</sup>

### **Example – Nevada General Improvement District**

NRS 318.197 permits a governing board of a general improvement district to fix rates, tolls or charges other than special assessments, including but not limited to, service charges and standby service charges, for services or facilities furnished by the district. NRS 318.197 is permissive rather than mandatory in that the governing board “may” fix rates, tolls or charges to cover the costs of services or facilities furnished.

The board may “pledge the revenue for the payment of any indebtedness or special obligations of the district.” Such rates and tolls constitute a perpetual lien on and against the property served, and may be collected on the tax roll together with the county’s general taxes (NRS 318.201). In addition, NRS 318.225 grants the governing board the power and authority to levy ad valorem taxes. NRS 318.275 permits the district to borrow money and issue GO bonds, revenue bonds, and special assessment bonds. Revenue bonds issued for the purpose of acquiring or improving facilities appertaining to the basic purpose of the district must be made payable solely out of the net revenues for any and all of the income-producing facilities and services provided by the district (NRS 318.320). General obligation bonds and other general obligation securities payable from general property taxes may be additionally secured by a pledge of and lien on net revenues. (NRS 318.325).

Applying GASB Statement 34, ¶67(a-c) to the Nevada statutory framework for general improvement districts, since a general improvement district is not required to recover costs through rates, tolls, or charges under NRS 318.197, an enterprise fund is not required to be used. However, if the general improvement district’s activity is financed with debt that is secured solely by a pledge of the net revenues from fees and charges of the activity, then it would be required to use the enterprise fund accounting. This would be the case if the district issued revenue bonds pursuant to NRS 318.320. If the district’s activity is financed with debt secured by both taxes and user fees, then it is not required to use the enterprise fund accounting, as would be the case under NRS 318.325 for GO bonds secured by taxes or a combination of taxes and fees. Finally, under ¶67(c), if the pricing policies of the district for the fees and charges are designed to recover its costs, including capital costs (such as depreciation or debt service), then the enterprise fund accounting must be used.

If the general improvement district did not meet the conditions requiring the use of enterprise fund accounting pursuant to GASB Statement No. 34, ¶67, then standard governmental fund reporting must be used. If the general improvement district contemplated creating a major special revenue fund, then at least 20% of the total inflows reported in the fund must be restricted and/or committed to the purpose for which the fund was created. The restricted and committed revenue must be recognized as revenue of the special revenue fund rather than the general fund. Total inflows include restricted revenues, committed revenues, transfers in and any other financing sources.

**.If you have any questions about this guidance letter, please call the Local Government Finance Section of the Division of Local Government Services, Department of Taxation at (775) 684-2100.**

**WEBSITE LOCATIONS:**

Nevada Revised Statutes (NRS): <http://www.leg.state.nv.us/NRS/>

Nevada Administrative Code: <http://www.leg.state.nv.us/NAC/CHAPTERS.html>

Department of Taxation Guidance letters: <http://www.tax.state.nv.us>; then select “Publications;” then select Assessment Standards Publications and “Guidance letters.”

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<sup>6</sup> Ibid, p. 37 and New York Division of Local Government and School Accountability, “Fund Balance Reporting and Governmental Fund Type Definitions,” p. 5, accessed 4-17-15 at <https://osc.state.ny.us/localgov/pubs/releases/gasb54.pdf>