ARP Accounting and Financial Reporting in North Carolina

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Accounting and financial reporting guidance for American Rescue Plan monies seems to be a never-ending soap opera with constant twists and turns. While there is extensive GAAP-guidance for government mandated nonexchange transactions related to asset, liability, revenue, and expense/expenditure recognition, it has proven more challenging to readily fit all the square evolving ARP guidelines and options into the GAAP round holes. This blogpost focuses on asset, liability, revenue and expense/expenditure recognition guidelines for the various ways that ARP funds may be received, managed, and expended.

Initial Receipt of ARP Funds

The North Carolina General Statutes (G.S. 159-13.2) allow local governments to adopt a multi-year grant project ordinance (classified as a special revenue fund) for a variety of operating and/or capital projects that are primarily funded with federal and state grant monies. The budgetary authority lasts for the duration of the projects or activities and does not have to be renewed year to year. Both for budgetary purposes and audit trail necessity, it is highly recommended that a special revenue fund be the "point of entry" for all ARP receipts (i.e., the first and second tranches). From that point, the recipient government will decide for what allowable purposes the funds will be appropriated and spent. The monies may be spent directly out of the ARP special revenue fund or transferred to one or more other funds (e.g., general fund, enterprise funds, capital project fund) for allowable uses.

Asset, Liability, Revenue, and Expense/Expenditure Recognition of ARP Funds

ARP funds meet the definition of government-mandated nonexchange transactions as defined in GASB Statement No. 33, Accounting and Financial Reporting for Nonexchange Transactions*.* As such, assets (e.g., ARP funds) are to be reported as restricted until used for the provider's specified purpose or purposes and revenues are to be recognized only when all applicable eligibility requirements have been met. Specifically it is noted in Part 1(C)(2) of Compliance and Reporting Guidance, State and Local Fiscal Recovery Funds (*SLFRF Compliance Guidance*) that

"…recipient…may use funds to cover eligible costs that your organization incurred during the period that begins on March 3, 2021, and ends on December 31, 2024, as long as the award funds for the obligations incurred by December 31, 2024, are expended by December 31, 2026."

Thus, eligibility requirements are met when an obligation is incurred *no later than* December 31, 2024, *and* the expenditure occurs no later than December 31, 2026.

The *SLFRF Compliance Guidance* also states in Part 1(C)(2) the following:

"Any funds not obligated or expended for eligible uses by the timelines above must be returned to Treasury, including any unobligated or unexpended funds that have been provided to subrecipients and contractors as part of the award closeout process pursuant to 2 C.F.R. 200.344(d). **For the purposes of determining expenditure eligibility, Treasury's final rule provides that "incurred" means the recipient has incurred an obligation, which has the same meaning given to "financial obligation" in 2 CFR 200.1."** (emphasis added).

Finally, 2 CFR 200.1 (Uniform Guidance) defines "financial obligation" as the following:

"*Financial obligations,* when referencing a recipient's or subrecipient's use of funds under a Federal award, means orders placed for property and services, contracts and subawards made, and similar transactions that require payment."

Therefore, eligibility requirements for ARP funds are considered to have been fulfilled in the fiscal year when *both* the obligation and expenditure requirements for an eligible purpose have been met. While that does not have to be in the same fiscal year, the majority of small and medium sized governments will most likely meet both requirements in the same fiscal year. Revenue recognition finally occurs when both the obligation requirement and expenditure requirements have been met. Until all eligibility requirements are met, the recipient government reports the restricted funds as unearned revenues (i.e., a liability).

Revenue Recognition Scenarios

Revenue recognition may only occur in one fund. Assuming that the ARP funds are all initially received and recorded in the special revenue fund, the revenues are considered unearned in that fund until used for an eligible purpose. When all eligibility requirements are met then the funds are considered revenue.

For governments that decide to spend their ARP funds directly out of the special revenue fund, revenue is considered earned when both the obligation and expenditure have occurred. There will be an expenditure or expenditures in the fund. The previously unearned ARP revenue is reclassified as revenue.

Many governments will be using some or possibly all of their ARP resources for activities that are accounted for in other funds, most notably the general fund or an enterprise fund. It is still highly recommended that the ARP funds initially be received and recorded in the special revenue fund and then transferred *as the purposes for use of the funds have been determined.* The following are some examples of these transactions:

- If a government has determined that it is using some or all of their ARP funds to reimburse *prior* general fund expenditures, all that is necessary is to transfer the funds from the special revenue fund to the general fund. Revenue recognition is then met for that amount in the special revenue fund as the obligations and expenditures have already occurred in the general fund. The transfer of the funds is simply the mechanism to get the monies moved from one fund to another. Internal records should support what specific expenditures were being reimbursed for ARP reporting purposes. For GAAP purposes, the special revenue fund reports a transfer out and the general fund reports a transfer in. *There is no revenue recognition in the general fund.* This would be the same approach if the revenue replacement was for an enterprise fund.

- For governments using ARP for forward-looking expenditures in the general fund or enterprise fund, it is recommended that the transfers occur *as the funds' use(s) has been determined and when the dollars will be properly procured AND expended by the recipient fund in that same fiscal year.* This is the most transparent way to recognize revenue in the special revenue fund as the monies are being transferred and used in the same fiscal year by the recipient fund.

- Assume a government has decided to use some or all of their ARP funds for a multi-year enterprise fund capital project. To report the proper timing of revenue recognition in the special revenue fund, it is recommended that the transfer of funds be on an as needed or annual basis, ensuring that the dollars will be properly procured and spent by the recipient enterprise fund in the same fiscal year as the transfer. The special revenue fund will report a transfer out and the enterprise fund will report a transfer in for each fiscal year that it occurs. *There is no revenue recognition in the enterprise fund.* For multi-year projects, it is likely that obligations will be incurred in a fiscal year before the actual expenditure occurs. The obligation alone is not sufficient for revenue recognition thus it is not recommended that a transfer occurs at that time but rather when the actual expenditure will be made. (*Remember the deadlines for obligations and expenditures that were mentioned earlier.)*

- Occasionally, monies may be transferred from a special revenue fund to another fund but not properly obligated and expended by the end of the fiscal year. The special revenue fund ultimately cannot recognize that revenue until both proper obligation and expenditure has occurred. The unspent funds should be transferred back to the special revenue fund and reported as unearned revenue. This would require adjusting entries at the end of the fiscal year for proper GAAP financial reporting preparation for both funds.

Conclusion

In evaluating the proper revenue recognition for funds as units are procuring and spending their ARP dollars, every option was explored. It was hoped that there would be a way to more easily recognize revenue such as when governing boards had made use decisions, when contracts were entered into, or other proper obligating procedures had been completed. However, it became increasingly clear that the following prevented any other interpretation of revenue recognition timing due to the following requirements cited earlier:

"…recipient…may use funds to cover eligible costs that your organization incurred during the period that begins on March 3, 2021, and ends on December 31, 2024, as long as the award funds for the obligations incurred by December 31, 2024, are expended by December 31, 2026."

While the majority of governments will meet the full eligibility requirements years before the dates above, it is possible for some that revenue recognition could be extended until 2026. Thus, there was no other conclusion that could be reached.

Credits

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