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Preparing and reporting on cash- and tax-basis financial statements

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AICPA

Preparing and Reporting on Cash- and Tax-Basis Financial Statements

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AICPA

FEEDBACK ON "PREPARING AND REPORTING ON CASH- AND TAX-BASIS FINANCIAL STATEMENTS"

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Preparing and Reporting on Cash- and Tax-Basis Financial Statements

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Foreword

Those of you with a working knowledge of cash- and tax-basis financial statements are undoubtedly aware that the authoritative literature on the subject is somewhat vague. The reaction to this situation generally falls into one of two conflicting categories.

Many practitioners like the flexibility the current guidance allows. They believe this flexibility is one of the key reasons why cash- and tax-basis statements are a cost-effective alternative to GAAP, and the last thing needed is an authoritative standard that diminishes the exercise of judgment. Other practitioners believe that the existing guidance is too broad and would welcome something more definitive.

We believe this publication balances these two conflicting views. It is not a substitute for judgment but rather a resource, a tool to help you make the judgments required in preparing and reporting on cash- and tax-basis financial statements.

Part One of the guide is a discussion of key accounting concepts and an overview of current authoritative guidance and unique issues for cash- and tax-basis statements. These issues and the related discussion are indexed in the front of the guide.

Part Two consists of detailed guidelines on recognition, measurement, disclosure and reporting issues unique to cash- and tax-basis statements. Included in this section are the results of a survey we recently conducted of PCPS (AICPA's Private Companies Practice Section) members to determine how some of these issues are handled in practice by your peers.

Part Three contains numerous example financial statements and note disclosures. These were gathered as part of the survey, and again, you have the opportunity to see how other practitioners have handled situations that may be similar to your own. Included in this section are financial statements from entities in seven different industries, including local government, real estate limited partnerships, and not-for-profit.

The appendix to this guide includes a number of practice aids, including a disclosure checklist supplement and a planning memo for cash- and tax-basis statements.

We would like to thank the Technical Issues Committee of the PCPS and all the members that responded to our survey.

We hope you find the guide useful in your practice.

Sincerely,

Susan L. Menelaides

Susan L. Menelaides, CPA
Director, Technical Information

Preparing and Reporting on
Cash- and Tax-Basis
Financial Statements

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Preparing and Reporting on Cash- and Tax-Basis Financial Statements

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Part One:

General Guidance

Chapter 1
Overview

For many years, financial statements prepared on the cash- and tax- bases of accounting have provided useful financial information to management, owners, creditors, and other financial statement users. Users of cash- and tax-basis financial statements often find them to be understandable and relevant to their various needs. Also, the preparers of cash- and tax-basis statements have found them to be cost-effective alternatives to generally accepted accounting principles (GAAP) statements because accounting records are often maintained on the cash- and tax-methods of accounting.

Because there is very little authoritative guidance that explicitly addresses cash- and tax-basis financial statements, practitioners frequently struggle with which (and to what extent) recognition, measurement, and disclosure rules apply to cash- and tax-basis statements. The recent proliferation of complex accounting rules issued by the FASB and the AICPA -- particularly those related to disclosure of matters not measured in the financial statements -- have exacerbated the practitioner's dilemma.

Views on which recognition, measurement, and disclosure rules apply to cash- and tax-basis statements are very divergent: On one end of the spectrum are practitioners who believe that all accounting standards should be stringently applied to all types of financial statements, regardless of the basis of accounting; on the other end of the spectrum are those who believe that authoritative accounting standards were developed solely for financial statements prepared in accordance with GAAP, and as a result, accounting standards do not apply to statements prepared on other comprehensive bases of accounting.

This practice guide is not intended to resolve these differences in viewpoints; rather, it is intended to inform you of some of the most frequently-encountered issues faced by your colleagues in dealing with their clients' cash- and tax-basis financial statements, and to give you the opportunity to see how they have handled them.

1994 PCPS Survey

The basis of this practice guide is a survey mailed to 2,000 members of the AICPA's Private Companies Practice Section in September 1994. We asked them to tell us how, and to what extent, they apply current accounting and auditing literature to cash- and tax-basis statements, including information about presentation and disclosure issues. We also asked them to send us sample cash- and tax- basis statements, some of which are illustrated in Part Three to this guide.

Organization of this Practice Guide

This guide is comprised of three parts:

Part One includes an introduction to financial statements prepared on an other comprehensive basis of accounting (OCBOA) and a discussion of unique issues for cash- and tax-basis financial statements.

Part Two discusses the often complex recognition, measurement, disclosure, and reporting issues surrounding OCBOA statements. This section includes graphical presentation and discussion of the results of the PCPS survey.

Part Three includes example financial statements and disclosures provided by survey respondents and engagement tools such as a planning and review memo and a disclosure checklist.

Nonauthoritative Nature of the Practice Guide

This publication is issued as a nonauthoritative guide and is not intended as a substitute for professional judgment or for authoritative technical literature. Users are urged to refer directly to applicable authoritative pronouncements for the text of technical standards. The practice guide has not been approved, disapproved, or otherwise acted upon by any senior technical committees of the AICPA, the FASB or the GASB and has no official or authoritative status.

Terminology and Abbreviations

While the 1994 PCPS Survey and the contents of this guide focus primarily on the cash- and tax-bases of accounting, much of our advice can be applied to other comprehensive bases of accounting. As a result, we frequently use the terms "other comprehensive basis of accounting" and "OCBOA" throughout this guide.

Legend of abbreviations

ARB	=	Accounting Research Bulletin
APB	=	Accounting Principles Board Opinion
SFAS	=	Statement of Financial Accounting Standards
FASBI	=	Financial Accounting Standards Board Interpretation
TB	=	Technical Bulletin
SAS	=	Statement on Auditing Standards
AU	=	Reference to section number in *AICPA Professional Standards* (vol. 1)
SSARS	=	Statement on Standards for Accounting and Review Services
AT	=	Statement on Standards for Attestation Engagements
SOP	=	AICPA Statement of Position
TPA	=	AICPA Technical Practice Aid

Chapter 2
Introduction to Cash- and Tax-Basis Financial Statements

Why are Cash- and Tax-Basis Financial Statements Issued?

Typically, entities issue cash- and tax-basis financial statements when they are considered to be a cost-effective alternative to GAAP financial statements. Preparing OCBOA financial statements is generally less costly than preparing GAAP financial statements for the following two reasons:

- Less extensive disclosure requirements. As discussed elsewhere in this guide, OCBOA financial statements do not require all of the extensive disclosures required for GAAP statements. The requirement is that the financial statements "include all informative disclosures that are appropriate for the basis of accounting used."

- Ability to prepare tax returns and financial statements from the same information. When tax-basis financial statements are issued, a significant portion of the cost can be absorbed by the preparation of the tax return.

A September 1990 survey of PCPS members indicated that over 80% of the respondents used OCBOA for selected clients. The most typical industries in which OCBOA statements were used include:

- Professional services

- Medical

- Retail

- Real estate

- Construction

- Manufacturing

- Farming/Agriculture

Issue #1: Under what circumstances are OCBOA statements appropriate? When are they inappropriate?

This issue is not addressed directly in authoritative accounting literature.

Writing in *The Journal of Commercial Bank Lending*, Judith O'Dell, former chairperson of the Technical Issues Committee of the PCPS, addresses the issue of when OCBOA financial statements are appropriate for lending decisions. She notes that OCBOA financial statements can be efficient and appropriate for borrowers meeting some or all of the following criteria:

- The business is owned by a manager who is closely involved in day-to-day operating decisions and who carries in his or her mind--at all times--a fairly accurate picture of the company's financial position.

- The company is a small, closely held business with little or no unsecured debt.

- The company has a cash flow that is parallel to its income and expenses (for cash-basis statements).

- The company is not highly leveraged.

OCBOA financial statements would **not** be appropriate for a potential borrower that:

- Anticipates going public

- Has loan covenants requiring GAAP-basis financial statements

- Has numerous absentee owners

- Has substantial unfunded obligations, commitments, and contingent obligations that would not be recorded on the income tax or cash basis

Determining whether OCBOA financial statements are appropriate is tied directly to the needs of the financial statement users.

The 1994 survey of PCPS member firms asked, "Which external user group(s) frequently are provided OCBOA financial statements?" The response to that question was:

Survey Results
User Groups That Frequently
Receive OCBOA Financial Statements

	Percent
Lending institutions	78%
Bonding companies	14%
Regulatory or government funding agencies	5%
Vendors or creditors	4%
Outside investors	2%
National affiliates or affiliate organizations	1%
Other	2%
None, statements are for client use only	11%

In other words, 78% of the survey respondents indicated that lending institutions frequently receive OCBOA financial statements, while only 2% indicated that outside investors frequently are provided OCBOA statements.

Overview of Authoritative OCBOA Literature and a Summary of Key Issues

Guidance on OCBOA financial statements is contained in the audit, rather than the accounting, literature. Sources of authoritative guidance are SAS 62, *Special Reports*, AU §623 and Auditing Interpretations, *Special Reports*, AU §9623.

Nonauthoritative guidance on OCBOA financial statements can be found in this publication and in the AICPA's Technical Practice Aids, Section 1500, *Cash Basis Statements or Modifications Having Substantial Support*.

Many issues have arisen in practice for which there is no authoritative guidance. These issues are summarized as follows. A more detailed discussion of these issues is continued in chapters 3, 4 and 5 of this guide.

- *Measurement.* Should nontaxable income and expenses be included in tax-basis financial statements? What cash-basis modifications are considered to have substantial support? At what point do cash-basis modifications become so extensive that the financial statements are really GAAP basis with a departure? See chapter 3.

- *Display.* SAS 62 says, "Terms such as balance sheet, statement of financial position, statement of income, statement of operations, and statement of cash flows, or similar unmodified titles are generally understood to be applicable only to financial statements that are intended to present financial position, results of operations, or cash flows in conformity with generally accepted accounting principles." Consequently, the auditor should consider whether the financial statements that he or she is reporting on are "suitably titled." What is considered to be "suitably titled"? Is it appropriate to use titles that are not expressly forbidden? How should the financial statements report a change in the basis of accounting from GAAP in the previous year to OCBOA in the current year? See chapter 4.

- *Disclosure.* This is perhaps the most heavily debated issue relating to OCBOA financial statements. Guidance on OCBOA disclosures is contained primarily in AU §623.09 and .10. Those two paragraphs provide some definitive guidance, but also allow OCBOA financial statement preparers to use considerable judgment in providing informative disclosures that are "appropriate for the basis of accounting used," or that are "similar" to GAAP disclosures. The terms "appropriate" and "similar" are open to interpretation, as discussed in more detail in chapter 4.

- *Reporting.* Guidance on reporting on OCBOA financial statements is contained in the audit literature. SSARS Interpretation No. 12 (AR §9100) provides guidance on standard compilation and review reports accompanying OCBOA financial statements. In a compilation or review, is there a requirement to modify your report in the event of a lack of consistency, or for a significant uncertainty (including going concern)? See chapter 5.

What's An Other Comprehensive Basis of Accounting?

By "other" we mean other than GAAP. SAS 62, *Special Reports*, (AU §623) defines the following as other comprehensive bases of accounting.

- *Tax basis.* The basis of accounting the reporting entity uses (or expects to use) to file its income tax return for the period covered by the financial statements.

- *Cash/Modified cash basis.* The cash receipts and disbursements basis of accounting and modifications of the cash basis having substantial support, such as recording depreciation on fixed assets or accruing current income taxes.

- *Regulatory.* A basis of accounting the reporting entity uses to comply with the requirements or financial reporting provisions of a governmental regulatory agency to whose jurisdiction the entity is subject. An example is a basis of accounting insurance companies use pursuant to the rules of a state insurance commission.

- *Other.* A definite set of criteria having substantial support that is applied to all material items appearing in financial statements, such as the price-level basis of accounting.

Under SAS 62, reports on financial statements prepared in compliance with the requirements of a governmental regulatory agency must be restricted to distribution within the entity and for filing with the regulatory agency. Because these types of financial statements are not intended for general use, they are not discussed in this publication.

SAS 62 (AU 623.27) specifies certain bases of accounting that are **not** considered OCBOA. These include:

- A loan agreement that requires the borrower to prepare consolidated financial statements in which assets, such as inventory, are presented on a basis that is not in conformity with GAAP or an other comprehensive basis of accounting.

- An acquisition agreement that requires the financial statements of the entity being acquired to be prepared in conformity with GAAP except for certain assets, such as receivables, inventories, and properties for which a valuation basis is specified in the agreement.

The above situations are not considered OCBOA statements because the criteria used to prepare such financial statements are not considered to be "criteria having substantial support," even though the criteria are definite.

Issue #2: How do you know whether the accounting basis used is considered OCBOA; that is, is the accounting basis based on "a definite set of criteria having substantial support that is applied to all material items"?

Occasionally, the question arises as to whether some other basis of accounting that differs from GAAP can be considered an OCBOA. In responding to a 1994 Survey question, respondents indicated that

99% of the OCBOA statements their firms report on are on the cash, modified cash, and tax bases of accounting. In other words, the survey respondents seemed to indicate that they consider these three bases -- and virtually no others -- to meet the "substantial support" criterion. The author therefore believes that, rather than question whether some other accounting basis can be considered OCBOA, practitioners are well-advised to stay within the bases of accounting currently viewed as having substantial support.

A Review of Key Terms and Concepts

Much of the guidance contained in this publication is based on the concepts and logical methods described in GAAP accounting literature. The purpose of this section is to provide you with the background necessary to apply the guidance provided and, in the event you encounter a situation for which guidance has not been provided, to apply sound accounting reasoning to come to an appropriate conclusion.

A basis of accounting (including an "other" basis of accounting) is a framework for determining what and how information is presented in the financial statements and related notes. This framework must address three separate issues:

- Recognition. When should an item be incorporated into the financial statements?

- Measurement. How will you quantify the item?

- Display and disclosure. How do you describe the item in the financial statements? What other information should be presented in the notes to prevent the financial statements from being misleading?

Recognition. An item and the information about it should be recognized in the financial statements when the following four criteria are met:

- Definition--The item meets the definition of an element of financial statements.

- Measurability--It has a relevant attribute that can be reliably measured.

- Relevance--The information about it may make a difference to financial statement users.

- Reliability--The information is representationally faithful, verifiable, and neutral.

Measurement. The item must have a relevant attribute that can be quantified monetarily with sufficient reliability. Some items may meet the definition of a financial statement element but may not be measurable. For example, the creation of product awareness by advertising and promotion may result in future benefits--an asset under generally accepted accounting principles. But it will not be recorded as an asset because it fails to meet the measurement criteria. How will you quantify--monetarily--product awareness? If you can quantify it, will that measurement be reliable?

Display and Disclosure. Some information is better provided, or can only be provided, by notes to financial statements, by supplementary information, or by other means of financial information. For example:

- Information that is essential to understanding the information recognized in the financial statements, such as a summary of significant accounting policies.

- Information that may be relevant to financial statement users but does not meet all the recognition criteria.

Keep in mind that if an item meets the recognition criteria, it should be recognized. Disclosure is not a substitute for financial statement recognition.

In discussing the broad characteristics of accounting, the FASB has noted the following:[1]

> Those who are unfamiliar with the nature of accounting are often surprised at the large number of choices that accountants are required to make. Yet choices arise at every turn.
>
> Decisions must first be made about the nature and definition of assets and liabilities, revenues and expenses, and the criteria by which they are to be recognized. Then a choice must be made of the attribute of assets to be measured.
>
> If costs have to be allocated, methods of allocation must be chosen. Further, choices must be made about the level of aggregation or disaggregation of the information to be disclosed in financial reports. Should a particular subsidiary be consolidated or should its financial statements be presented separately? Still other choices concern the selection of the terminal date of an enterprise's financial year, the form of descriptive captions to be used in the financial statements, the selection of matters to be commented on in notes in supplementary information, and the wording to be used.

Using OCBOA financial statements requires decisions to be made about a large number of issues. The guidance that follows is intended to help practitioners make those decisions.

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[1] FASB Concepts Statement No. 2, *Qualitative Characteristics of Accounting Information*, paragraph 8.

Part Two:

Recognition, Measurement, Disclosure and Reporting

Chapter 3
Recognition and
Measurement Guidelines

Recognition is concerned with determining when an item should be incorporated into the financial statements. In general, an item and the information about it are recognized in GAAP financial statements when the following four criteria are met:

- Definition. The item meets the definition of an element of financial statements.

- Measurability. It has a relevant attribute that can be reliably measured.

- Relevance. The information about it may make a difference to financial statement users.

- Reliability. The information is representationally faithful, verifiable, and neutral.

This chapter discusses recognition and measurement issues for cash-, modified cash-, and tax-basis financial statements.

Cash Basis

Under the cash basis of accounting, transactions would be recorded on the basis of cash receipts and disbursements. As a result:

- Certain revenue and the related assets are recognized when received rather than when earned, and

- Certain expenses are recognized when paid rather than when the obligation is incurred.

Under the cash basis, long-term assets are not capitalized so there is no depreciation or amortization. Accruals are not made and prepaid assets are not recorded. Under the "pure" cash basis, the statement of assets and liabilities would include only cash and owners' equity.

Typically, a cash-basis presentation consists of a summary of cash receipts and disbursements. In this form of presentation, cash receipts from sales, the incurrence of debt, contributions, and so forth, and disbursements for debt repayment, expenses, and the purchase of fixed assets are summarized to show the change in the cash balance for a period.

Pure cash-basis financial statements may be appropriate for certain smaller companies when cash flow is of primary importance to management and to a limited number of users. Examples of some entities that may use the pure cash basis of accounting include:

- Estates and trusts

- Civic ventures

- Student activity funds

Modified Cash Basis

The modified cash basis of accounting is a hybrid that combines elements of the cash and accrual basis of accounting. For example, a modified cash basis balance sheet may include the capitalization of long-term assets and inventory, but no accrual of accounts receivable or recognition of prepaid assets. Authoritative literature (SAS 62) says that modifications to the cash basis should have substantial support.

Issue #3: What cash-basis modifications are considered to have "substantial support"?

SAS 62 makes reference to only two modifications as having substantial support: depreciation on fixed assets and accruing income taxes. Clearly, other modifications that can be considered to have substantial support have evolved through common usage and practice.

An AICPA Technical Practice Aid (Section 1500.05) offers that a modification would have substantial support if:

- It is equivalent to the accrual basis of accounting -- for example, if you capitalize fixed assets, you should also record depreciation. Refer to *Issue #4* for a discussion of modified cash-basis financial statements becoming tantamount to accrual-basis statements with a departure from GAAP.

- It is logical. Interrelated accounts--for example sales and purchases -- should be on the same basis. Reporting sales on the cash basis and cost of sales on the accrual basis would be illogical and may produce misleading financial statements.

Writing in *The CPA Journal*, Wayne G. Bremser and Kenneth M. Hiltebeitel identify the following interrelated accounts as possible cash basis modifications:[2]

- Plant and equipment, accumulated depreciation, depreciation expense, long-term debt, and interest expense

- Income taxes payable, income tax expense

- Inventory, cost of goods sold

- Prepaid expenses, expiration of prepayments

- Accrued liabilities, accrued expenses

In deciding whether to include a modification, consider cost/benefit and materiality. When determining cost/benefit, remember that cost includes both the incremental cost of preparing the financial statements and the incremental cost of auditing or reviewing those financial statements. Assessing benefit will depend largely on the needs of the users.

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[2]"A Look At The Modified Cash Basis," by Wayne G. Bremser, PhD, CPA and Kenneth M. Hiltebeitel, PhD, CPA, *The CPA Journal*, February 1992.

The 1994 survey of PCPS members asked the question, "What modifications do your clients typically make in cash or modified-cash statements?" The response to that question was:

Survey Results
Typical Modifications to
Cash-Basis Financial Statements

	Percent
Capitalize expenditures for property, plant and equipment	94%
Record depreciation expense and accumulated depreciation	93%
Record liabilities for short-term and long-term borrowings	87%
Capitalize expenditures for inventory	52%
Accrue current income tax liability	35%
Accrue payroll taxes	10%
Accrue pension or profit sharing contributions	5%
Set up prepaid expenses for insurance, etc.	2%

In other words, 94% of the survey respondents indicated that their clients typically capitalized fixed assets for modified cash-basis financial statements, while only 35% accrued the current income tax liability.

The Technical Practice Aid also notes that if the modifications to a cash-basis statement are so extensive that the statements are equivalent to accrual-basis financial statements, they should be considered GAAP basis with a departure (or departures). For example, financial statements that are presented in conformity with GAAP, except that material capital leases are not capitalized, are not considered modified cash-basis financial statements.

Issue #4: At what point do modified cash-basis financial statements become GAAP-basis statements with a departure(s)?

Except for the one example provided in the TPA, this issue is not addressed directly in the literature. You will need to use your judgment to determine if "modified cash basis" statements are "tantamount to GAAP-basis financial statements with a departure(s)."

Messrs. Bremser and Hiltebeitel believe that some possible cash-basis modifications are normally considered as "the last level of adjustment to bring statements to GAAP basis or GAAP basis with a departure(s)." These possible adjustments are:

- Accounts receivable and unpaid purchases
- Deferred income taxes and deferred tax expense
- Capital lease assets and obligations under capital leases

Using this logic, if a set of financial statements included one of these three modifications, that may be an indication that they are equivalent to GAAP basis with a departure(s).

Be alert for instances in which cash- or modified cash-basis statements are really income-tax basis statements. If the financial statement amounts agree with the entity's tax return (except that financial statements may include nontaxable income items and nondeductible expenses), you should designate the statements as being on the income tax basis of accounting.

Tax Basis

The income tax basis of accounting is based on the principles and rules for accounting for transactions under the federal income tax laws and regulations. Few new measurement guidelines need to be established because the method is based on tax laws. The income tax basis of accounting covers a range of alternative bases, from cash to full accrual, depending on the nature of the taxpayer, and in some circumstances, the taxpayer's elections.

The tax basis of accounting is believed to be useful to small, nonpublic entities who find that the cost of GAAP financial statements is not beneficial in relation to the needs of likely users. This basis is most useful when users are primarily interested in the tax aspects of their relationship with the entity. For example, investors in tax-driven partnerships may be primarily interested in the tax consequences of transactions. However, they typically want more information than would be provided by a tax return.

Tax-basis financial statements can be less costly to prepare than GAAP statements, primarily because CPAs can use the same basic knowledge to prepare both the tax return and the financial statements. As a reminder, tax returns are not considered financial statements and, therefore, there are no reporting requirements associated with the preparation of a tax return.

Issue #5: What are the common recognition and measurement issues encountered when preparing tax-basis financial statements?

Nontaxable revenues and nondeductible expenses. Under federal income tax laws, some transactions are not recognized. For example, receipts of interest on obligations of state and local governments and proceeds from life insurance policies are not included in revenue. Costs such as premiums paid on officers' life insurance policies are not deductible. However, in practice, nontaxable revenues and nondeductible expenses are generally recognized in tax-basis income statement(s) of revenue and expenses.

Nontaxable revenues should be recognized when they are received (cash basis) or when they are earned (accrual basis). Nondeductible expenses should be reported and charged to expense in the period in which they are paid (cash basis) or when they are incurred (accrual basis).

The 1994 PCPS survey asked respondents to "Indicate how you typically present nontaxable income and nondeductible expenses in tax-basis statements." The response to that question was:

Survey Results
Presentation of Nontaxable Income and Nondeductible Expenses in Tax-Basis Financial Statements

	Percent
As separate line items in the revenue and expense sections of the income statement	45%
As additions and deductions to net income	23%
Disclosed in the notes	17%
Usually not material and ignored	6%
Don't distinguish; included with regular income and expense items	5%
As additions/deductions to equity in the reconciliation	3%
As "other" revenue and expense on the income statement	1%

Additional income taxes for prior years. An IRS exam may result in additional income taxes being assessed for prior years. Two alternative methods may be used to account for additional taxes for prior years.

- The amount may be charged to expense in the current period if there are no corresponding adjustments to the balance sheet for expenses capitalized or revenue recognized.

- The amount may be treated as a prior-period adjustment and charged to retained earnings.

The IRS may disallow amounts charged to expense in prior years and require those amounts to be capitalized and amortized or may require recognition of previously unreported revenue. Such amounts, net of income tax adjustments, should be treated as prior period adjustments. Otherwise, either of the above methods is considered acceptable. The method used should be disclosed.

Accounting changes for tax purposes. For tax purposes, the effects of an accounting change may be recognized prospectively over a specified number of years. Accounting changes should be treated in the same manner as they are treated in the tax return.

S Corporations. Income of an S Corporation is taxable to its shareholders. Consequently, such a corporation may be required to maintain information on distinct classes of retained earnings. However, in tax-basis financial statements, S Corporations usually report retained earnings as a single amount and should report distributions to stockholders.

Chapter 4
Display and
Disclosure Guidelines

Display

Display has to do with how various items are presented and described in the financial statements. Again, because the literature is not extensive in this area, preparers of OCBOA financial statements will need to make judgments about display.

Issue #6: What titles are appropriate for OCBOA financial statements?

The answer to this question is partially addressed in SAS 62 (AU §623). Paragraph 7 of that Statement reads as follows:

> .07 Terms such as balance sheet, statement of financial position, statement of income, statement of operations, and statement of cash flows, or similar unmodified titles are generally understood to be applicable only to financial statements that are intended to present financial position, results of operations, or cash flows in conformity with generally accepted accounting principles. Consequently, the auditor should consider whether the financial statements that he or she is reporting on are suitably titled. For example, cash basis financial statements might be titled *Statement of Assets and Liabilities Arising From Cash Transactions*, or *Statement of Revenue Collected and Expenses Paid,* and a financial statement prepared on a statutory or regulatory basis might be titled *Statement of Income--Statutory Basis.* If the auditor believes that the financial statements are not suitably titled, the auditor should disclose his or her reservations in an explanatory paragraph of the report and qualify the opinion.

Although this quotation is from the auditing literature, it should also be applied to compiled and reviewed statements.

The authoritative literature makes it clear that OCBOA financial statements should be appropriately titled so as not to imply that they are GAAP-basis statements. Limited examples of appropriate titles are given. Note that the literature is silent as to appropriate captions within the financial statements. For example, "Statement of Income" is not an appropriate OCBOA financial statement title, but within the statement itself, is it appropriate to use the caption "net income"? For example, should captions such as "excess of revenue collected over expenses paid," "excess of expenses paid over revenue collected," and "accumulated excess of revenue collected over expenses paid" be presented? The author believes that modification of GAAP-basis financial statement captions is not necessary. Through review of financial statements submitted to us, we observed that GAAP-basis financial statement captions are commonly presented in OCBOA financial statements.

The 1994 survey of PCPS members asked the question, "What do you consider to be appropriate OCBOA financial statement titles?" The responses to that question were:

Survey Results
Appropriate Titles for
(Modified) Cash Basis Financial Statements

	Percent
Statement of Assets and Liabilities--(Modified) Cash Basis	64%
Statement of Assets and Liabilities Arising from Cash Transactions	33%
Statement of Assets, Liabilities and Equity	2%
Balance Sheet--(Modified) Cash Basis	1%
Statement of Revenues and Expenses--(Modified) Cash Basis	61%
Statement of Revenues Collected and Expenses Paid	33%
Statement of Cash Receipts and Disbursements	2%
Statement of Income--(Modified) Cash Basis	2%
Other	2%

Survey Results
Appropriate Titles for
Income Tax Basis Financial Statements

	Percent
Statement of Assets, Liabilities and Equity--Income Tax Basis	95%
Balance Sheet--Income Tax Basis	2%
Other	3%
Statement of Revenue and Expenses--Income Tax Basis	94%
Statement of Income--Income Tax Basis	2%
Statement of Operations--Income Tax Basis	1%
Other	3%

In a related question, the Survey asked, "When modifications are made to cash-basis statements, which terminology do you typically use in referring to the entity's basis of accounting?" The responses to that question were:

Survey Results Terminology Used in Referring to Accounting Method That is Not "Pure" Cash	
	Percent
Modified Cash Basis	57%
Cash Basis	37%
Income Tax Basis	5%
Other	1%

Issue #7: How should you present the effect of a change from GAAP-basis statements in a prior year to OCBOA statements in the current year?

Note that a change from GAAP-basis to OCBOA statements (or vice versa) does not represent a change in accounting principles as described in APB 20, *Accounting Changes.* When only the current year's OCBOA statements are presented, there are three ways to present the effect of the change to OCBOA:

- Show opening retained earnings as previously reported on GAAP-basis, with an adjustment to convert to OCBOA.
- Show opening retained earnings on the adjusted OCBOA basis.
- Show the effects of the adjustment to convert as a cumulative-effect adjustment in the income statement.

If prior year financial statements are presented in comparative form, they should be restated and presented under the basis to which the company has changed.

SAS 62 specifically states that the effects of the differences between GAAP and OCBOA do not need to be quantified. The 1994 Survey asked the question, "Which method does your firm typically use for such situations?" The responses to that question were:

Survey Results Presentation of Change from GAAP To OCBOA Financial Statements	
	Percent
Show beginning retained earnings as previously reported on GAAP-basis with an adjustment to convert to OCBOA	58%
Show opening retained earnings on the OCBOA basis	29%
Show the effects of the adjustment to convert as a cumulative-effect adjustment in the income statement	13%

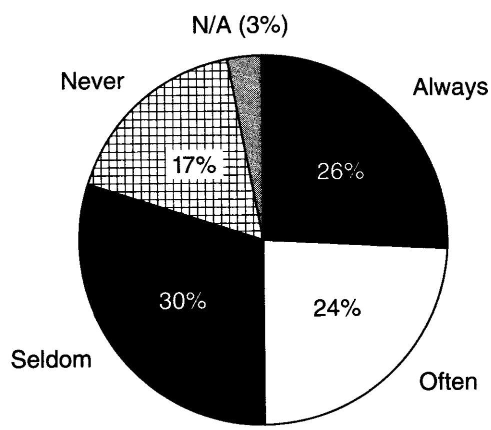
See *Issue #11* in chapter 5 for a discussion of reporting considerations resulting from a change to OCBOA.

Issue #8: Should a statement of cash flows be included with OCBOA financial statements?

SFAS 95, *Statement of Cash Flows*, requires entities that provide a set of financial statements that report both financial position and results of operations to provide a statement of cash flows. Many practitioners believe the terms "financial position" and "results of operations" relate only to GAAP-basis statements, and as a result, a statement of cash flows is not required for OCBOA statements. Other practitioners believe that SFAS 95 is not exclusive to GAAP statements and, in fact, that statements of cash flows for OCBOA presentations often provide valuable information about investing and financing activities that is not readily apparent in the other financial statements.

The 1994 Survey of PCPS members asked the question, "Indicate how frequently you include a statement of cash flows with OCBOA financial statements." The responses to the question were:

Survey Results
Frequency of Including
Statement of Cash Flows



Analysis

The Survey also asked the respondents to comment on the factors that influence their decision on whether to include a statement of cash flows in OCBOA financial statements. The comments received indicate the following:

- *Type of Financial Statement.* In general, practitioners are more likely to include a statement of cash flows in tax-basis financial statements. In instances where the modifications to the cash basis create material differences between the statement of revenues and expenses and cash flows, a separate statement of cash flows will be prepared. Note: cash flows from operations may not be apparent even from cash-basis financial statements.

- *Understandability and Usefulness.* Those practitioners that believe the client management and financial statement users understood the statement of cash flows and found the information meaningful were more likely to include it with OCBOA financial statements. Those that felt the information was not easily understood or irrelevant were less likely to include it.

- *Client Request.* Many practitioners leave it up to the client to decide if the statement should be included. However, rarely does the client request a statement of cash flows.

Disclosure

Determining the adequacy of disclosure in OCBOA financial statements is probably the most challenging aspect of issuing these types of financial statements. Accounting pronouncements do not discuss whether the disclosure requirements apply to OCBOA financial statements. The authoritative guidance on OCBOA financial statement disclosures is provided in SAS 62. It allows for considerable judgment in the nature and extent of OCBOA financial statement disclosures; however, it provides the following guidelines:

- OCBOA financial statements should include a **summary of significant accounting policies** that discusses the basis of presentation and describes how that basis differs from GAAP.

- If OCBOA financial statements include items that are the same as or similar to those in GAAP statements, **similar informative disclosures** are appropriate.

- Matters that are **not specifically identified on the face of the financial statements** should be considered for disclosure. These items include: related party transactions, restrictions on assets and owners' equity, subsequent events, and uncertainties.

The author strongly urges you to carefully read paragraphs .09 and .10 of SAS 62, which discuss the disclosure guidance summarized above.

Issue #9: In determining the adequacy of OCBOA financial statement disclosures, what is meant by the phrase "substantially similar informative disclosures"? What information should be disclosed?

The 1994 Survey respondents considered the needs of financial statements users to be the most important factor in determining what information should be disclosed in cash- and tax-basis financial statements. In other words, financial statement disclosures should respond to the needs of the users. In general, when determining the adequacy of OCBOA disclosures, consider whether the information is useful to financial statement users. Useful information is:

- Relevant
- Reliable
- Comparable
- Consistent

Issue #10: What disclosures should you consider making in OCBOA financial statements?

General Discussion of 1994 Survey Results

The Survey asked practitioners to indicate the frequency (specifically, always, often, seldom, never or not applicable) with which they made certain disclosures. The respondents were asked to base their assessment of frequency **only on those clients where the disclosure was relevant**.

The Survey specifically instructed participants to exclude from their assessment compiled financial statements that omit substantially all disclosures and instances in which a particular disclosure is irrelevant (e.g., disclosure about pension plans is irrelevant if the company does not have a pension plan). However, it was noted that many respondents who answered "seldom" and "never" commented that the financial statements omitted all disclosures or that the item was irrelevant to the entities' operations. Thus, many "seldom" or "never" responses should be considered "not applicable."

In general, the respondents indicated they were **most likely** to include disclosures about the following items:

- Terms of debt agreements and future minimum payments
- Terms of leases and future minimum payments
- Information about defined benefit and defined contribution pension plans
- Commitments and contingencies
- Going-concern uncertainties (discussed in chapter 5)

The respondents **sometimes** include disclosures about:

- Off-balance sheet risk and concentration of credit risk

- Income taxes

They were **least likely** to include disclosures about:

- Fair value of financial instruments

- Postretirement and postemployment benefits

- For Common Interest Realty Associations (CIRAs), disclosures related to future major repairs and replacements

A graphical presentation of the survey results related to the above-noted disclosures is included on the following pages with the exception of going-concern uncertainties, which is presented in chapter 5.

The Survey also asked the respondents to comment on the factors they considered in determining whether to include certain disclosures. In general, those factors included the following:

- *Relevancy, usefulness, understandability.* If the information was judged to be important to the users, it was more likely to be disclosed. Information about commitments and contingencies was generally perceived to be more relevant and easier to understand than information about fair value of financial instruments. Client circumstances may make certain information less relevant. For example, if the financial statements had a distribution limited to the geographic area where an entity does all its business, information about geographic concentrations of credit risk may not have been considered relevant.

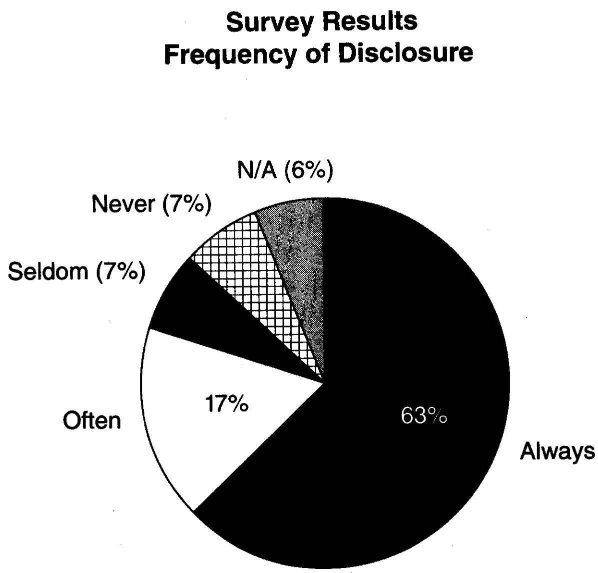
- *Cost/benefit.* Information that was costly to obtain was less likely to be disclosed unless the benefits of disclosure clearly outweighed the cost.

- *Inclusion of the item in the financial statements.* Practitioners were more likely to disclose information related to specific items that were recognized in the financial statements than to disclose "off-balance-sheet information," such as concentration of credit risk.

Graphical Presentation of 1994 Survey Results

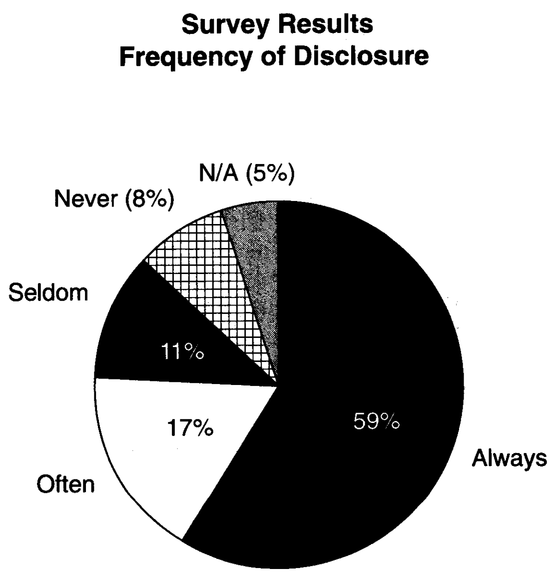
*Disclosures that practitioners are **most likely** to include*:

Terms of Debt Agreements and Future Minimum Payments



The information typically presented in the disclosures about debt includes interest rates, maturities, and collateral on notes payable and other debt, including a five-year schedule of maturities.

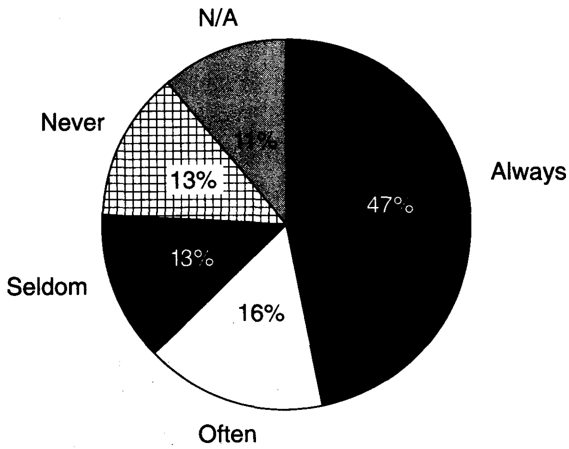
Terms of Leases and Future Minimum Payments



For a lessee, disclosure includes a general description of leasing arrangements and lease payments for the next five years.

Information about Defined Benefit and Defined Contribution Pension Plans

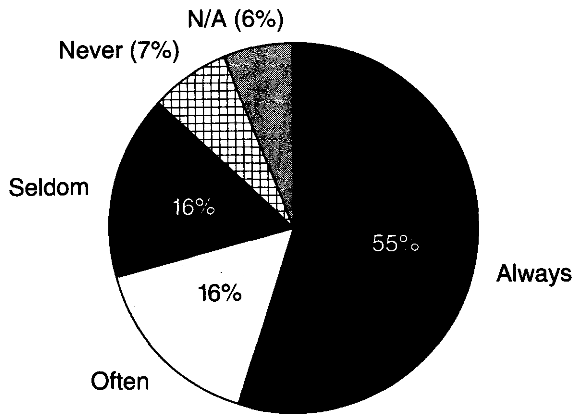
Survey Results
Frequency of Disclosure



Practitioners who indicated that their clients seldom or never disclose pension information often cited time and expense as their rationale for not disclosing this information. However, many respondents indicated that this information was not disclosed because the financial statements omitted all disclosures. As a result, many of these "seldom" or "never" responses should be viewed as "not applicable" responses.

Commitments and Contingencies

Survey Results
Frequency of Disclosure

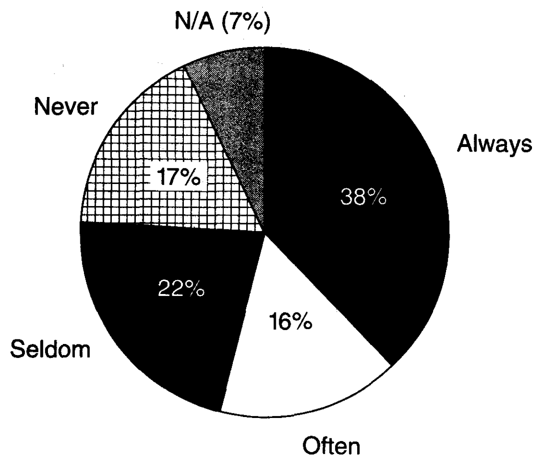


Practitioners who tended not to disclose commitments and contingencies noted that their clients' OCBOA financial statements typically omit **all** disclosures. Thus, many of the "seldom" or "never" responses should be considered "not applicable."

*Disclosures that practitioners **sometimes** include:*

Off-Balance-Sheet Risk and Concentration of Credit Risk

Survey Results
Frequency of Disclosure



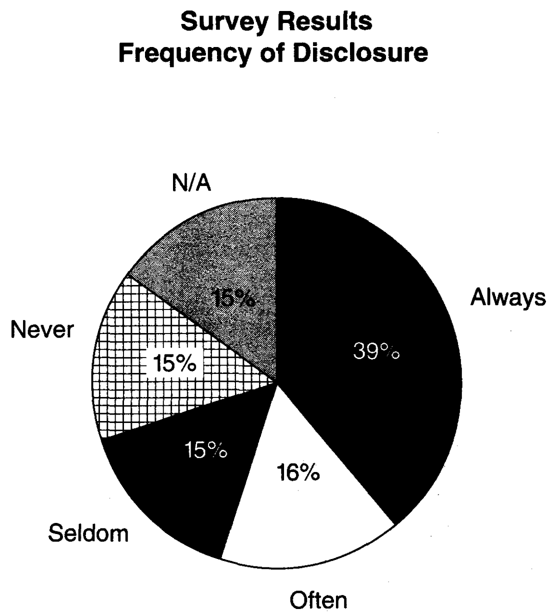
SFAS No. 105, *Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk and Financial Instruments with Concentrations of Credit Risk*, requires disclosure about the extent, nature, and terms of financial instruments with off-balance-sheet risk. These financial instruments include financial guarantees, loan commitments, letters of credit, interest rate swaps, and forward and futures contracts.

The Statement also requires disclosure of significant concentrations of credit risk arising from financial instruments, including:

- Information about the activity, region, or economic characteristic that identifies the concentration.
- The amount of the accounting loss due to credit risk the entity would incur if parties to the financial instruments that make up the concentration failed completely to perform according to the terms of the contracts and the collateral or other security, if any, for the amount due proved to be of no value to the entity.
- The entity's policy of requiring collateral or other security to support financial instruments subject to credit risk, information about the entity's access to that collateral or other security, and the nature and a brief description of the collateral or other security supporting those financial instruments.

Keep in mind that financial instruments include bank deposits, trade accounts, notes, loans, and investments in debt and equity securities.

Income Taxes



OCBOA financial statements often disclose the following information relating to income taxes:

- An explanation, where applicable, if income tax is not provided or if there is an unusual relationship between income tax expense and income before income taxes.

- The amount of tax credits.

- The amount of unused net operating loss and tax credit carryovers, and their expiration dates.

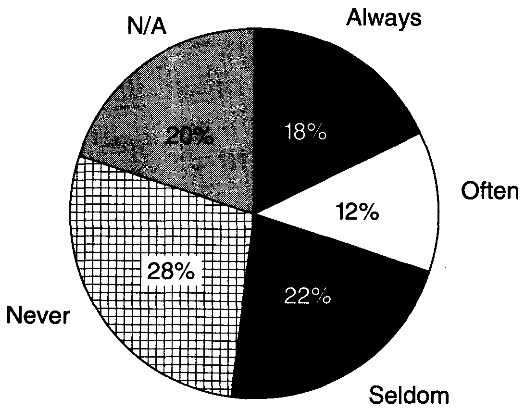
Many practitioners that responded "seldom" or "never" noted that deferred taxes do not generally apply to OCBOA financial statements. Most practitioners (in all categories of response) noted that, even though deferred taxes may not be recognized in the financial statements, other disclosures, for example, net operating loss carryovers, would still apply.

*Disclosures that practitioners are **least likely** to include*:

The 1994 Survey results indicated that the following disclosures are those which practitioners are least likely to include in OCBOA financial statements. We have included a general discussion of the GAAP disclosure requirements for each of these items. Practitioners should apply professional judgment to determine whether these disclosures are necessary to ensure that OCBOA financial statements are informative of matters affecting their use, understanding, and interpretation.

Fair Value of Financial Instruments

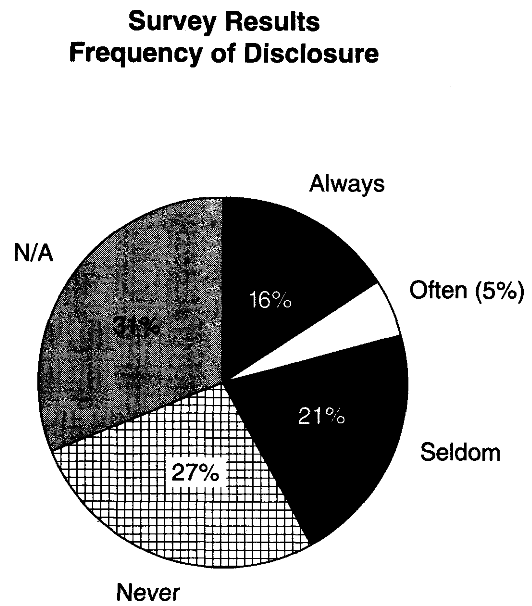
Survey Results
Frequency of Disclosure



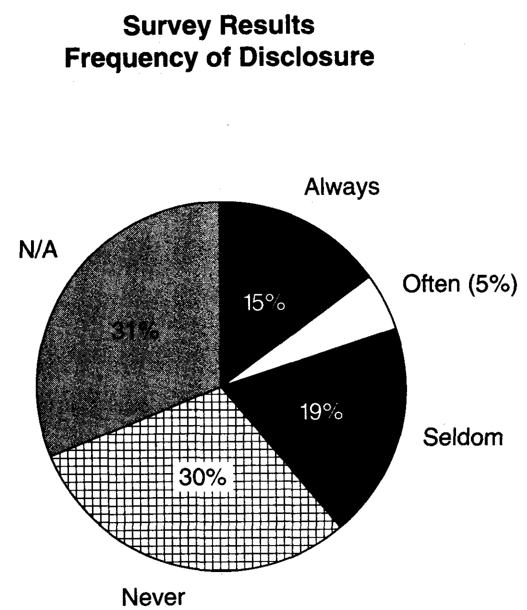
SFAS No. 107, *Disclosures about Fair Value of Financial Instruments,* requires entities to disclose the fair value of financial instruments for which it is practicable to estimate that value along with the methods and significant assumptions used to make the estimate. If it is not practicable for an entity to make an estimate, the entity should disclose information pertinent to estimating the fair value of that financial instrument or class of financial instruments (such as the carrying amount, effective interest rate, and maturity) and the reason why it is not practicable to estimate fair value.

Also, SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities,* effective for fiscal years beginning after December 15, 1993, requires among other things that entities issuing GAAP financial statements record unrealized gains and losses on trading securities and those available for sale. Because recording unrealized gains and losses is not appropriate for cash- and tax-basis statements, this Statement was not included in the 1994 Survey.

<u>Postretirement and Postemployment Benefits</u>



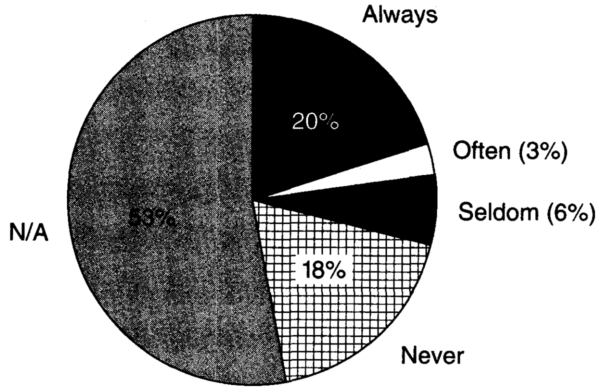
SFAS No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, describes the accounting and disclosure requirements for postretirement benefits other than pensions. The Statement requires accounting that is similar to that required for pensions (see SFAS No. 87). In general, the expected cost of providing postretirement benefits should be accrued by entities during the years an employee renders service. Prior to the Statement, many companies accounted for postretirement benefits on a cash basis.



Postemployment benefits are those provided to former or inactive employees after employment but before retirement. SFAS No. 112, *Employers' Accounting for Postemployment Benefits,* requires accrual accounting, which is a change from the method used by companies before the Statement became effective.

CIRA Future Major Repairs and Replacements

Survey Results
Frequency of Disclosure



Under GAAP, common interest realty associations are required to disclose information relating to future major repairs and replacements. This information is important because it helps users analyze the future cash flow of the association.

Other Disclosures (Not Included in the Survey)

Through review of financial statements submitted to us, it was noted that the following information was generally included in the disclosures to OCBOA financial statements:

General

Practitioners often include on each page of the financial statements a reference to the notes to the financial statements, which are an integral part of the financial statements. For example, "The accompanying notes are an integral part of the financial statements" is commonly used, but other language may also be appropriate. Also, SSARS 1 requires that each page of the financial statements include a reference such as "See accountant's review (compilation) report."

Significant Accounting Policies

As stated in chapter 5, SAS 62 and Interpretation 12 of SSARS 1 require that OCBOA statements disclose the basis of accounting and a description of how the basis differs from GAAP (the differences need not be quantified). This disclosure is typically made in the significant accounting policies note.

Cash Basis. The significant accounting policies note for cash and modified cash-basis financial statements often includes a discussion of any accrual adjustments or modifications. Note that modifications or adjustments to the cash basis should have substantial support.

Tax Basis. The significant accounting policies note for tax-basis financial statements typically included:

- Whether the basic method of accounting is cash or accrual.
- The tax filing status of the entity, if other than a normal taxable corporation.
- That revenues and related assets and expenses and related obligations are recognized when they are reported or deducted for federal income tax purposes. This disclosure commonly included discussion of specific items such as the use of tax-basis accelerated depreciation methods and the direct write-off method for recording uncollectible accounts.
- How nontaxable income and nondeductible expenses are reported.
- The nature of any optional tax methods of accounting followed.
- The nature of any important judgments or policies necessary for an understanding of the methods of recognizing revenue and allocating costs to current and future periods.

Interim Financial Statements. Disclosures made in interim financial statements generally include information on how inventories and costs of sales were determined. Disclosures in interim statements also frequently indicated that:

- Deferrals and accruals have been provided only when they would have been provided at year-end, and
- Thus, the statements should not be viewed as an indicator of results for the year.

Accounting Changes

Disclosures of accounting changes generally describe the nature and effect on income of the change in the period in which the change is made. Accounting changes consist of changes in the methods of accounting and changes in accounting estimates.

Business Combinations

In the period in which a business combination occurs, information disclosed typically includes the following:

- The names and brief descriptions of the acquired or combined companies.
- Information about any adjustments made to the carrying bases of the assets and liabilities of any of the companies as a result of the combination, as well as the period for which the results of operations of the acquired or combined companies are included in the statement of revenues and expenses.
- The consideration given, including the number and type of any shares of stock issued.

- Contingent payments, options, and commitments arising from the combination and specified in the related agreement.

Related Party Transactions

The existence of related party transactions that are material individually or in the aggregate, and the nature and amounts of the transactions and balances are disclosed.

Subsequent Events

The nature and financial effects of material events and transactions that occurred subsequent to the balance-sheet date and prior to the issuance of the financial statements are disclosed.

Assets and Liabilities

Information disclosed on assets and liabilities commonly includes these items:

- Restricted cash, segregated from cash available for current operations, with a description of the nature of the restriction.

- The aggregate market value of marketable securities.

- Accounts and notes receivable from officers, employees, and affiliates, presented separately with disclosure of the effective interest rate on notes receivable.

- The major classes of property, plant, and equipment (including assets recorded under capital lease agreements); depreciation expense for the period; the method(s) used in computing depreciation; and the aggregate, accumulated depreciation (a lessor should make separate disclosure of leased property).

- The method of determining inventory cost (for example, LIFO, FIFO).

Stockholders' Equity

The financial statements often disclose information on stockholders' equity as follows:

- For each class of stock, the number of shares authorized, issued, and outstanding; the par or stated value; and, in summary form, the pertinent rights and privileges of each outstanding class (if more than one class is outstanding).

- The existence of stock option and stock purchase plans.

- Restrictions on the payment of dividends.

- Changes for the period in the separate components of stockholders' equity.

Income and Expense

The nature and financial effects of material events or transactions that are unusual in nature or infrequent in occurrence are often disclosed.

Risks and Uncertainties

The AICPA recently issued SOP 94-6, *Disclosure of Certain Significant Risks and Uncertainties*, effective for years ending after December 15, 1995. The Statement was not finalized when we conducted our PCPS Survey and, therefore, was excluded from the survey. In general, the Statement will require the following for GAAP financial statements:

- *Nature of Operations.* Companies will be required to describe major products or services indicating their relative importance. They will also have to describe the location of their principal markets.

- *Use of Estimates in the Preparation of Financial Statements.* Notes to the financial statements should include an explanation that the preparation of financial statements requires the use of management's estimates.

- *Certain Significant Estimates.* The Statement supplements the requirements of SFAS No. 5, *Accounting for Contingencies.* This Statement adds a requirement that the notes discuss the near-term effects on the financial statements of the risks and uncertainties associated with estimates. It also specifies certain estimates not included in SFAS No. 5: long-term operating assets and profitable long-term contracts.

- *Current Vulnerability Due to Certain Concentrations.* Any concentration that makes the entity vulnerable to the risk of a near-term severe impact should be disclosed when it is at least reasonably possible that the events that could cause the near-term severe impact will occur. Concentrations that make an entity vulnerable to risk include:

    - Volume of business with a particular customer, supplier, lender, grantor, or contributor

    - Revenue from particular products, services, or fund-raising events

    - Available sources of supply of materials, labor, services, licenses, or rights

    - Operations concentrated in a particular market or geographical area

Note that AU §623.10 requires disclosure of uncertainties for OCBOA statements.

You may want to consider disclosing additional information prescribed by SOP 94-6 when preparing OCBOA financial statements.

Potential Adjustment From IRS Exams for Tax-Basis Financial Statements

Because of the potential adjustment that could result from an IRS examination, some firms include a note disclosure to that effect. Consider the following two examples:

- These financial statements were prepared on the basis of accounting the company uses for income tax purposes, which is a comprehensive basis of accounting other than generally accepted accounting principles. Because many types of transactions are susceptible to varying interpretations under federal and state income tax laws and regulations, the amounts reported in the accompanying financial statements may be subjected to change at a later date upon final determination by the taxing authorities.

- The corporation prepares its financial statements in conformity with methods of accounting it considers appropriate for federal income tax reporting. As with all tax presentations, these tax accounting methods are subject to review and possible adjustment by the Internal Revenue Service.

Note that the first example specifically states that the tax basis of accounting is not GAAP. The first example also explicitly states that amounts reported in the financial statements may change, while the second example says that the accounting methods are subject to review and possible adjustment.

Chapter 5
Reporting Considerations

The Standard Audit Report

Guidelines for reporting on OCBOA financial statements that have been audited is contained in SAS 62. In general, an auditor's report on OCBOA financial statements will differ from a report on GAAP financial statements in the following ways:

- The financial statements described in the first and the opinion paragraphs will conform to the titles of the OCBOA financial statements. To avoid confusion, OCBOA financial statements should not use titles such as "balance sheet" and "income statement." See chapter 4 for further discussion.
- An extra paragraph describing the basis of presentation is included immediately preceding the opinion paragraph.
- The opinion paragraph makes reference to "presents fairly...<u>on the basis of accounting described in Note X</u>." Note that a common error in practice is to make reference to "presents fairly...in conformity with GAAP."

The following are example reports on audited cash- and tax-basis financial statements:

<u>Cash Basis</u>

We have audited the accompanying statements of assets and liabilities arising from cash transactions of XYZ Company as of December 31, 19X2 and 19X1, and the related statements of revenue collected and expenses paid for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

[Standard second paragraph]

As described in Note X, these financial statements were prepared on the basis of cash receipts and disbursements, which is a comprehensive basis of accounting other than generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the assets and liabilities arising from cash transactions of XYZ Company as of December 31, 19X2 and 19X1, and its revenue collected and expenses paid during the years then ended, on the basis of accounting described in Note X.

<u>Tax Basis</u>

We have audited the accompanying statements of assets, liabilities, and capital--income tax basis of ABC Partnership as of December 31, 19X2 and 19X1, and the related statements of revenue and expenses--income tax basis and of changes in partners' capital accounts--income tax basis for the years then ended. These financial statements are the responsibility of the

Partnership's management. Our responsibility is to express an opinion on these financial statements based on our audits.

[Standard second paragraph]

As described in Note X, these financial statements were prepared on the basis of accounting the Partnership uses for income tax purposes, which is a comprehensive basis of accounting other than generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the assets, liabilities, and capital of ABC Partnership as of December 31, 19X2 and 19X1, and its revenue and expenses and changes in partners' capital accounts for the years then ended, on the basis of accounting described in Note X.

Standard Review and Compilation Reports

SAS 62 and Interpretation 12 of SSARS 1 indicate that OCBOA financial statements should disclose the basis of accounting and a description of how the basis differs from GAAP (the differences need not be quantified). Also, SAS 62 requires that auditor's reports on OCBOA statements be modified to state the basis of accounting and that the basis is a comprehensive basis of accounting other than GAAP. Interpretation 12 indicates that no such modification is necessary in review and compilation reports. (Note: paragraph 20 of SSARS 1 requires that the basis of accounting be disclosed in financial statements that omit substantially all disclosures. If such disclosure is not made, the accountant should modify the compilation report to describe the basis of accounting.)

Audit Report Modifications

The circumstances requiring modification to the standard auditor's report accompanying OCBOA financial statements are as follows (see AU §623.31):

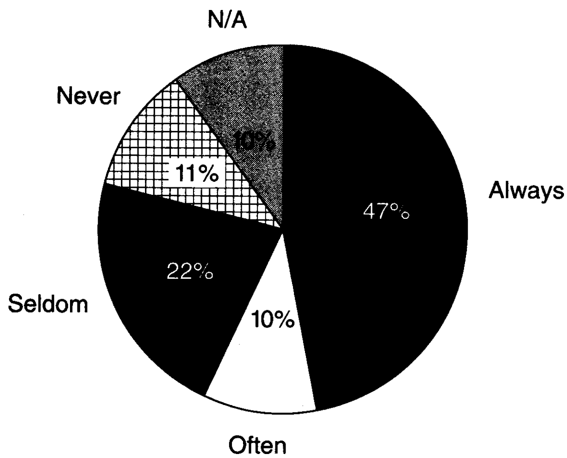
- *Lack of Consistency in Accounting Principles.* If there has been a change in accounting principles or in the method of their application, and assuming the change is relevant, you should add an explanatory paragraph to the report, following the opinion paragraph. This paragraph should describe the change and refer to the related note disclosure. See AU §508.34 through .36 for additional guidance.

- *Uncertainties.* If the financial presentations are affected by uncertainties about future events and the outcome of these events cannot be reasonably estimated at report date, you should add an explanatory paragraph. This paragraph would follow the opinion paragraph.

  Keep in mind that uncertainties may lead you to disclaim an opinion. See AU §508.16 through .33 for further guidance.

- *Going Concern Uncertainties.* If you have substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time not to exceed one year beyond the date of the financial statement, you should add an explanatory paragraph after the opinion paragraph of the report. See AU §341.

Survey Results
Frequency of Disclosure About
Going-Concern Uncertanties



- *Other Auditors.* When you decide to make reference to the report of another auditor as a basis, in part, for your opinion, you should disclose that fact in the introductory paragraph of the report and should refer to the report of the other auditors in expressing your opinion. See AU §508.12 and .13.

- *Comparative Financial Statements with Different Opinions.* If you express an opinion on prior-period financial statements that is different from the opinion you previously expressed on that same information, you should disclose all of the substantive reasons for the different opinion in a separate explanatory paragraph preceding the opinion paragraph.

- *Suitable Titles.* As discussed in chapter 4, OCBOA financial statements should be appropriately titled so as not to imply that they are GAAP statements. If you believe that the financial statements are not suitably titled, you should disclose your reservations in an explanatory paragraph and qualify your opinion. See AU §623.07.

- *Appropriate Disclosures.* Your opinion should be based on your judgment regarding whether the financial statements, including the related notes, are informative of matters that may affect their use, understanding, and interpretation. See AU §623.09. Also see chapter 4 for a discussion of OCBOA financial statement disclosures.

Issue #11: Is a change from GAAP to OCBOA a situation that requires a modification to the standard report?

No. If a client switches from GAAP to OCBOA or from OCBOA to GAAP, you are not required to modify an audit report; however, you may consider adding an explanatory paragraph that highlights:

- A difference in the current basis of presentation from that used in prior years, or
- That another report has been issued on the entity's financial statements prepared in conformity with another basis of presentation. For example, when cash basis financial statements are issued in addition to GAAP financial statements. See footnote 33 of SAS 62.

Issue #12: Is a change in tax law considered to be a change in accounting principle when issuing tax-basis financial statements?

No. A change in the tax law is not considered to be a change in accounting principle for which you would need to add an explanatory paragraph. Disclosure may be necessary.

Issue #13: What other report modifications are common?

You may come across a situation where the entity has departed from the stated OCBOA accounting method. For example, a tax-basis financial statement may include an allowance for doubtful accounts or unearned income. Or, a cash-basis financial statement may include the capitalization of fixed assets but no depreciation expense. In these situations, it may be appropriate to modify your report for a departure from the basis of accounting. See section 2 of Part Three for sample report modifications.

As with reports on GAAP-basis financial statements, there may be other instances where you wish to add an explanatory paragraph to emphasize a matter regarding the financial statements. Some firms include the following explanatory paragraph immediately preceding the opinion paragraph of tax-basis financial statements:

> Because many types of transactions are susceptible to varying interpretations under federal income tax laws and regulations, the amounts reported in the accompanying financial statements may be subject to change at a later date upon final determination by the taxing authorities.

Review and Compilation Report Modifications

Issue #14: Do audit report modifications apply to compilations and reviews?

The circumstances requiring modification to the standard compilation or review report are the same as those that require modification to the standard auditor's report with the following exceptions:

- Modification stating the basis of accounting used and that the basis is a comprehensive basis other than GAAP is not required unless the financial statements omit such disclosures.
- Normally, neither an uncertainty nor an inconsistency in the application of accounting principles would cause the accountant to modify the standard compilation or review report, as long as the financial statements appropriately disclose such matters. However, you are not precluded from adding a paragraph to emphasize a matter regarding the financial statements. See AR §100.40.

In situations in which a client changes its basis of accounting from GAAP to OCBOA or vice versa, you generally would not modify your review or compilation report.

See section 2 of Part Three for sample report modifications.

Part Three:

Example Financial Statements

and Disclosures and Engagement Tools

THE CHILDREN'S CENTER
FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED
AUGUST 31, 19X2

Independent Auditor's Report

To the Board of Trustees of
The Children's Center

We have audited the accompanying statement of assets, liabilities and fund balance — modified cash basis of The Children's Center (the "Center") at August 31, 19X2 and the related statement of support and revenue, expenses and changes in fund balance — modified cash basis and of functional expenses — modified cash basis for the year then ended. These financial statements are the responsibility of the Center's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1, the Center's policy is to prepare its financial statements using the modified cash basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the assets, liabilities and fund balance of The Children's Center at August 31, 19X2 and its support and revenue, expenses and changes in fund balance for the year then ended on the basis of accounting described in Note 1.

[Signature of Firm]

[City and State]

[Date]

The Children's Center

**Statement of Assets, Liabilities and Fund Balance —
Modified Cash Basis**

August 31, 19X2

Assets

Cash and cash equivalents	$306,258
Restricted cash	108,084
Property and equipment (net of accumulated depreciation of $928)	9,018
Deposits	10,000
	$433,360

Liabilities and Fund Balance

Deferred revenue	$107,934
Fund balance	325,426
	$433,360

See accompanying notes to financial statements.

The Children's Center

Statement of Support and Revenue, Expenses and Changes in Fund Balance — Modified Cash Basis

For the Year Ended August 31, 19X2

Support and Revenue	
Fund raising activities (net of direct costs of $53,541)	$ 235,920
Exchange club projects	105,302
Corporate and foundation	536,134
Unsolicited and other donations	69,754
Total support and revenue	947,110
Expenses	
Program services:	
Parent aide	333,674
Parent education	202,486
Public awareness	143,282
Community education	89,984
	769,426
Supporting services:	
Management and general	100,718
Fund raising	55,264
	155,982
Total expenses	925,408
Excess of support and revenue over expenses	21,702
Fund balance, beginning of year	303,724
Fund balance, end of year	$ 325,426

See accompanying notes to financial statements.

The Children's Center
Statement of Functional Expenses
For the Year Ended August 31, 19X2

	Program Services					Supporting Services			
	Parent Aide	Parent Education	Public Awareness	Community Education	Total	Management & General	Fundraising	Total	Total Expenses
PERSONNEL EXPENSES:									
Salaries	$232,576	$123,124	$ 97,324	$64,060	$517,084	$ 55,730	$23,296	$ 79,026	$596,110
Payroll taxes	17,880	11,638	6,192	4,554	40,264	4,000	1,082	5,082	45,346
Insurance — employee	12,296	7,542	5,076	3,672	28,586	4,200	884	5,084	33,670
Contract labor	1,490	5,852	—	720	8,062	22,800	22,450	45,250	53,312
Total personnel expenses	264,242	148,156	108,592	73,006	593,996	86,730	47,712	134,442	728,438
OPERATING EXPENSES:									
Client education supplies	1,096	15,134	834	430	17,494	—	—	—	17,494
Computer hardware/software	3,350	1,674	1,336	1,086	7,446	746	290	1,036	8,482
Credit card discounts	450	234	178	146	1,008	108	1,048	1,156	2,164
Depreciation	—	—	—	—	—	—	928	928	928
Dues and subscriptions	1,798	1,102	670	438	4,008	416	130	546	4,554
Insurance	14,286	10,336	5,908	4,092	34,622	3,144	886	4,030	38,652
Maintenance and repairs	3,010	1,558	1,378	878	6,824	228	240	468	7,292
Meals and entertainment	2,344	306	1,434	904	4,988	296	188	484	5,472
Mileage	7,470	1,860	2,082	736	12,148	374	288	662	12,810
Office supplies	5,518	3,522	2,056	1,508	12,604	1,370	462	1,832	14,436
Other expense	1,046	600	668	426	2,740	1,206	460	1,666	4,406
Postage	5,100	2,996	4,518	1,024	13,638	636	—	636	14,274
Printing	2,040	224	7,184	716	10,164	—	406	406	10,570
Professional education	6,664	5,046	1,154	1,172	14,036	2,398	1,250	3,648	17,684
Program evaluation	1,160	1,196	704	70	3,130	246	140	386	3,516
Rent	3,144	2,150	1,100	882	7,276	792	232	1,024	8,300
Telephone	6,110	3,714	2,032	1,422	13,278	1,116	346	1,462	14,740
Utilities	3,428	2,372	1,294	936	8,030	850	248	1,098	9,128
Volunteer education	620	—	—	—	620	—	—	—	620
Volunteer recognition	798	306	160	112	1,376	62	10	72	1,448
Total operating expenses	69,432	54,330	34,690	16,978	175,430	13,988	7,552	21,540	196,970
TOTAL FUNCTIONAL EXPENSES	$333,674	$202,486	$143,282	$89,984	$769,426	$100,718	$55,264	$155,982	$925,408

See accompanying notes to financial statements.

The Children's Center

Notes to Financial Statements

August 31, 19X2

Note 1—Summary of Significant Accounting Policies

Organization

The Children's Center (the "Center") is a nonprofit corporation incorporated under the Texas Non-Profit Corporation Act. The purpose of the Center is to use its funds exclusively for charitable, scientific and educational purposes, especially the prevention of child abuse.

Basis of Accounting

The records of the Center are maintained on the modified cash basis of accounting and the accompanying statements have been prepared on that basis. Except for depreciation and deferred revenues all transactions are recognized as either revenue or expenses. Noncash transactions except depreciation are not recognized. The modified cash basis differs from generally accepted accounting principles primarily because certain revenues are recognized when received rather than when earned and certain expenses are recognized when paid rather than when the obligation is incurred.

Property and Equipment

Property and equipment are recorded at cost and consist of the office building and equipment. Depreciation is computed on the straight-line method based on estimated useful lives of 30 years and five years, respectively.

Deferred Revenue

Deferred revenue is used to account for unused restricted funds. As disbursements are used for their restricted purposes, revenue is recognized in an amount equal to the disbursement.

Cash Equivalents

The Center considers all highly liquid debt instruments with a maturity of three months or less to be cash equivalents.

Note 2—Commitments and Contingencies

The Center's offices are located in a building that was donated to the Center in December, 19X2. The land on which the building is located is being leased on a month-to-month basis at a monthly rate of $700. See Note 3.

Note 3—Subsequent Events

In July, 19X2 the Center entered into a "purchase and sale agreement" which provided for the purchase of a building in the amount of $230,000 and the assumption of a lease of the land on which the building is located. The building purchase was executed on September 28, 19X2 and was financed in part by a $220,000 note payable to a bank. The terms of the note provide for quarterly interest payments at the bank's prime rate through the note maturity date. A $100,000 principal payment was due and made in December, 19X2, and the remaining balance is due September, 19X4. The note is secured by a leasehold deed of trust and security agreement and an assignment of rents and leases.

The assumed lease referred to above is an operating lease that requires annual payments of $19,600 through September, 19X6. The Center has the option to terminate the lease in March, 19X6. If the lease is not terminated, the annual payment will be revised to reflect six percent of the value of the land, which will be determined as set forth in the lease agreement.

In February, 19X3, the Center entered into a construction contract for $138,000 to design and construct certain building and leasehold improvements.

FALLSTON FIRE PROTECTION DISTRICT
COMBINED FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED
JUNE 30, 19X4

Independent Accountant's Report

To the Board of Directors of
Fallston Fire Protection District

We have compiled the accompanying combined statement of assets, liabilities, and fund balances (arising from cash transactions) of Fallston Fire Protection District as of June 30, 19X4 and the related combined statement of revenues, expenditures, and changes in fund balance (arising from cash transactions) and combined statement of revenues, expenditures, and changes in fund balance — budget and actual (arising from cash transactions) for the year then ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. These financial statements have been prepared on the modified cash basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles.

A compilation is limited to presenting information in the form of financial statements that is the representation of the management of Fallston Fire Protection District. We have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

[Signature of Firm]

[City and State]

[Date]

Fallston Fire Protection District

Combined Statement of Assets, Liabilities, and Fund Balances
All Fund Types and Account Group
(Arising from Cash Transactions)
June 30, 19X4

	Governmental Fund Types		General Fixed Assets Account Group	Totals (Memorandum Only)
	General	Capital Project		
Assets				
Cash and investments — Notes 1 and 3	$236,034	$361,812	$ —	$ 597,846
Fixed assets — Notes 1 and 4	—	—	1,575,232	1,575,232
	$236,034	$361,812	$1,575,232	$2,173,078
Fund Equity				
Investment in general fixed assets	$ —	$ —	$1,575,232	$1,575,232
Fund balance — undesignated	236,034	361,812	—	597,846
	$236,034	$361,812	$1,575,232	$2,173,078

See accompanying notes and accountant's compilation report.

Fallston Fire Protection District

Combined Statement of Revenues, Expenditures, and Changes in Fund Balance — All Governmental Fund Types (Arising from Cash Transactions) Year Ended June 30, 19X4

	Governmental Fund Types		Totals
	General	Capital Project	(Memorandum Only)
Revenues			
Taxes	$716,680	$ —	$716,680
Ambulance fees	247,794	—	247,794
Miscellaneous	32,408	—	32,408
	996,882	—	996,882
Expenditures			
Public safety	791,454	—	791,454
Capital outlay	17,734	—	17,734
	809,188	—	809,188
Excess of revenues over expenditures	187,694	—	187,694
Other financing sources (uses)			
Operating transfers in	—	100,000	100,000
Operating transfers out	(100,000)	—	(100,000)
	(100,000)	100,000	—
Excess of revenues and other financing sources over expenditures and other uses	87,694	100,000	187,694
Fund balance, beginning of year	148,340	261,812	410,152
Fund balance, end of year	$236,034	$361,812	$597,846

See accompanying notes and accountant's compilation report.

Fallston Fire Protection District

Combined Statement of Revenues, Expenditures, and Changes in Fund Balance — Budget and Actual — All Governmental Fund Types (Arising from Cash Transactions) Year Ended June 30, 19X4

	General Fund			Capital Project Fund			Totals (Memorandum Only)		
	Budget	Actual	Variance — Favorable (Unfavorable)	Budget	Actual	Variance — Favorable (Unfavorable)	Budget	Actual	Variance — Favorable (Unfavorable)
Revenues									
Taxes	$ 702,900	$ 716,680	$ 13,780	$ —	$ —	$ —	$ 702,900	$ 716,680	$ 13,780
Ambulance fees	200,000	247,794	47,794	—	—	—	200,000	247,794	47,794
Miscellaneous	36,000	32,408	(3,592)	—	—	—	36,000	32,408	(3,592)
	938,900	996,882	57,982	—	—	—	938,900	996,882	57,982
Expenditures									
Public safety	836,900	791,454	45,446	—	—	—	836,900	791,454	45,446
Capital outlay	24,000	17,734	6,266	176,064	—	176,064	200,064	17,734	182,330
Operating contingency	30,000	—	30,000	—	—	—	30,000	—	30,000
	890,900	809,188	81,712	176,064		176,064	1,066,964	809,188	257,776
Excess (Deficiency) of revenues over expenditures	48,000	187,694	139,694	(176,064)	—	176,064	(128,064)	187,694	315,758
Other financing sources (uses)									
Operating transfers in	—	—	—	100,000	100,000	—	100,000	100,000	—
Operating transfers out	(100,000)	(100,000)	—	—	—	—	(100,000)	(100,000)	—
	(100,000)	(100,000)	—	100,000	100,000	—	—	—	—
Excess (Deficiency) of revenue and other financing sources over expenditures and other uses	(52,000)	87,694	139,694	(76,064)	100,000	176,064	(128,064)	187,694	315,758
Fund balance, beginning of year	40,000	148,340	108,340	276,064	261,812	(14,252)	316,064	410,152	94,088
Fund balance, end of year	$ (12,000)	$ 236,034	$ 248,034	$200,000	$ 361,812	$161,812	$ 188,000	$ 597,846	$ 409,846

See accompanying notes and accountant's compilation report.

Fallston Fire Protection District

Notes to Financial Statements

June 30, 19X4

Note 1 — Summary of Significant Accounting Policies

Basis of Accounting

The District uses the cash basis of accounting for preparation of financial statements and budgeting. Under the cash basis of accounting, revenues are recognized when they are received rather than when they are earned, and expenditures are recognized when paid rather than when the obligation is incurred.

Scope of Reporting Entity

The District has developed criteria to determine whether outside agencies with activities that benefit the citizens of the District should be included within its financial reporting entity. The criteria include, but are not limited to, whether the District exercises oversight responsibility on financial interdependency, selection of governing authority, designation of management, ability to significantly influence operating and accountability for fiscal matters, scope of public service and special financing relationships.

The District has determined that no outside agencies meet the above criteria.

Budget Procedures

A budget is prepared for each fund in accordance with the cash basis of accounting and legal requirements set forth in the Oregon Local Budget Law. Budget amounts shown in the financial statements include the original and supplemental budget amounts and all appropriation transfers approved by the Board of Directors.

The District employs the following procedures in establishing the budgetary data reflected in the financial statements.

The appointed budget officer develops a proposed budget for submission to the budget committee appointed by the Board of Directors. The operating budget includes proposed expenditures and the means for financing them for the upcoming year, along with estimates for the current year and actual data for the two preceding years.

After the proposed budget is prepared, the budget officer publishes a "Notice of Budget Committee Meeting" in at least one newspaper of general circulation. At the budget committee meeting, the budget message is delivered explaining the proposed budget and any significant changes in the District's financial position. The budget committee meets thereafter as many times as necessary until the budget document is completed.

After approval by the budget committee and the required public hearing, and prior to July 1, the budget is adopted by the Board of Directors, and appropriations are enacted by resolution. Appropriations control expenditures in broad categories as required by Oregon Local Budget Law. More detailed classifications of budgeted expenditures are adopted for administrative control purposes. Budget appropriations lapse at year end.

The governing body is authorized to transfer appropriations within any fund by resolution. Revisions that increase total expenditures in any fund may be made only through a supplemental budget. The procedures for adopting an original budget are also followed for adopting a supplemental budget. No supplemental budgets were adopted during the year.

Expenditures may not legally exceed budget appropriations at the following legal level of control for each department in each fund:

Personal services
Materials and services
Capital outlay

Appropriations are made at the same level of control described above.

General Fixed Assets

Fixed assets are recorded at cost. In accordance with governmental accounting standards, no depreciation of fixed assets is recorded.

General fixed asset purchases are recorded as expenditures in governmental funds and capitalized in the General Fixed Assets Account Group. Maintenance and repairs are charged to expenditures in various budgetary funds as incurred and are not capitalized. Upon disposal, the General Fixed Assets Account Group is relieved of the assets' estimated original cost or other basis; any receipt from such disposal is accounted for as revenue of the General Fund.

Cash and Investments

District monies are invested as allowed by Oregon Statute. Presently all investments are in bank short-term investments, the Local State Government Investment Pool, and U.S. Government obligations.

Investments are stated at cost; market value of investments is approximately the same as cost.

Property Taxes

Fallston County assesses, collects, and distributes property taxes for all local governments within the County. Property taxes are billed in October of each year. Unpaid personal and real property taxes become liens against the property on January 1 and July 1, respectively. Property taxes are payable in three installments due November 15, February 15, and May 15. A 3% discount is allowed for full payment by November 15. Interest at 16% annually is charged for late payments.

Income Taxes

The District is a municipal corporation exempt from federal and state income taxes.

Other Information

Fire protection and ambulance services are provided through an agreement with the Fallston City Fire Department. The District pays one-half of the salaries and fringe benefits of the City fire personnel. The City provides personnel to operate the District fire equipment.

The District does not employ anyone. The firemen are employees of the City of Fallston.

The District does not directly contribute to any pension plans, however it does reimburse the City of Fallston for one-half of the pension costs related to City fire personnel.

Expenditures may not legally exceed budgeted appropriations of each expenditure category.

All interest income is reported as revenue of the General Fund.

Note 2 — Organization and Fund Structure

The District was organized under the laws of the State of Oregon relating to Fire Districts and Rural Fire Districts. The District was proclaimed organized by the Fallston County Court as formed by an election held November 7, 19U0.

The government is vested in five board members. Each board member is elected for a term of four years.

The accounts of the District are organized on the basis of funds and account groups, each of which is considered to be a separate entity. The operations of each fund are accounted for by providing a separate set of self-balancing accounts which are comprised of each fund's assets, liabilities, fund equity, revenues, and expenditures, as appropriate. Government resources are allocated to and for individual funds based upon the purpose for which they are to be spent and the means by which spending activities are controlled.

The funds and account groups of the District consist of the following:

General Fund

This fund is used to finance the general operations of the District and, subject to restrictions of the Local Budget Law, its assets may be transferred to another fund for any authorized purpose. The principal revenue source is a tax levy.

Capital Project Fund

This fund accounts for cash accumulated to purchase fixed assets.

General Fixed Assets Account Group

This account group accounts for the investment in fixed assets of the District.

The "Totals (Memorandum Only)" column in the combined financial statements is provided for information only and should not be considered consolidated totals.

Note 3 — Cash and Investments

Cash and investments consisted of the following at June 30, 19X4:

Cash on hand	$ 200
Checking account	4,140
State local government investment pool	193,306
Farm Credit Discount note	400,200
Total	$597,846

The Farm Credit Discount note is an obligation of the U.S. Government. The note was purchased May 20, 19X4 for $400,200. The note matures May 10, 19X5 at par value of $420,000; the effective annual yield is 5.0466%.

Note 4 — Fixed Assets

Fixed assets and related changes therein consisted of the following:

	Balances June 30, 19X3	Additions	Disposals	Balances June 30, 19X4
Building	$ 488,510	$ —	$ —	$ 488,510
Vehicles	849,038	11,784	—	860,822
Equipment	219,950	5,950		225,900
Totals	$1,557,498	$ 17,734	$ —	$1,575,232

FISHER FARMS, INC.
FINANCIAL STATEMENTS AND
SUPPLEMENTARY INFORMATION
YEARS ENDED JUNE 30, 19X4 AND 19X3

Independent Accountant's Report

To the Stockholders
Fisher Farms, Inc.
Daytona Beach, Florida

We have reviewed the accompanying statements of assets, liabilities and stockholders' equity — cash basis of Fisher Farms, Inc. as of June 30, 19X4 and 19X3, and the related statements of revenues and expenses — cash basis and of retained earnings — cash basis for the years then ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management of Fisher Farms, Inc.

A review consists principally of inquiries of Company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with the cash basis of accounting, as described in Note 1.

Our reviews were made for the purpose of expressing limited assurance that there are no material modifications that should be made to the financial statements in order for them to be in conformity with the cash basis of accounting, as described in Note 1. The information included in the accompanying schedule of operating expenses — cash basis is presented only for supplementary analysis purposes. Such information has been subjected to the inquiry and analytical procedures applied in the reviews of the basic financial statements. This information is presented on the cash basis of accounting, and we are not aware of any material modifications that should be made thereto.

[Signature of Firm]

[City and State]

[Date]

Fisher Farms, Inc.

Statements of Assets, Liabilities and Stockholders' Equity — Cash Basis
June 30, 19X4 and 19X3

	19X4	19X3
ASSETS		
Current Assets		
Cash	$ 923,908	$1,134,952
Deposits	—	86,610
Note receivable	39,306	1,208
Employee loans receivable	14,220	19,194
Note receivable — Ken Fisher	37,114	—
Total current assets	1,014,548	1,241,964
Property and Equipment		
Building and improvements	1,628,132	1,622,650
Machinery and equipment	6,784,542	6,587,232
Livestock	6,200	6,200
Autos and trucks	2,685,680	2,545,996
Communication devices	69,636	56,650
Office furniture and fixtures	617,644	473,632
	11,791,834	11,292,360
Less: Accumulated depreciation	9,306,984	8,734,994
Total property and equipment	2,484,850	2,557,366
Other Assets		
Utility deposits and bonds	1,430	1,990
Note receivable	—	76,420
Investments — stocks	—	20,000
Total other assets	1,430	98,410
Total assets	$3,500,828	$3,897,740

See accountant's review report and notes to financial statements.

Fisher Farms, Inc.

Statements of Assets, Liabilities and Stockholders' Equity — Cash Basis June 30, 19X4 and 19X3

	19X4	19X3
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Employee savings payable	$ 1,300	$ —
Stockholders' Equity		
Common stock, 5,000 shares authorized, 800 shares issued, 600 shares outstanding, par value $1	800	800
Retained earnings	3,874,628	4,272,840
Treasury stock	(375,900)	(375,900)
Total stockholders' equity	3,499,528	3,897,740
Total liabilities and stockholders' equity	$3,500,828	$3,897,740

See accountant's review report and notes to financial statements.

Fisher Farms, Inc.

Statements of Revenues and Expenses — Cash Basis
Years Ended June 30, 19X4 and 19X3

	19X4	19X3
Revenues		
Produce sales	$36,334,334	$32,193,282
Product handling income	—	5,236
Harvest and sharecrop income	565,532	971,738
Discounts earned	259,686	163,782
Fuel tax refunds	3,270	4,118
Insurance claims	4,014	4,262
Miscellaneous income	10	38
Total revenues	37,166,846	33,342,456
Operating expenses	41,283,040	38,422,016
Loss from operations	(4,116,194)	(5,079,560)
Other revenues and (expenses)		
Gain on sale of assets	560	1,862
Interest earned	29,428	29,654
Rental income	32,200	80,330
Loss on marketable security	(20,000)	—
Casualty loss	(9,832)	—
Total other revenues and (expenses)	32,356	111,846
Net loss	$ (4,083,838)	$ (4,967,714)

See accountant's review report and notes to financial statements.

Fisher Farms, Inc.

Statements of Retained Earnings — Cash Basis
Years Ended June 30, 19X4 and 19X3

	19X4	19X3
Retained earnings, beginning of year	$ 4,272,840	$ 7,825,904
Net loss	(4,083,838)	(4,967,714)
Add: Contributions from stockholders	10,310,000	18,570,000
Less: Distributions to stockholders	(6,624,374)	(17,155,350)
Retained earnings, end of year	$ 3,874,628	$ 4,272,840

See accountant's review report and notes to financial statements.

Fisher Farms, Inc.

Notes to Financial Statements

June 30, 19X4 and 19X3

Note 1 — Summary of Significant Accounting Policies

Fisher Farms, Inc. is an agricultural business located in Daytona Beach, Florida. The Corporation raises vegetables that are distributed to brokers for marketing.

Assets and liabilities are recorded and revenues and expenses are recognized on the cash basis, modified for depreciation; consequently, certain revenues are recognized when received rather than when earned, and certain expenses are recognized when paid rather than when the obligation is incurred.

Property and equipment are stated at cost less accumulated depreciation computed on the declining balance and straight-line methods. The assets are depreciated over their estimated useful lives, which range from five to 35 years.

The Corporation, with the consent of its stockholders, has elected to have its income taxed under Section 1372 of the Internal Revenue Code, which provides that, in lieu of corporation income taxes, the stockholders are taxed on their proportionate share of the Corporation's taxable income. Therefore, no provision or liability for federal income taxes is reflected in the accompanying financial statements.

Certain prior year amounts have been reclassified to conform with the current year presentation.

Note 2 — Uninsured Cash Balances

The Corporation has interest-bearing deposits in one commercial bank. At June 30, 19X4, the Corporation's deposits exceeded Federal Depository Insurance Corporation coverage by $823,908.

Note 3 — Deposits

The Corporation had made deposits in the amount of $86,610 for equipment not placed in service at June 30, 19X3. The balance of $21,652 was paid upon delivery in August, 19X3.

Note 4 — Note Receivable

The note receivable consists of a promissory note from Fred Smythe dated April 27, 19X3. Weekly payments of $80 plus interest on the unpaid principal balance are to be received until April 28, 19X5, at which time the uncollected principal balance of $38,328 is due in full. The note bears interest at the prevailing prime rate and is secured by real estate recorded in Plat Book 29, page 118, of the Public Records of Daytona Beach, Florida.

Note 5 — Employee Loans Receivable

The Company extended loans to two employees in 19X3 and to one employee in 19X4. The loans outstanding as of June 30, 19X3 were repaid on March 31, 19X4 and May 30, 19X4, respectively. The loan outstanding as of June 30, 19X4 is due on January 31, 19X5 and bears interest at the prevailing prime rate.

Note 6 — Note Receivable — Ken Fisher

The note receivable represents an unsecured promissory note from Ken Fisher, a relative of William Fisher (stockholder), dated December 31, 19X3. Weekly payments of $400 plus interest are to be received through December 31, 19X4 at which time the uncollected principal balance of $26,714 is due in full. The note bears interest at the prevailing prime rate.

Note 7 — Investments

The Corporation owned 16,000 shares of stock in Sunshine, Inc., a small, privately-owned entity. It is not practicable to estimate the fair value of the Corporation's investment in Sunshine, Inc. as of June 30, 19X3 because of lack of quoted market prices and the inability to estimate fair value without incurring excessive costs.

Sunshine, Inc. filed for protection from creditors under Chapter 11 of the Federal Bankruptcy Code in September 19X3. A final hearing was held on October 14, 19X3, and the plan was confirmed and a final decree issued. No distributions were made to unsecured creditors or stockholders. As of June 30, 19X4, the stock has no value and has been written off by the Corporation.

Note 8 — Treasury Stock

On June 1, 1990, Fisher Farms, Inc. distributed 25% of the fair market value of all assets owned by Ken Fisher in exchange for his 200 shares of stock in the Corporation. The exchange was a tax free spin-off under Section 355 of the Internal Revenue Code.

Note 9 — Custom Farming Costs

The Corporation receives custom farming services from Hope Harvesting, Inc. (Hope). The Corporation and Hope have common stockholders. During the years ended June 30, 19X4 and 19X3, the Corporation paid Hope $9,042,526 and $8,796,410 for these services.

Note 10 — Rent — Land

The Corporation grows crops on various tracts of land that are leased under seasonal and one-year operating leases expiring in May and June, 19X5. Future minimum rental payments required under the above operating leases are $325,500 in 19X5.

Note 11 — Contingent Liability

Fisher Farms, Inc. has guaranteed payment on a $1,900,000 mortgage note of the three stockholders, William Fisher, William Banks and Robert Fisher. The mortgage is secured by land owned by the three stockholders and is due November 30, 19X7 with interest charged at 1/2% above prime. One of the stipulations in the note is that Fisher Farms, Inc. will not create any liens or other encumbrances other than those that currently exist on the Corporation's real or personal property. In addition to the mortgage note, the stockholders and their respective spouses have a line of credit from CountryBank in the amount of $4,500,000 each. This line of credit is guaranteed by the Corporation. The line of credit bears interest at the prime rate and matures on October 3, 19X4.

Outstanding balances:	19X4	19X3
Mortgage note	$3,040,000	$3,800,000
Line of credit	8,700,000	3,000,000

SUPPLEMENTARY

INFORMATION

Fisher Farms, Inc.

Schedules of Operating Expenses — Cash Basis

Years Ended June 30, 19X4 and 19X3

	19X4	19X3
Advertising	$ 28,994	$ 5,200
Consultant fees	770	9,472
Contributions	11,840	3,716
Contributions — political	1,000	9,380
Custom farming costs	9,042,526	8,796,410
Data processing — software services	1,150	792
Depreciation	627,388	806,536
Dues and subscriptions	110,550	65,664
Employee relations and expense	68,888	69,970
Equipment rental	115,300	10,332
Farming supplies and maintenance	2,694,600	2,027,126
Fertilizers and chemicals	7,838,950	6,697,098
Field workers' facilities	90,260	102,634
Fuel and oil	708,550	765,004
Freight and hauling	111,768	—
Insurance	1,733,696	1,827,490
Insurance — officers life	7,950	30,278
Interest expense	—	10
ITC reduction basis recovery	458	—
Labor camp appliances	9,298	5,204
Machine hire/land preparation	380,142	353,390
Management fees	24,176	24,000
Miscellaneous	11,394	29,472
Office expense	89,094	48,450
Packing supplies	2,929,708	2,624,216
Payroll	5,180,600	5,336,196
Payroll — officers	400,072	380,764
Penalties	68	78
Permits and licenses	46,022	35,736
Plants and seeds	2,849,760	2,845,590
Produce cooling and drying	20,774	4,370
Produce shipping	202,520	171,548
Professional fees	167,204	180,026
Rent — land	1,853,846	1,251,740
Repairs	2,247,178	2,250,892
Road expenses — drivers and tolls	24,496	19,004
Safety equipment and training	38,030	50,632
Security costs	3,292	1,346
Taxes	800,226	795,040
Telephone	200,626	226,560
Travel	4,016	896
Truck allowances — employees	31,776	38,400
Uncollectible advances	—	15,530
Uniforms	2,300	2,182
Utilities	571,784	503,642
Total	$41,283,040	$38,422,016

See accountant's review report.

ALEXANDER & AMES LIMITED PARTNERSHIP
FINANCIAL STATEMENTS
AS OF AND FOR THE YEAR ENDED
DECEMBER 31, 19X3

Independent Accountant's Review Report

The Partners
Alexander & Ames Limited Partnership

We have reviewed the accompanying statements of assets, liabilities, and partners' capital — income tax basis of Alexander & Ames Limited Partnership as of December 31, 19X3 and the related statements of revenues and expenses — income tax basis, partners' capital — income tax basis, and cash flows — income tax basis for the year then ended in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. All the information included in these financial statements is the representation of the Partnership's management.

A review consists principally of inquiries of Partnership personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, with the exception of the matter described in the following paragraph, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with the income tax basis of accounting.

The Partnership's financial statements have been modified to defer recognition of unearned dues and to provide an allowance for doubtful accounts which should be recognized in the accompanying statement of revenues and expenses to conform with the basis of accounting used in preparing the Partnership's income tax return. If the effects of these modifications were included, partners' capital would be increased by approximately $160,000 as of December 31, 19X3 and revenues in excess of expenses would be increased by approximately $40,000 in 19X3.

[Signature of Firm]

[City and State]

[Date]

Alexander & Ames Limited Partnership

Statement of Assets, Liabilities and Partners' Capital — Income Tax Basis
December 31, 19X3

Assets	
Property and equipment	$11,864,666
Less accumulated depreciation	(2,810,112)
	9,054,554
Cash	450,944
Accounts receivable, less allowance for doubtful accounts of $49,360	451,194
Inventory	311,214
Prepaid expenses and other assets	24,046
Financing fees, less accumulated amortization of $57,096	259,124
Syndication costs	312,166
	$10,863,242
Liabilities and Partners' Capital	
Debt	$ 7,566,966
Accounts payable	276,502
Accrued payroll and related costs	117,792
Other accrued expenses	23,998
Unearned dues	369,586
Total liabilities	8,354,844
Partners' capital	2,508,398
	$10,863,242

See accompanying notes and accountant's review report.

Alexander & Ames Limited Partnership

Statement of Revenues and Expenses — Income Tax Basis
For the Year Ended December 31, 19X3

Revenues	
Membership dues	$3,970,334
Initiation fees	389,638
Tennis court fees and lessons	1,103,224
Other income	726,936
Sports shop and cafe, less cost of sales of $701,800	517,940
Total revenues	6,708,072
Expenses	
Management fee	50,700
Maintenance and operating	504,448
Utilities	391,460
Advertising and promotions	191,088
Payroll and related costs	2,774,706
Insurance	136,984
Administrative	212,028
Real estate taxes	351,246
Provision for doubtful accounts	34,878
Total expenses	4,647,538
Net operating income	2,060,534
Partnership expenses	(9,572)
Interest expense, net	(765,476)
Depreciation and amortization	(610,094)
Loss on sale of equipment	(4,240)
Revenues in excess of expenses	$ 671,152

See accompanying notes and accountant's review report.

Alexander & Ames Limited Partnership

Statement of Partners' Capital —
Income Tax Basis
For the Year Ended December 31, 19X3

	Limited Partners	Special Limited Partner	General Partner	Partners' Capital
Balance, December 31, 19X2	$1,017,392	$1,256,710	$(69,276)	$2,204,826
Cash distributions	(238,924)	(55,138)	(73,518)	(367,580)
Revenues in excess of expenses	436,254	100,674	134,224	671,152
Balance, December 31, 19X3	$1,214,722	$1,302,246	$(8,570)	$2,508,398

See accompanying notes and accountant's review report.

Alexander & Ames Limited Partnership

Statement of Cash Flows —
Income Tax Basis
For the Year Ended December 31, 19X3

Increase (Decrease) in Cash

Cash flows from operating activities	
Revenues in excess of expenses	$ 671,152
Adjustments to reconcile revenues in excess of expenses to cash flows from operating activities	
Depreciation and amortization	610,094
Loss on sale of equipment	4,240
(Increase) decrease in:	
Accounts receivable	(23,494)
Inventory	(102,916)
Prepaid expenses	1,472
Accounts payable and accrued expenses	74,992
Unearned dues	32,874
Net cash flows from operating activities	1,268,414
Cash flows from investing activities	
Acquisition of equipment	(277,138)
Proceeds from sale of equipment	620
Net cash flows from investing activities	(276,518)
Cash flows from financing activities	
Repayment of debt	(473,574)
Cash distributions	(367,580)
Net cash flows from financing activities	(841,154)
Increase in cash	150,742
Cash at beginning of year	300,202
Cash at end of year	$ 450,944
Supplemental disclosures of cash flow information:	
Cash paid during the year for interest	$ 774,170

See accompanying notes and accountant's review report.

Alexander & Ames Limited Partnership

Notes to Financial Statements

For the Year Ended December 31, 19X3

Note 1—Organization

The Partnership, formed in 19W8, is a limited partnership in accordance with the provisions of the Uniform Partnership Act as in effect in the State of Minnesota.

The Partnership owns and operates a racquet and swim club (the "Club") located in Minnesota. The Club has approximately 3,000 members at December 31, 19X3. The Club extends credit to members for the payment of dues and other charges.

The General Partner of the Partnership is John Alexander.

Profit and Loss Allocations

Prior to December 1, 19X2 profits and losses from annual operations were allocated 99% to the Limited Partners and 1% to the General Partner.

Subsequent to November 30, 19X2 and until the Class A Limited Partners have received distributions of net cash flow equal to their Preferred Return, profits and losses from annual operations are allocated 65% to the Class A Limited Partners, 15% to the Special Limited Partner and 20% to the General Partner.

After the Class A Limited Partners have received cumulative distributions of net cash flow equal to their Preferred Return, profits and losses from annual operations will be allocated 45% to the Class A Limited Partners, 15% to the Special Limited Partner and 40% to the General Partner.

Net Cash Flow Allocation From Operations

Subsequent to November 30, 19X2, net cash flow is allocated 65% to the Class A Limited Partners, 15% to the Special Limited Partner and 20% to the General Partner until such time as the Class A Limited Partners have received cumulative distributions equal to their Preferred Return.

The balance of any net cash flow will be distributed 45% to the Class A Limited Partners, 15% to the Special Limited Partner and 40% to the General Partner.

Preferred Return

The Preferred Return means a 9% per annum cumulative noncompounded return on the Adjusted Capital Contribution of the Class A Limited Partners. The Adjusted Capital Contribution means the Original Capital Contributions are reduced only by distribution from the net proceeds of sale or refinancing.

Note 2—Summary of Significant Accounting Policies

Accounting Method

The Partnership's financial statements are prepared on the accounting basis used for federal income tax purposes. The Partnership uses the Accelerated Cost Recovery System (ACRS) and Modified Accelerated Cost Recovery System (MACRS) in depreciating its property. Under ACRS and MACRS, depreciation is determined over periods of time that are shorter than those used under generally accepted accounting principles. Additionally, the income tax methods used to capitalize and amortize amortizable assets differ from those used under generally accepted accounting principles.

The income tax basis financial statements have been modified for the following items: 1) income tax regulations require unearned dues to be recognized in income during the period the dues are received; the financial statements defer the recognition of dues until the period they are earned; and 2) the financial statements include an allowance for doubtful accounts; income tax regulations do not allow for such an account.

Syndication costs are carried as an asset of the Partnership and not amortized. Under generally accepted accounting principles these costs would be deducted from partners' capital.

Concentration of Credit Risk

The Partnership places its cash with one banking institution. At times the amount on deposit exceeds the insured limit of the institution and exposes the Partnership to a collection risk.

Allowance for Doubtful Accounts

An allowance for doubtful accounts has been established based upon management's estimate of uncollectible accounts.

Inventories

Inventories, which consist of merchandise for sale in the sports shop, food and beverages, are stated at the lower of cost (first-in, first-out method) or market.

Membership Dues and Initiation Fees

Membership dues are billed in advance and recorded in accounts receivable and unearned dues. The dues are recognized as revenue in the month earned. Initiation fees are recorded as revenue in the period when the fee is collected.

Property and Equipment

Property and equipment are carried at cost. Depreciation is computed using income tax methods. The cost of maintenance and repairs is charged to income as incurred; significant renewals or betterments are capitalized.

Organization Costs

Organizational costs are amortized over 60 months using the straight-line method.

Financing Fees

Financing fees are amortized over the term of the related debt using the straight-line method. During 19X2 financing fees related to retired debt were written off. The financing fees related to new debt were capitalized.

Start-Up Costs

Start-up costs are amortized over 60 months using the straight-line method.

Income Taxes

No provision for income taxes has been made, as the liability for such taxes is that of the Partners rather than that of the Partnership.

Note 3—Property and Equipment

Property and equipment at December 31, 19X3 consisted of the following:

		Depreciation Lives — Years
Land	$ 975,720	—
Building	9,320,050	7 - 40
Tenant improvements	1,568,896	5 - 7
	$11,864,666	

Depreciation expense was $512,836 during 19X3.

Note 4—Debt

At December 31, 19X3, debt consisted of the following:

Mortgage loan payable in monthly payments of $73,124, including interest at 9.375%, through January 19X6 when the interest rate changes to 3.5% above the Three Year Treasury Base Rate. Beginning February 1, 19X6 monthly payments will be adjusted to reflect the new interest rate, the payments will be based upon a 15-year term. The remaining principal is due January 1, 19X9. The mortgage is secured by property, equipment and a personal guaranty.	$6,778,186
10% unsecured note payable to the Special Limited Partner due in monthly installments of $16,546, including principal and interest, through February 1, 19X9 when the unpaid balance is due.	788,780
	$7,566,966

Note 5—Amendment of the Partnership Agreement

The Partnership Agreement was amended effective November 30, 19X2. The primary purpose of the amendment was to create a new class of limited partner (the Special Limited Partner) and to change the allocations of profits, losses and cash distributions.

Effective November 30, 19X2, John Ames surrendered his 67 limited partnership units in exchange for $1,450,000 and a 15% special limited partnership interest. Additionally, as part of this exchange $200,000 was paid down on the note payable to the Special Limited Partner, the interest rate on this note was reduced to 10% from 12%, and the term of the note was shortened.

Note 6—Transactions With Affiliates

At December 31, 19X3, the Partnership owed Partners or affiliated entities $788,780.

During 19X3 a management fee of $50,700 was paid to a Partner.

RIGGS & RIGGS REALTY
FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 19X3 AND 19X2

Independent Accountant's Report

To the Partners of
Riggs & Riggs Realty

We have compiled the accompanying balance sheets — federal income tax basis of Riggs & Riggs Realty as of December 31, 19X3 and 19X2, and the related statements of operations and partners' deficit — federal income tax basis and schedules of partners' deficit accounts — federal income tax basis for the years then ended in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. These financial statements have been prepared on the federal income tax basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles.

A compilation is limited to presenting information in the form of financial statements that is the representation of the management of Riggs & Riggs Realty. We have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

These financial statements are the financial statements of Riggs & Riggs Realty only and do not include the accounts of other related business entities under common ownership or control, as described in Note 1.

[Signature of Firm]

[City and State]

[Date]

RIGGS & RIGGS REALTY

Balance Sheets
(Federal Income Tax Basis)

December 31, 19X3 and 19X2

	19X3	19X2
Assets		
Investment in real estate, at cost, collateral for deed of trust notes payable (Notes 2 and 4)		
Land under development	$ 4,832,321	$ 3,089,753
Development and predevelopment costs	11,273,049	12,058,072
Land not under development	3,412,001	5,928,211
	19,517,371	21,076,036
Cash	84,517	90,275
Accounts receivable — other	2,262	1,136
Notes receivable from related parties (Note 3)	191,861	194,229
Subdivision bonds	502,325	244,200
Visitors center		
Land	170,452	170,451
Building, net of accumulated depreciation of $51,224 in 19X3 and $42,643 in 19X2	189,076	197,657
Intangibles, net of accumulated amortization of $101,483 in 19X3 and $95,989 in 19X2	—	5,494
Deferred interest (Notes 2 and 6)	3,151,344	2,224,815
	4,291,837	3,128,257
Total assets	$23,809,208	$24,204,293
Liabilities and Partners' Deficit		
Deed of trust notes payable, collateralized by investment in real estate (Note 4)	$18,588,053	$19,371,436
Accounts payable and accruals (Note 5)	278,483	190,037
Payables to related parties (Note 6)	16,712,108	15,545,648
Deposits from purchasers	150,500	92,500
Total liabilities	35,729,144	35,199,621
Partners' deficit	(11,919,936)	(10,995,328)
Total liabilities and partners' deficit	$23,809,208	$24,204,293

See accompanying notes and accountant's compilation report.

RIGGS & RIGGS REALTY

Statements of Operations and Partners' Deficit
(Federal Income Tax Basis)

Years Ended December 31, 19X3 and 19X2

	19X3	19X2
Real estate revenue (Note 2)	$ 8,683,118	$ 6,034,500
Cost of real estate revenue	7,516,252	4,995,898
Gross profit	1,166,866	1,038,602
Selling, general and administrative expenses		
Management fee (Note 7)	230,000	240,000
Real estate taxes	79,431	88,347
Bad debts (Note 3)	—	6,234
Maintenance	91,033	81,519
Media advertising	300,700	161,933
Marketing	68,918	96,697
Contributions	—	750
Professional fees	28,531	22,324
Depreciation and amortization	14,074	29,793
Utilities	20,538	13,176
Community association dues	7,006	6,101
Business license	5,494	3,500
Other	21,910	7,849
	867,635	758,223
Operating income	299,231	280,379
Interest expense, net of interest income of $18,244 in 19X3 and $12,168 in 19X2 (Notes 2 and 6)	(1,254,756)	(1,604,353)
Other income	30,917	13,668
Net loss	(924,608)	(1,310,306)
Partners' deficit, beginning of year	(10,995,328)	(9,685,022)
Partners' deficit, end of year	$(11,919,936)	$(10,995,328)

See accompanying notes and accountant's compilation report.

RIGGS & RIGGS REALTY

Schedules of Partners' Deficit Accounts
(Federal Income Tax Basis)

Years Ended December 31, 19X3 and 19X2

	Riggs Partnership	Roberts Partnership	Alan Rowe	Total
Percentage interest	50%	37.5%	12.5%	100.0%
Partners' deficit, December 31, 19X1	$ (4,842,511)	$ (3,631,883)	$ (1,210,628)	$ (9,685,022)
Net loss	(655,153)	(491,365)	(163,788)	(1,310,306)
Partners' deficit, December 31, 19X2	(5,497,664)	(4,123,248)	(1,374,416)	(10,995,328)
Net loss	(462,304)	(346,728)	(115,576)	(924,608)
Partners' deficit, December 31, 19X3	$ (5,959,968)	$ (4,469,976)	$ (1,489,992)	$ (11,919,936)

See accompanying notes and accountant's compilation report.

Riggs & Riggs Realty

Notes to Financial Statements
(Federal Income Tax Basis)

Years Ended December 31, 19X3 and 19X2

Note 1 — Summary of Significant Accounting Policies

Organization and Purpose

The Partnership was organized on March 27, 19W5 under the laws of the Commonwealth of Virginia for the purpose of acquisition, ownership, management, lease, and ultimate disposition of real estate. The Partnership is engaged in real estate development in Virginia. Under the terms of the Partnership Agreement, the Partnership will terminate on December 31, 200Y, unless amended otherwise.

The accounting and reporting policies of the Partnership reflect practices appropriate to the real estate development industry. The significant accounting policies are summarized below.

Related Business Entities

The Partnership is related to other business entities through common ownership or control. These financial statements do not include any other related business entities that are under common ownership or in which the partners have a direct or indirect controlling financial interest. The financial effects of control of two or more business enterprises by common ownership are more appropriately reflected in combined financial statements presented in accordance with generally accepted accounting principles applicable to consolidations.

Basis of Accounting

The accompanying financial statements have been prepared on the federal income tax accrual basis of accounting. Revenue from real estate sales is primarily recognized when all conditions precedent to closing have been performed, which is generally at the time of settlement.

Land costs and real estate taxes are allocated to blocks within sections in land under development and land not under development based on the acreage in the block to the total acreage at the beginning of the year. Actual physical development has commenced on land under development but not on land not under development. Land under development is allocated to the cost of real estate revenue on a block-by-block basis using the relative sales value of the portion of the block sold during the year to the total estimated sales value of the block unsold at the beginning of the year.

Development and predevelopment costs also include development management fees, real estate taxes and interest. Development costs are allocated to various blocks within sections in land under development based upon specific indentification and the total acreage under development during the year. Development management fees are allocated to blocks in land under development based on costs incurred in the block to costs incurred during the year on all blocks. Development costs and development management fees are allocated to the cost of real estate revenue on a block-by-block basis using the relative sales value of the portion of the block sold during the year to the total estimated sales value of the block unsold at the beginning of the year. Development management fees charged as a period cost were based on management's estimates.

Interest costs incurred on land under development is first capitalized to the specific blocks within the section to which the loan relates. The balance of the interest, as required by the Internal Revenue Code, is capitalized to blocks in land under development based on the accumulated production expenditures of each block to the accumulated production expenditures of the remaining sold and unsold blocks under development. Accumulated production expenditures include land, development and predevelopment costs. Interest costs incurred on land not under development are expensed until actual physical development commences, at which time interest costs are capitalized. Interest and real estate tax costs on finished lots are expensed.

Because real estate development covers more than one accounting period, revision of estimates relating to cost allocations are accounted for in the period in which the revision becomes known and future periods.

Selling, general and administrative expenses are charged to operations as incurred.

Investment in Real Estate

Investment in real estate is recorded at cost and includes land, land acquisition, development, interest on land under development and real estate tax costs.

Visitors Center

The Visitors Center building is recorded at cost and depreciated using the straight-line method over 31.5 years.

Intangibles

Permanent loan fees are amortized using the straight-line method over the five-year term of the related deed of trust note payable.

Deposits from Purchasers

Deposits received from prospective purchasers are applied at settlement as a portion of the down payment.

Income Taxes

No provision for income taxes has been made, as the liability for such taxes is that of the Partners rather than that of the Partnership.

Note 2 — Investment in Real Estate

During 19X3, of 556 single family and townhouse lots available for sale, 328 were sold and 180 were under contract. During 19X2, of 521 single family and townhouse lots available, 248 were sold and 262 were under contract.

Included in the real estate investment at December 31, 19X3, are capitalized interest of $1,296,648 and real estate taxes of $803,092 and at December 31, 19X2, are capitalized interest of $1,328,212 and real estate taxes of $783,332.

Interest cost incurred for the year ended December 31, 19X3 is $2,029,746, of which $756,745 was capitalized. Interest cost incurred for the year ended December 31, 19X2 is $1,889,690, of which $273,169 was capitalized. Interest on notes payable to partners was deferred in 19X3 and 19X2. See Note 6.

Note 3 — Notes Receivable From Related Parties

Notes receivable from related parties are from related business entities and are unsecured, due on demand, and bear interest at the prime rate. At December 31, related party notes receivables are as follows:

	19X3	19X2
Notes receivable	$162,188	$158,250
Accrued interest	29,673	35,979
Totals	$191,861	$194,229

Note 4 — Deed of Trust Notes Payable

The Partnership obtained financing from a commercial bank for the acquisition, development and sale of single family and townhouse lots. The maximum amount of the loan is $20,000,000 at any one time and $69,935,500 in the aggregate. Principal curtailments are due as lots are sold. In addition, principal curtailments of $66,875 are due December 31, 19X3, June 30, 19X4, and September 30, 19X4. The maximum amount of the loan is permanently reduced by the principal curtailments of $66,875 each and for the sale of nonresidential properties and multifamily lots. All principal and interest are due on September 30, 19X4. Interest is payable monthly at prime plus 3% to March 31, 19X4, and at prime plus 4% from April 1, 19X4 to September 30, 19X4. Extension fees of 1% of the maximum loan amount are payable by June 30, 19X3 and June 30, 19X4. During 19X3, the commercial bank sold the loan to an investor. The balance outstanding was $17,863,234 and $18,638,310 at December 31, 19X3 and 19X2, respectively.

Following is a summary of deed of trust notes outstanding at December 31:

	19X3	19X2
Deed of trust note payable (above)	$17,863,234	$18,638,310
Purchase money note payable, principal and interest at 12%, payable in monthly installments of $2,070, maturing June 1, 200Y	724,819	733,126
Totals	$ 18,588,053	$ 19,371,436

The following is a schedule, by years, of future amounts due on the notes, excluding interest:

Year Ending December 31,	
19X4	$18,456,684
19X5	9,500
19X6	10,750
19X7	12,000
Thereafter	99,119
Totals	$18,588,053

Note 5 — Accounts Payable and Accruals

Accounts payable and accruals at December 31 consist of the following:

	19X3	19X2
Accrued interest payable	$154,570	$145,177
Accounts payable — trade	123,913	12,263
Estimated costs to complete lots sold	—	32,597
Totals	$278,483	$190,037

Note 6 — Payables To Related Parties

Payables to related parties are from partners and related business entities and, at December 31, consist of the following:

	19X3	19X2
Accounts payable, related business entity	$ 314,683	$ 224,762
Notes payable, related business entity Unsecured notes payable; interest payable annually on December 31, at the prime rate; principal and unpaid interest due on demand	4,376,680	4,376,680
Notes payable, partners Unsecured demand notes payable; interest at prime rate	8,869,401	8,719,391
Deferred interest	3,151,344	2,224,815
Total accounts and notes payable	$16,712,108	$15,545,648

Deferred interest on notes payable to partners is not deductible until paid.

Note 7 — Related Party Transactions

A related business entity provided subcontract land development services at costs of approximately $3,521,500 for the year ended December 31, 19X3, and $718,500 for the year ended December 31, 19X2. Development management services provided by a related business entity totaled approximately $600,000 for the year ended December 31, 19X3, and $650,000 for the year ended December 31, 19X2.

MILLER MEDICAL EQUIPMENT
FINANCIAL STATEMENTS
AND SUPPLEMENTAL INFORMATION
YEARS ENDED
DECEMBER 31, 19X3 AND 19X2

Independent Accountant's Report

To the Board of Directors and Stockholders of
Miller Medical Equipment

We have compiled the accompanying statements of assets, liabilities and stockholder's equity — federal income tax basis of Miller Medical Equipment as of December 31, 19X3 and 19X2, and the related statements of revenues, expenses and retained earnings — federal income tax basis and statements of cash flows — federal income tax basis for the years then ended, together with the supplementary schedules of costs of sales and rentals, selling, delivery, retail, and general and administrative expenses — federal income tax basis for the years then ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. These financial statements have been prepared on the federal income tax basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles.

A compilation is limited to presenting information in the form of financial statements that is the representation of the management of Miller Medical Equipment. We have not audited or reviewed the accompanying financial statements and supplemental schedules of costs of sales and rentals, selling, delivery, retail, and general and administrative expenses and, accordingly, do not express an opinion or any other form of assurance on them.

[Signature of Firm]

[City and State]

[Date]

MILLER MEDICAL EQUIPMENT

Statements of Assets, Liabilities and Stockholder's Equity — Income Tax Basis

December 31, 19X3 and 19X2

	19X3	19X2
Assets		
Current Assets		
Cash	$ 54,568	$ 7,596
Accounts receivable — trade	3,460,346	1,741,070
Inventory	475,818	392,950
Other current assets	15,664	9,110
	4,006,396	2,150,726
Rental Equipment — net of accumulated depreciation of $2,013,724 and $1,567,110	2,306,998	1,227,432
Property and Equipment		
Vehicles	401,858	221,184
Computer equipment	259,158	181,000
Furniture and fixtures	164,978	140,770
Leasehold improvements	180,560	145,704
	1,006,554	688,658
Less accumulated depreciation	374,716	276,094
	631,838	412,564
Other Assets		
Deposits	17,300	16,620
Loan origination fees — net of accumulated amortization of $2,726 and $4,650	17,724	4,650
	35,024	21,270
	$6,980,256	$3,811,992
Liabilities and Stockholder's Equity		
Current Liabilities		
Note payable — line of credit	$ 430,000	$ —
Current portion of long-term debt	469,220	268,206
Notes payable — vendors	432,692	—
Accounts payable — trade	631,428	744,652
Accrued salaries and wages	72,472	29,456
Accrued and withheld payroll taxes	61,474	39,080
Accrued taxes and other expenses	53,974	32,556
	2,151,260	1,113,950
Long-Term Debt — net of current portion	2,226,540	830,370
Stockholder's Equity		
Capital stock — no par value; 25,000 shares authorized; 1,000 issued and outstanding	8,182	8,182
Retained earnings	2,594,274	1,859,490
	2,602,456	1,867,672
	$ 6,980,256	$3,811,992

See accountant's compilation report and notes to financial statements.

MILLER MEDICAL EQUIPMENT

Statements of Revenues, Expenses and Retained Earnings — Income Tax Basis

Years Ended December 31, 19X3 and 19X2

	19X3	19X2
Revenues		
Equipment rentals	$ 7,275,534	$5,271,156
Home care sales	1,672,222	1,038,688
Retail sales	1,990,216	1,076,032
	10,937,972	7,385,876
Cost of Sales and Rentals	3,525,668	2,110,344
Gross Profit	7,412,304	5,275,532
Operating Expenses		
Selling	1,273,530	874,698
Delivery	1,012,602	730,108
Retail	717,550	587,630
General and administrative	3,465,298	2,570,074
	6,468,980	4,762,510
Revenue from Operations	943,324	513,022
Interest and Miscellaneous Income	7,048	1,160
Excess of Revenues Over Expenses	950,372	514,182
Retained Earnings — Beginning	1,859,490	1,511,424
Less distributions to stockholder	215,588	166,116
Retained Earnings — Ending	$2,594,274	$1,859,490

See accountant's compilation report and notes to financial statements.

MILLER MEDICAL EQUIPMENT

Statements of Cash Flows — Income Tax Basis

Years Ended December 31, 19X3 and 19X2

	19X3	19X2
Cash Flows from Operating Activities		
Excess of revenues over expenses	$ 950,372	$ 514,182
Adjustments to reconcile excess of revenues over expenses to net cash provided by operating activities:		
Depreciation and amortization	784,032	496,740
Loss on asset disposition	—	3,000
Interest	4,618	—
Changes in assets and liabilities:		
Accounts receivable	(1,039,276)	(406,776)
Inventory	87,132	(216,662)
Other current assets	(6,554)	(330)
Other assets	(680)	2,092
Accounts payable	(113,228)	275,212
Accrued expenses	86,832	71,778
	753,248	739,236
Cash Flows from Investing Activities		
Acquisition of property and equipment	(791,008)	(741,760)
Acquisition of home medical company assets	(1,440,000)	—
	(2,231,008)	(741,760)
Cash Flows from Financing Activities		
Proceeds from borrowing	2,348,786	500,240
Payments on debt	(339,402)	(345,622)
Payments on vendor notes	(269,064)	—
Distributions to stockholder	(215,588)	(166,116)
	1,524,732	(11,498)
Increase (decrease) in Cash	46,972	(14,022)
Cash — Beginning	7,596	21,618
Cash — Ending	$ 54,568	$ 7,596
Supplemental Disclosures of Cash Flow Information		
Cash paid during the year for interest	$ 173,152	$ 91,908
Schedule of noncash investing and financing transactions:		
Long-term debt refinanced	$ 855,978	
Vender notes payable incurred for rental inventory	$ 694,490	

See accountant's compilation report and notes to financial statements.

Miller Medical Equipment

Notes to Financial Statements

Years Ended December 31, 19X3 and 19X2

Note 1—Summary of Significant Accounting Policies

Nature of Business

The Company, formerly doing business as Miller Brothers, sells and rents oxygen and home medical equipment to patients covered by Medicare or other insurance. The Company also has three retail outlets, which it opened during 19X3 and 19X2. The Company serves western Pennsylvania, eastern Ohio, and northern West Virginia.

Basis of Accounting

The Company prepares its financial statements on the accrual basis of accounting used for income tax reporting. This basis differs from generally accepted accounting principles primarily because depreciation is calculated using the statutory accelerated cost recovery periods instead of useful lives and accounts receivable are written off when deemed uncollectible, with no allowance for doubtful accounts reflected in the financial statements.

Inventory

Inventory is valued at the lower of cost or market using the first-in, first-out method of valuation.

Depreciation

Rental equipment and property and equipment are stated at cost. Depreciation is computed using the accelerated cost recovery and modified cost recovery methods allowable under the Internal Revenue Code. The recovery periods being used are 5 and 7 years for furniture, fixtures and equipment and 31.5 years for leasehold improvements.

Loan Origination Fees

Loan origination fees associated with the acquisition of the bank note are amortized using the straight-line method over the term of the note agreement.

Retirement Plans

Profit sharing costs are funded as accrued.

Income Taxes

Effective January 1, 19X1, the Company elected to be taxed as an S Corporation under Section 1362(a) of the Internal Revenue Code. The effect of this election is that taxable results of operations and tax credits generated are reportable on the individual income tax return of the stockholder. Accordingly, no provision for corporate income taxes has been made.

Note 2—Business Acquisition

Effective May 17, 19X3, the Company acquired certain assets of Medical Products, Inc., a home medical equipment company. The assets acquired were:

Accounts receivable	$ 680,000
Rental equipment	584,000
Inventory	170,000
Vehicles	6,000
	$1,440,000

The purchase was financed with a bank term note, described in Note 3.

Note 3—Notes Payable and Long-Term Debt

The Company has an $800,000 line of credit with a bank, payable on demand, with interest payable monthly at prime plus .75%. The line is collateralized by cash, accounts receivable, inventory and equipment. The balance outstanding at December 31, 19X3 was $430,000. The prime rate at December 31, 19X3 was 6%.

Long-term debt consists of the following at December 31:

	19X3	19X2
Bank term note, payable in monthly principal installments of $31,110, with interest payable monthly at prime plus 1.25% due June, 19X7, collateralized by cash, accounts receivable, inventory, equipment and the personal guarantee of the sole stockholder.	$2,426,722	$ —
Bank note, payable in monthly principal installments of $15,500, with interest payable monthly at prime plus 1%, due April, 19X5, collateralized by cash, accounts receivable, inventory and equipment. This debt was refinanced in 19X3.	—	849,500
Capitalized leases on equipment, payable in aggregate monthly installments of $4,410, with interest ranging from 17.5% to 24%, due on various dates through March, 19X3, collateralized by equipment with a cost of $309,182 and a net book value of $108,848 at December 31, 19X2.	269,038	249,076
	2,695,760	1,098,576
Less current portion	469,220	268,206
	$2,226,540	$ 830,370

Maturities of long-term debt are as follows:

19X4	$ 461,430
19X5	426,356
19X6	405,400
19X7	933,354
	$2,226,540

Total interest expense for the years ended December 31, 19X3 and 19X2 was $173,152 and $91,908, respectively.

All bank debt is secured by the personal guarantee of the stockholder and assignment of a $4,000,000 life insurance policy on the stockholder. The Company is also subject to the following covenants with respect to all bank notes and lines of credit: a minimum current ratio of 1.5:1, a minimum tangible net worth of $2,000,000, a minimum cash flow to debt service of 1.20 measured quarterly based on the previous four quarters, and a maximum debt to tangible net worth ratio of 1.75:1.

Note 4—Notes Payable — Vendors

The notes payable to vendors are short-term financing arrangements for the purchase of rental equipment inventory. They are payable in aggregate monthly installments of $55,122, which includes interest at rates of up to 20%. The notes are due at various dates through October, 19X4 and are collateralized by the equipment. Interest expense for 19X3 was $14,518.

Note 5—Retirement Plans

The Company maintains a qualified profit-sharing plan covering all eligible employees. The plan includes a deferred arrangement under section 401(k) of the Internal Revenue Code. The elective contributions to the 401(k) portion of the plan are funded by salary reductions of the participants. Company contributions to the plan are discretionary up to a maximum of 15% of annual wages paid and accrued for the year, and are generally based on net income.

Contributions for the years ended December 31, 19X3 and 19X2 were:

	19X3	19X2
Company	$104,256	$ 61,430
Employees	76,578	68,320
Total	$180,834	$129,750

Note 6—Commitments and Related Party Transactions

The Company leases four offices and warehouse facilities in Pennsylvania and West Virginia. The leases have terms ranging from one to six years and expire at various dates through August, 19X8. Total rental expense for the years ended December 31, 19X3 and 19X2 was $367,964 and $328,460, respectively.

Included in the above, are leases for two office facilities with the sole stockholder. The rentals on these leases for each of the years ended December 31, 19X3 and 19X2 were $169,440.

Future minimum rental payments are as follows:

	Stockholder	Other	Total
19X4	$150,240	$249,592	$ 399,832
19X5	150,240	246,792	397,032
19X6	150,240	209,720	359,960
19X7	150,240	64,800	215,040
19X8	—	43,200	43,200
	$600,960	$814,104	$1,415,064

Note 7—Operating Leases

The Company has entered into various vehicle and equipment leases payable in aggregate monthly payments of $12,270, expiring on various dates through November, 19X6. Total lease expense for the years ended December 31, 19X3 and 19X2 was $147,078 and $139,528, respectively.

Future minimum lease payments are as follows:

19X4	$132,540
19X5	91,830
19X6	28,396
	$252,766

Note 8—Subsequent Event

On January 4, 19X4, the Company purchased certain assets of Home-Med, Inc., an Ohio corporation, for $850,000. The assets purchased consist of accounts receivable, fixed assets, vehicles, supplies, furniture and fixtures, other assets, and a one-year covenant not to compete.

The purchase price was financed with a term note for $850,000, which is secured by the guarantee of the sole stockholder.

MILLER MEDICAL EQUIPMENT

Schedules of Costs of Sales and Rentals, Selling, Delivery and Retail Expenses — Income Tax Basis

Years Ended December 31, 19X3 and 19X2

	19X3	19X2
Costs of Sales and Rentals		
Inventory — beginning	$ 392,950	$ 176,286
Purchases	2,350,778	1,572,234
Supplies	564,416	277,050
Depreciation	623,694	408,246
Equipment rental	13,246	31,396
Freight	56,402	38,082
	4,001,486	2,503,294
Inventory — ending	475,818	392,950
	$3,525,668	$2,110,344
Selling Expenses		
Payroll, payroll taxes, and employee benefits	$ 659,544	$ 511,740
Bad debts	329,600	169,654
Commissions	108,236	30,126
Vehicle expense	79,946	72,518
Advertising	59,798	61,982
Entertainment and travel	36,406	28,678
	$1,273,530	$ 874,698
Delivery Expenses		
Payroll, payroll taxes, and employee benefits	$ 712,492	$ 533,818
Truck expense	212,854	164,166
Depreciation	67,140	17,662
Freight	20,116	14,462
	$1,012,602	$ 730,108
Retail Expenses		
Payroll, payroll taxes, and employee benefits	$ 360,184	$ 299,996
Rent	137,690	115,062
Advertising	82,698	82,074
Commissions	34,644	9,514
Store expense	27,892	32,064
Entertainment and travel	23,530	12,646
Telephone	23,222	16,992
Utilities	16,156	8,686
Vehicle expense	11,534	10,596
	$ 717,550	$ 587,630

MILLER MEDICAL EQUIPMENT

**Schedules of General and Administrative Expenses —
Income Tax Basis**

Years Ended December 31, 19X3 and 19X2

	19X3	19X2
General and Administrative Expenses		
Salaries and wages	$1,325,658	$1,130,038
Telephone	249,808	166,564
Rent	230,274	213,398
Office expense	212,198	162,804
Commissions	180,486	10,310
Interest	173,152	91,908
Payroll taxes	112,942	82,186
Retirement plan contribution	104,256	61,430
Insurance	102,904	88,486
Outside services	94,104	69,086
Employee benefits	91,752	66,956
Depreciation and amortization	90,334	66,002
Travel and entertainment	84,600	71,272
Other taxes	84,298	62,984
Professional fees	82,464	31,086
Utilities	48,782	44,486
Vehicle expense	40,488	20,638
Dues and subscriptions	35,222	26,376
Postage	34,134	24,338
Building expense	22,774	19,224
Data processing costs	21,294	19,618
Meetings and seminars	14,338	13,926
Leased equipment	13,666	13,950
Miscellaneous	9,408	5,144
Contributions	5,962	7,864
	$3,465,298	$2,570,074

MAXON METALS, INC.
FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 19X3 AND 19X2

Independent Accountant's Report

To the Board of Directors and Stockholders
Maxon Metals, Inc.

We have reviewed the accompanying balance sheets — federal income tax basis of Maxon Metals, Inc. as of December 31, 19X3 and 19X2, and the related statements of operations and retained earnings — federal income tax basis and of cash flows — federal income tax basis for the years then ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. All information and disclosures included in these financial statements are the representations of the owners of Maxon Metals, Inc.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit of financial statements in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying December 31, 19X3 and 19X2 financial statements in order for them to be in conformity with the federal income tax basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles.

[Signature of Firm]

[City and State]

[Date]

MAXON METALS, INC.

Statements of Assets, Liabilities and Equity
Federal Income Tax Basis

December 31, 19X3 and 19X2

	19X3	19X2
Assets		
Current Assets		
Cash and cash equivalents	$3,078,966	$3,608,930
Accounts receivable — contract (Note 2)	2,409,554	1,422,268
Advances to officers	7,812	—
Inventory	287,714	196,200
Total current assets	5,784,046	5,227,398
Property and Equipment		
Machinery and equipment	1,694,980	1,710,828
Transportation equipment	384,790	395,042
Office furniture and equipment	162,454	163,034
Leasehold improvements	363,798	363,798
Total cost	2,606,022	2,632,702
Accumulated depreciation and amortization (Note 3)	(2,362,850)	(2,343,812)
Net property and equipment	243,172	288,890
Other Assets		
Cash surrender value of officers' life insurance	24,454	23,610
Other	1,460	20,766
Total other assets	25,914	44,376
Total assets	$6,053,132	$5,560,664

See accountant's review report and notes to financial statements.

MAXON METALS, INC.

Statements of Assets, Liabilities and Equity
Federal Income Tax Basis

December 31, 19X3 and 19X2
(continued)

	19X3	19X2
Liabilities and Stockholders' Equity		
Current Liabilities		
Accounts payable and accruals (Note 4)	$ 548,646	$ 288,904
Billings in excess of costs on uncompleted contracts (Note 5)	976,754	445,108
Total current liabilities	1,525,400	734,012
Contributed Capital		
Common stock, $1,000 par value; 100 shares authorized; 60 shares issued and outstanding	60,000	60,000
Retained Earnings	4,467,732	4,766,652
Total stockholders' equity	4,527,732	4,826,652
Total liabilities and stockholders' equity	$6,053,132	$5,560,664

See accountant's review report and notes to financial statements.

MAXON METALS, INC.

Statements of Operations and Retained Earnings
Federal Income Tax Basis

Years Ended December 31, 19X3 and 19X2

	19X3	19X2
Contract revenue	$7,009,498	$8,116,380
Cost of contract revenue		
Direct costs		
Materials and supplies	1,710,330	1,729,310
Salaries and wages	1,184,132	1,264,664
Subcontracts	1,670,596	1,838,942
Other	99,486	92,560
	4,664,544	4,925,476
Indirect costs	813,520	967,278
	5,478,064	5,892,754
Gross profit	1,531,434	2,223,626
General and administrative expenses		
Salaries and wages	1,298,552	2,139,444
Profit-sharing plan contribution	—	6,138
Other	596,938	539,786
	1,895,490	2,685,368
Operating loss	(364,056)	(461,742)
Financing income	88,148	132,590
Net loss	(275,908)	(329,152)
Retained earnings, beginning of year	4,766,652	5,255,804
Distributions to stockholders	(23,012)	(160,000)
Retained earnings, end of year	$4,467,732	$4,766,652

See accountant's review report and notes to financial statements.

MAXON METALS, INC.

Statements of Cash Flows
Federal Income Tax Basis

Years Ended December 31, 19X3 and 19X2

	19X3	19X2
Cash flows from operating activities		
Net loss	$ (275,908)	$ (329,152)
Noncash items included in net loss:		
Depreciation	45,718	60,204
(Increase) decrease in:		
Contract receivables	(987,286)	2,103,570
Inventory	(91,514)	(3,260)
Cash surrender of officers' life insurance	(844)	(1,200)
Other assets	—	(408)
Increase (decrease) in:		
Accounts payable and accruals	259,742	(100,832)
Billings in excess of costs on uncompleted contracts	531,646	(895,508)
Net cash (used) provided by operating activities	(518,446)	833,414
Cash flows from investing activities		
Property and equipment purchases	—	(60,000)
Advances to officers	(7,812)	—
Decrease in certificates of deposit	—	2,132,038
Decrease in other assets	19,306	—
Net cash provided by investing activities	11,494	2,072,038
Cash flows from financing activities		
Distributions to stockholders	(23,012)	(160,000)
Net (decrease) increase in cash and cash equivalents	(529,964)	2,745,452
Cash and cash equivalents, beginning of year	3,608,930	863,478
Cash and cash equivalents, end of year	$3,078,966	$3,608,930

See accountant's review report and notes to financial statements.

Maxon Metals, Inc.

Notes to Financial Statements
Federal Income Tax Basis

December 31, 19X3 and 19X2

Note 1—Summary of Significant Accounting Policies

Basis of Accounting

The accompanying financial statements have been prepared on the method of accounting used for federal income tax reporting purposes.

If the accompanying financial statements were prepared in conformity with generally accepted accounting principles, contract revenue and costs would be recognized under the percentage-of-completion method of accounting, an allowance for uncollectible accounts receivable would be established, property and equipment would be depreciated over their estimated useful lives, and the related party lease would be capitalized as an asset and liability.

The Corporation has elected to be treated as a Small Business Corporation (S corporation) under Internal Revenue Code Section 1362. This election provides that, in lieu of corporate income taxes, the taxable items and credits pass directly to the stockholders. Therefore, these financial statements do not include federal or state income taxes which would otherwise be applicable.

The accrual completed contract method of accounting recognizes contract revenue and costs when a contract is completed or substantially completed. A contract is considered substantially completed when all costs except insignificant items have been incurred and the installation has been accepted by the customer.

Contract costs include all direct material and labor costs and those indirect costs related to contract performance, such as rent, depreciation, maintenance, and insurance. Indirect costs are allocated based on contract revenue. General and administrative costs are charged to expenses as incurred.

Amounts billed in excess of costs are classified as current liabilities under billings in excess of costs on uncompleted contracts. Contract retentions are included in contract receivables.

Cash and Cash Equivalents

Cash and cash equivalents consist of highly liquid investments with a maturity of three months or less when purchased.

At year end and throughout the year, the Corporation had on deposit with several banks amounts in excess of FDIC insurance limits. The Corporation has not experienced any losses in such accounts. The Corporation believes it is not exposed to any significant credit risk on cash and cash equivalents.

Contract Receivables

Contract receivables, including retentions, are recorded as progress billings are rendered in accordance with the provisions of the contracts. The Corporation uses the direct write-off method to record uncollectible accounts in compliance with the Internal Revenue Code.

Inventory

Inventory consists of aluminum, stainless steel, and fasteners used in metal fabrication and is valued at the lower of cost, based on the first-in, first-out method, or market.

Property and Equipment

Property and equipment are recorded at cost and depreciated using principally accelerated methods. Leasehold improvements are amortized over the life of the related leases or their estimated useful lives, whichever is shorter.

Property and equipment are depreciated over the following recovery periods:

Machinery and equipment	5 years
Transportation equipment	5 years
Office furniture and equipment	5–7 years
Leasehold improvements	10–31.5 years

Expenditures for maintenance and repairs which do not materially extend the lives of the assets are charged to earnings. When property or equipment is sold or otherwise disposed of, the cost and related accumulated depreciation are removed from the respective accounts, and the resulting gain or loss is reflected in earnings.

Profit-Sharing Plan

The Corporation adopted a profit-sharing plan effective November 22, 19V4. Substantially all full-time employees are eligible to participate. The Corporation's contributions on behalf of its employees are determined annually by the Board of Directors. The Corporation did not make a contribution for 19X3. Profit-sharing contributions were $3,069 for the year ended December 31, 19X2.

Statement of Cash Flows

For purposes of the statement of cash flows, cash and cash equivalents include money market accounts and operating bank accounts.

The Corporation did not pay any interest expense for 19X3 and 19X2.

Note 2—Contract Receivables

An aging summary of contract receivables at December 31, is as follows:

	19X3	19X2
Billed		
Current	$1,131,718	$ 364,284
30 days	486,854	306,318
60 days	189,138	79,914
90 days and over	129,326	258,478
	1,937,036	1,008,994
Unbilled retentions	456,512	319,046
Unbilled amounts on completed contracts	16,006	94,228
Totals	$2,409,554	$ 1,422,268

Completed and uncompleted contract receivables at December 31, are as follows:

	19X3	19X2
Completed contracts		
Billed, including retentions	$ 906,052	$ 706,966
Unbilled retentions	116,772	125,206
Unbilled amounts on completed contracts	16,006	94,228
Uncompleted contracts		
Billed	1,030,984	302,028
Unbilled retentions	339,740	193,840
Totals	$2,409,554	$ 1,422,268

Receivables written off as uncollectible totaled $30,158 for the year ended December 31, 19X3 and $2,000 for the year ended December 31, 19X2. Recoveries of receivables written off as uncollectible totaled $17,000 for the year ended December 31, 19X2.

Note 3—Depreciation and Amortization

The accumulated depreciation and amortization balances at December 31, are as follows:

	19X3	19X2
Machinery and equipment	$1,689,162	$ 1,701,064
Transportation equipment	308,130	296,002
Office furniture and equipment	161,612	160,440
Leasehold improvements	203,946	186,306
Totals	$2,362,850	$ 2,343,812

Note 4—Accounts Payable and Accruals

Accounts payable and accruals consist of the following at December 31:

	19X3	19X2
Trade accounts payable	$ 343,222	$ 157,726
Subcontract payables	156,130	86,104
Accrued payroll	40,626	39,814
Accrued and withheld payroll taxes	3,124	860
Sales tax payable	5,544	4,400
Total	$ 548,646	$ 288,904

Note 5—Billings in Excess of Costs on Uncompleted Contracts

Billings in excess of costs on uncompleted contracts at December 31 are as follows:

	19X3	19X2
Billings on uncompleted contracts	$4,320,008	$ 2,258,286
Costs incurred on uncompleted contracts	(3,343,254)	(1,813,178)
Billings in excess of costs on uncompleted contracts	$ 976,754	$ 445,108

Note 6—Commitment Under Lease Agreement

On December 15, 19V6, the Corporation signed a lease with its stockholders for an office and production facility located in Fairfax, Virginia. The facility lease is for 25 years, terminating December 15, 200Y. The base annual rent was $343,000 for 19X3 and 19X2. Increases in the base annual rent are to be based on the Consumer Price Index, not to exceed 6 percent. The stockholders pay the real estate taxes and the Corporation pays all maintenance charges and operating costs for the facility. The rental payments include an escalation for increases in real estate taxes.

The following is a schedule, by years, of the Corporation's future minimum lease payments:

Years Ending December 31,	
19X4	$ 353,000
19X5	353,000
19X6	353,000
19X7	353,000
19X8	353,000
Later years	1,059,000
Total	$2,824,000

Rent expense for each of the years ended December 31, 19X3 and 19X2 was $353,000.

Example Disclosures

BASIS OF ACCOUNTING

Cash Basis

Principles of Accounting

The Company prepares its financial statements on the cash basis of accounting but includes refundable and prepaid income taxes and liabilities for payroll withholdings payable. Under this basis, revenues are recognized when collected rather than when earned and expenses are generally recognized when paid rather than when incurred. Consequently, accounts receivable due from patients, trade accounts payable and prepaid and accrued expenses, other than those mentioned above, are not included in the accompanying financial statements.

Accounting Method

The books and records of the Company are maintained on a modified cash basis of accounting whereby depreciation is recorded as well as cash receipts and disbursements. The financial statements present assets and liabilities arising from cash transactions, net of depreciation. This modified cash basis differs from generally accepted accounting principles primarily because income is recognized when it is received rather than when earned and expenses are recognized when paid rather than when incurred.

Method of Accounting

The Company prepares its financial statements using the modified cash basis. Under this method, revenues are recognized when collected rather than when earned, and expenses are generally recognized when paid rather than when incurred. This basic approach is modified to include inventory, depreciation and amortization of capital assets, liabilities for sales tax, accrued payroll taxes, retirement contributions, and income taxes payable. Consequently, accounts receivable due from customers, trade accounts payable, and accrued expenses other than those mentioned above were not included in the financial statements as of September 30, 19X4.

Tax Basis

Basis of Accounting

The accompanying financial statements have been prepared from the records and accounts of the Partnership, which are maintained primarily for U.S. federal income tax reporting purposes. Accordingly, such statements do not purport to present the Partnership's financial position, results of operations or changes in partners' capital in conformity with generally accepted accounting principles.

Since many types of transactions are susceptible to varying interpretations under federal income tax laws and regulations, the amounts reported in the financial statements may be subject to change at a later date on final determination by the respective taxing authorities.

Basis of Accounting

The Company prepares its financial statements on the income tax basis of accounting. The primary differences between the Company's accounting basis and generally accepted accounting principles are: 1) depreciation using federal income tax methods and lives, rather than depreciating the cost of the assets over their estimated useful lives; 2) use of the direct write-off method for bad debts rather than an allowance for uncollectibles; 3) capitalizing labor and overhead using rules prescribed by the Internal Revenue Service, rather than capitalizing overhead costs according to generally accepted accounting principles; 4) valuing inventory at cost rather than at lower of cost or market; and 5) expensing obsolete inventory when it is disposed rather than providing a reserve for obsolescence.

Basis of Accounting

The Company prepares its financial statements on the accrual basis of accounting used for income tax reporting whereby income and expenses are recorded in accordance with principles and practices used in reporting to the federal government for income tax purposes. This basis differs from generally accepted accounting principles (GAAP) in the following material areas. Tax law does not allow the deduction of interest expense accrued on loans from the majority owner. The interest expense deduction is taken when the interest is paid to the majority owner. GAAP requires that interest be expensed as incurred. In addition, useful lives and depreciation rates used for property and equipment are those established by income tax law. Accordingly, the accompanying financial statements are not intended to present financial position and results of operations in conformity with GAAP.

Basis of Accounting

The accompanying financial statements have been prepared on the accrual method of accounting used for federal income tax purposes. Although income tax rules are used to determine the timing of the reporting of revenues and expenses, nontaxable revenues and nondeductible expenses are included in the determination of net income. The following are the significant tax accounting policies used by the company that differ from generally accepted accounting principles:

a) The accelerated capital cost recovery systems, ACRS and MACRS, have been applied to provide for depreciation for post-1981 asset additions.

b) No provision has been made for deferred income tax benefits on temporary differences between financial statement income and taxable income.

c) No provision has been made in the financial statements for employees' compensation for future absences as required by SFAS No. 43.

Method of Accounting

The accompanying financial statements have been prepared on the basis of accounting used for federal income tax reporting purposes. Consequently, the completed contract method is used for accounting for contract revenue and costs.

If the accompanying financial statements were prepared in conformity with generally accepted accounting principles, contract revenue and costs would be recognized under the percentage-of-completion method of accounting. Accordingly, an allowance for uncollectible accounts receivable would be established, property and equipment would be depreciated over their estimated useful lives, and the related-party lease would be capitalized as an asset and liability.

Basis of Accounting

The financial statements are prepared on the basis of accounting used for the partnership's federal income tax return; consequently, depreciation of property and equipment is computed in accordance with the accelerated cost recovery system method required by the Internal Revenue Code. This method differs from the generally accepted accounting principles of computing depreciation over the estimated useful lives of the assets. Accordingly, the accompanying financial statements are not intended to present financial position, results of operations, and changes in partners' capital in conformity with generally accepted accounting principles.

Basis of Preparation

The Company prepares its financial statements on the basis used in the preparation of its federal income tax returns. The income tax returns are prepared on the accrual basis, except for income from partnerships. Income from partnerships is reflected as reported by the partnerships for income tax purposes, which in most cases, is on the cash basis of accounting.

Although income tax rules are used to determine the timing of the reporting of revenue and expenses, nontaxable revenue and nondeductible expenses are included in the determination of net earnings. The following are the Company's significant accounting policies under this basis:

Income Tax. Effective January 1, 19X3, the Company elected under the Internal Revenue Code to be an S corporation. In lieu of corporation income taxes, the shareholders of an S corporation are taxed on their proportionate share of the Company's taxable income. Therefore, no provision or liability for income taxes has been included in the financial statements.

Provision for Doubtful Accounts. No provision for doubtful accounts is made. The Company follows the practice of charging off all accounts deemed uncollectible directly to expense.

Property and Equipment. Property and equipment, as well as liabilities pertaining thereto, are recorded at cost as determined for income tax purposes. Leases are not capitalized.

Depreciation is provided on the straight line, declining balance, accelerated cost recovery and the modified accelerated cost recovery systems.

Installment Sales of Real Property. Gross profit on installment sales of real property is reported and recognized as cash is collected. The gross profit included in the related mortgage note receivable is presented as deferred revenue on the statements of assets, liabilities and stockholders' equity.

Differences between Federal Income Tax Basis of Accounting and Generally Accepted Accounting Principles

Certain of the aforementioned accounting policies and principles would differ under GAAP as follows:

Gain on the sale of real property would be recognized in one year on the full accrual method, rather than on the installment basis.

Depreciation on property and equipment would be provided on the straight-line method over the estimated useful lives of the assets, rather than on the accelerated basis allowed for income tax purposes.

Income from partnerships would be reflected on the accrual basis.

ASSETS

Market Value of Investments

The following disclosure was made in the accounting policies note of a welfare fund that issued cash-basis financial statements.

Valuation of Investments

The Plan's investments are stated at market value. Securities traded on the national securities exchange are valued at the last reported sales price on the last business day of the plan year. Investments traded in the over-the-counter market and listed securities for which no sale was reported on that date are valued at the average of the last reported bid and asked prices. For certain corporate bonds that do not have an established market value, the Plan's Board of Trustees has established a market value based on yield currently available on comparable securities of issuers with similar credit ratings.

The following disclosures were made in the notes to a cash-basis financial statement.

Summary of Significant Accounting Policies--Investments

Investments in farm cooperatives are carried at cost or at the value at which they were recorded using the equity method. No ascertainable market value is available for these investments, but in the opinion of management, the amount shown does not exceed the value to the overall program of the Company. The investment in a utility stock is recorded at cost.

* * * * *

Investments

At June 30, 19X4 and 19X3 investments consisted of the following:

	19X4	19X3
Preferred Stock--Omaha Power & Light	$ 100,000	100,000
Certificates of Deposit	100,000	100,000
Nebraska Corn Warehouse	310,621	241,080
Planters Corn Oil Mill	187,839	146,116
Stock--Farmer's Supply Assoc.	1,989	1,989
	$ 700,449	589,185

The Company owns 4,000 shares of Omaha Power & Light preferred stock. These securities are carried at cost. The other investments represent equity in farming cooperatives. These are noninterest-bearing and will mature at the election of the cooperative.

Concentration of Credit Risk

The following disclosure was made in a tax-basis financial statement:

Concentration of Credit Risk

The Partnership places its cash with one banking institution. At times the amount on deposit may exceed the federally insured limit of the institution. The Partnership has not experienced any losses in such account. The Partnership believes it is not exposed to any significant credit risk on cash and cash equivalents.

Uninsured Cash Balances

At June 30, 19X4, there were cash balances with Century Bank in excess of the FDIC insured limits.

Inventory--Tax-Basis

The following disclosure was taken from the notes of a tax-basis financial statement.

Inventories

	19X4	19X3
Materials and supplies	$ 121,133	$ 145,390
Work in process	179,306	138,649
Finished goods	151,906	146,158
	452,345	430,197
Section 263A adjustment under TRA 86	68,278	52,823
	$ 520,623	$ 483,020

The following disclosure was made in the significant accounting policies note of a tax-basis financial statement.

Inventory

Inventories are stated at a lower of cost (first-in, first-out method) or market. Capitalized costs under IRC Section 263A are 5.86% of the total inventory.

Capitalized Interest--Tax Basis

The following disclosure was made in the significant accounting policies note of a tax-basis financial statement. Note, the Company is a real estate development partnership.

Construction Period Interest and Real Estate Taxes

Construction period interest and real estate taxes incurred prior to 1987 are capitalized and amortized over ten years. Post-1987 interest is allocated to construction costs, and is depreciated over the life of the asset.

LIABILITIES

The following notes were included in tax-basis financial statements.

Income Taxes

Income taxes for the years ended July 31, 19X3 and 19X4 follows:

	19X4	19X3
Federal	$ 59,000	$ 56,000
State	20,000	19,000
	$ 79,000	$ 75,000

A reconciliation of income before provision for income taxes to federal taxable income follows:

Income before provision for income taxes	$ 166,766	$ 155,261
Adjustments to taxable income:		
Acme equity in net loss	9,601	7,663
Officers' life insurance	34,142	34,996
Other nondeductible expenses	3,246	4,247
State income taxes	(20,000)	(19,000)
Federal taxable income	$ 193,755	$ 183,167

The Company's income tax returns have never been examined by the Internal Revenue Service.

Income Taxes

As of January 1, 19X1, the Company elected by unanimous consent of its shareholders to be taxed under the provisions of subchapter "S" of the Internal Revenue Code. Under those provisions, the Company does not pay federal corporate income taxes on its taxable income. Instead, the stockholders are liable for individual federal income taxes on their respective shares of the Company's taxable income. The Company is subject to income tax in certain states.

Goodwill amortization and a portion of the entertainment expenses are not deductible on the corporate income tax returns, but are included in the expenses on the financial statements. This results in a difference between taxable income and net income as reported on the financial statements.

Income Taxes--Cash Basis

The following disclosures were made in the notes to cash-basis financial statements.

Income Taxes

For financial statement purposes, income taxes are reflected in the financial statements when paid.

For the year ended December 31, 19X3, the Company had an excess of expenses over revenues of $54,138 before income taxes. Accordingly, no income taxes were due for the year 19X3.

In addition, at December 31, 19X3, the Company had available a net operating loss of approximately $65,000 which the Company carried back to prior years for federal income tax purposes. This carryback resulted in a recovery of a portion of prior years' taxes paid and such amounts were credited to operations as a tax benefit of $23,000 in 19X2. For state income tax purposes, the net operating loss can be carried forward for a period of three years.

Income Taxes

The Company has federal net operating loss and contribution carryforwards that amounted to $73,239 and $52,364, respectively, available to offset future federal taxable income. The net operating loss and contribution carryforwards, if not used, will expire at various dates through the year 20X0. Such carryforwards are not available to reduce future state taxable income.

Loan Restrictions

The following disclosures were made in the notes to a tax-basis financial statement.

Loan Restrictions

The note payable and line of credit agreements contain certain financial restrictive covenants, summarized as follows:

- Tangible net worth to be equal to or greater than $1,200,000 through June 30, 19X5 and $1,500,000 through December 31, 19X7

- Debt/tangible net worth to be less than 3.50 to 1
- Working capital to be greater than $200,000
- Current ratio to be greater than 1 to 1

COMMITMENTS

Retirement Plans

The following disclosure was taken from a tax-basis financial statement.

The Company maintains a qualified profit-sharing plan covering all eligible employees. The plan includes a deferred arrangement under section 401(k) of the Internal Revenue Code. The elective contributions to the 401(k) portion of the plan are funded by salary reductions of the participants. Company contributions to the plan are discretionary up to a maximum of 15% of annual wages and are generally based on net income.

Contributions for the years ended December 31, 19X3 and 19X2 were:

(Detail not provided)

The following disclosures were taken from cash-basis financial statements.

<u>Pension and Profit Sharing</u>

Employees of the Company participate in a Money Purchase Pension Plan sponsored by the Company. All employees not excluded by class are eligible to enter the Plan on the entry date coincident with or nearest the completion of two years of service and attainment of age 21. For the plan years ending September 31, 19X3 and 19X2, the Company will contribute $10,970 and $10,800, respectively, on behalf of its employees. These amounts had been paid at December 31, 19X3 and 19X2.

<u>Pension Plan</u>

The pension commitments of the Company are for union employees covered under union agreements and for non-union employees under a profit-sharing plan in which contributions are discretionary by the Board of Directors. The Company made no contribution to the profit-sharing plan for the year ended June 30, 19X4.

<u>Pension Plan</u>

The Nonprofit Arts Council participates in the Arizona and New Mexico State Retirement Plans. The Arizona plan is a non-contributory defined benefit plan. The New Mexico plan is a defined contribution plan that contains a 401(k) elective deferral provision. The Council is required to contribute 1.5% of eligible compensation into this plan. The 401(k) elective deferral provision allows participants to receive additional contributions into the plan in lieu of receiving compensation. The Arizona State Retirement Plan, being a state plan, is exempt from many of the ERISA report and disclosure requirements. The plan covers two full-time employees whose salaries are fully funded by the Council. It also partially covers four other full-time employees whose salaries are partially funded by the state of Arizona. The total contributions to the plans by the Council during the year ended June 30, 19X4 were approximately $21,000.

Operating Leases

The following disclosure was taken from a tax-basis financial statement.

The Company has entered into various vehicle and equipment leases payable in aggregate monthly payments of $6,135, expiring on various dates through November, 19X6. Total lease expense for the years ended December 31, 19X3 and 19X2 was $73,539 and $69,764, respectively. Future minimum lease payments are as follows:

(Detail not provided)

Lease Classification

The following disclosure is an excerpt from a note included in a tax-basis financial statement. (The note also presented a five-year summary of the minimum lease payments.)

<u>Commitments</u>

The Partnership has a lease and option to purchase land presently used for parking. The terms of the lease call for monthly minimum rental payments, adjusted every third year based on the consumer price index, until March 31, 20X5. The Partnership is liable for all property taxes, insurance and assessments relating to the land. The Partnership may purchase the land at the end of the lease term for $60,000.

At the inception of the lease there was no reasonable assurance the Partnership would exercise the option to purchase the land at the end of the lease term. Therefore, the lease has been classified as an operating lease.

Other Contracts

The following disclosure was made in the notes to a cash-basis financial statement of a healthcare entity.

<u>Medical Services Agreement</u>

The Company entered into an agreement with Medcare for the provision of medical services, as an independent contractor, in connection with the operation of the Magnetic Resonance Imaging equipment. The shareholders of the Company are the same as the shareholders of Medcare. This relationship is an ongoing one, with either party having the right to terminate the agreement upon sixty days written notice.

Effective December 1, 19X3 and June 1, 19X2, respectively, the parties have agreed that Medcare was to receive a professional fee of $200 per MRI treatment. In addition, Medcare will continue to receive sixteen and two-thirds (16 2/3%) percent on the Company's patient receipts collected after December 1, 19X3 but applicable to professional services rendered prior to December 1, 19X3.

At December 31, 19X3 and 19X2, approximately $2,200 and $29,000 were due to Medcare for professional service fees due under this agreement for patient receipts collected but not remitted.

Unreported Health Claims

The following was disclosed in the notes of a welfare fund that issued tax-basis financial statements.

Plan liabilities for health claims incurred but not reported by participants at December 31, 19X3 and 19X2 have been estimated by management to be approximately $171,000 and 215,000, respectively.

Provisions of the plan provide for participants, who terminate employment with a contributing employer and cease to become an employee, as defined, to receive a fifty percent lump-sum distribution of their Reserve Dollar Bank. In certain circumstances, upon retirement, they may be eligible to receive a one hundred percent distribution of their Reserve Dollar Bank less any administration cost. Lump-sum distributions amounted to $25,500 in 19X3 and $8,750 in 19X2.

Future Construction

The following disclosure was made in the notes to a cash-basis financial statement.

The Company plans to construct an additional building adjacent to its current facility. Estimated costs to complete are $275,000 to $300,000.

CONTINGENCIES

Lawsuit

The following disclosure was made in a note to a tax-basis financial statement.

Contingencies

The Company has been named in lawsuits that involve accidents on ladders allegedly sold by the Company. The possible loss from these lawsuits could range from $150,000 to $250,000. Management believes these lawsuits are without merit and the resulting liability, if any, will not have a material adverse effect on the Company's financial position.

Environmental Losses

The following disclosures were made in the notes to cash-basis financial statements.

Contingent Liabilities

The partnership is involved in an investigation by the Colorado Division of Environmental Response and Remediation (DERR) because a parcel of property once owned by the partnership is suspected of having leaking underground storage tanks located on it. Although the partnership denies responsibility for the gasoline that has contaminated the water table, the DERR maintains that the partnership is one of a number of responsible parties.

Due to the fact that the investigation is still in its preliminary stages, no estimate could be derived for the amount of loss the partnership could be liable for. The DERR continues to investigate the matter.

Contingencies

The Company is involved in several legal matters contending liability relating to soil contamination. One matter was a lawsuit that was settled shortly after December 31, 19X2 wherein the Company agreed to pay $54,167 toward the soil contamination clean up costs. For the remaining unrelated matters, no amount, if any, of potential liability can be determined as of the balance-sheet date.

OTHER DISCLOSURES

Major Customers

The following disclosure was made in the notes to a tax-basis financial statement.

Major Customers

Net sales for the years ended July 31, 19X4 and 19X3 include sales to the following major customers (each of which accounted for more than 10% of the total net sales of the company for those years).

	Amount of Net Sales Year Ended July 31,		Trade Receivable Balance July 31	
	19X4	19X3	19X4	19X3
Allview, Inc.	$ 2,055,774	$ 1,400,032	$ 250,883	$ 171,838
Glassworks	678,297	746,535	60,026	57,301
	$ 2,734,071	$ 2,146,567	$ 310,909	$ 229,139

The following disclosure was made in the summary of significant accounting policies note to a tax-basis financial statement.

Accounts Receivable

The Corporation grants credit to individuals, insurance companies, and state and federal government agencies. At December 31, 19X3 and 19X2 the percentage of receivables due from state and federal government agencies amounted to 63.4% and 62.3%, respectively.

Major Supplier

The following disclosure was made in the notes to a tax-basis financial statement.

Major Supplier

Approximately 26% of raw material purchases for 19X3 were from a single supplier.

Consolidations

The following disclosure was made in the notes of a tax-basis financial statement.

On November 15, 19X2, the Company purchased a 40% interest for $80,000 in Technotrends. On June 8, 19X3, an additional 10.5% interest was acquired at a cost of $29,400. During the year ended July 31, 19X4, the percentage of interest in Technotrends increased to 74.3% due to stock redemptions. This investment is accounted for as follows:

	19X4	19X3
Investment at original cost, 202 shares	$ 109,400	$ 109,400
Equity in net income (loss) at July 31:		
Total of prior years	6,400	14,063
Current year	(9,601)	(7,663)
	(3,201)	6,400
Investment at carrying value	$ 106,199	$ 115,800
Company's share of the underlying equity in net assets	$ 133,190	$ 141,112

The difference between the investment amount carried in these financial statements and the Company's share of the underlying equity in the net assets of Technotrends is due to stock redemptions.

Summarized financial statement information for Technotrends follows:

	19X4	19X3
Assets	$ 549,475	$ 600,116
Liabilities	$ 370,215	$ 410,196
Net loss	$ (12,928)	$ (10,319)

Sale of Receivables

The following disclosure was made in the notes of a tax-basis financial statement.

Sales of Customer Installment Contracts

The company has sold customer installment contracts to SecondBank. Substantially all of the contracts are without recourse. The bank retains portions of the contract amounts as reserves that are released to the Company as the customers make monthly payments. Refunds of the reserves in the event of default or early payment are recognized as incurred. Management anticipates no significant losses under these arrangements, and, accordingly, no provision has been made for future losses on contracts outstanding.

Foreign Currency Translation

The following disclosures were included in notes to tax-basis financial statements. Note, the foreign currency gain was displayed as a separate line item below income from operations on the statement of revenues and expenses.

Summary of Significant Accounting Policies--Foreign Currency Translation

Foreign currency transactions are translated to U.S. currency at the rates of exchange at the dates of the transactions. Interest expense on loans denominated in other currencies is computed at the exchange rate in effect at year end. The Partnership recognizes foreign currency gains or losses on its loan and accrued interest based on exchange rates at its year end.

Notes Payable

A 225,000,000 Spanish peseta note is due to Spanish Bank BV. Interest is accrued and compounded annually on the anniversary of each draw-down at a rate of 18%. The note is secured by the limited partner's rights and interests in the net profits of the Partnership and any distribution of any nature by the Partnership that the limited partner is or may be entitled to receive.

In 19X3, for financial statement purposes, the Partnership recognized a foreign currency gain of $487,062 for this note based on the December 31, 19X3 exchange rate of 142.86 Spanish pesetas to $1 U.S.

REPORT MODIFICATIONS

Departure from the Cash Basis of Accounting--Review Report

The following is an example of a report modification for a departure from the cash basis of accounting.

[First two paragraphs standard review report]

Based on our review, with the exception of the matter described in the following paragraph, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with the cash basis of accounting, as described in Note 1.

As disclosed in Note 1 to the financial statements, management has informed us that land and buildings are stated at appraised value, which is not a generally accepted modification to the cash basis of accounting. If the land and buildings were stated at cost, property, plant and equipment and stockholders' equity would have been decreased by $850.000.

The following is an example of a report modification for a departure from the cash basis of accounting. Note, the entity is a not-for-profit voluntary health and welfare organization.

[First two paragraphs standard review report]

Based on our review, with the exception of the matter described in the following paragraph, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with the cash basis of accounting, as described in Note 1.

As discussed in Note 1 to the financial statements, the capitalization of property, plant, and equipment in conjunction with the recording of depreciation over the estimated useful lives of such assets is a generally accepted modification of the cash basis of accounting. Management has informed us that property, plant, and equipment have been capitalized; however, a provision for depreciation has not been included in the accompanying financial statements. The effect of this departure from the cash basis of accounting on the accompanying financial statements has not been determined.

Departure from Cash Basis--Audit Report

The following is an example of a departure from the standard auditor's report for a departure from the cash basis of accounting. Note, the entity is a trade union applying fund accounting.

[First two paragraphs standard audit report.]

As described in Note 1, the Organization prepares its financial statements on a modified cash basis, which is a comprehensive basis of accounting other than generally accepted accounting principles.

The cash balance and related income and disbursements of the Political Activities Committee Fund are not recorded in the financial statements, and transfers to the Fund are recorded as an expense. In our opinion, the modified cash basis of accounting requires that the Fund be included in the Statement of Assets, Liabilities and Fund Balance and the related Statement of Revenue, Expenses and Changes in Fund Balance, and transfers to the Fund should be recorded as a change in fund balance. It was not practicable to determine the effects of the unrecorded fund on the financial statements.

In our opinion, except for the effects of not recording the Political Activities Committee Fund as discussed in the preceding paragraph, the financial statements referred to above present fairly, in all material respects, the assets, liabilities, and fund balances of the American Zoological Organization as of December 31, 19X3 and its revenue, expenses, and changes in fund balances for the year then ended on the basis of accounting described in Note 1.

Departure from Tax Basis--Review Report

The following is an example of a report modification for a departure from the tax basis of accounting.

[First two paragraphs standard review report]

Based on our review, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with the income tax basis of accounting.

The Partnership's financial statements have been modified to defer recognition of unearned dues, which should be recognized as revenues in the accompanying statement of income to conform with the basis of accounting used in preparing the Partnership's income tax return. If the effects of these modifications were included, partners' capital would be increased by approximately $85,000 and $80,000 as of December 31, 19X3 and 19X2, respectively, and revenues in excess of expenses would be increased by approximately $25,000 and $20,000 in 19X3 and 19X2, respectively.

Going Concern Considerations--Audit

The following paragraph immediately followed the opinion paragraph of an auditor's report accompanying a tax-basis financial statement.

The accompanying financial statements have been prepared assuming that the Partnership will continue as a going concern. As discussed in note C to the financial statements, because of insufficient cash flows, the Partnership has been unable to meet its debt service requirements. Also, the Partnership continued to experience operating losses during 19X3. These conditions raise substantial doubt about the Partnership's ability to continue as a going concern. Management's plans in regard to these matters are also discussed in note C. These financial statements do not include any adjustments that might result from the outcome of this uncertainty.

* * * * *

<u>Note C--Going Concern</u>

The Partnership is three months in arrears with its mortgage payments. The mortgagee has indicated that it has elected to assign the mortgage to HUD. In addition, the Partnership experienced a substantial operating loss for the year ended December 31, 19X3.

These circumstances raise substantial doubt about the Partnership's ability to continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

The Partnership has applied for and received Section 8 rental assistance under the Loan Management Set Aside Program.

The Partnership intends to apply to HUD for a provisional workout arrangement once the assignment has been approved.

Going Concern Considerations--Compilation

The following paragraph immediately followed the second paragraph of a compilation report accompanying a tax-basis financial statement.

As discussed in Note 4, certain conditions indicate that the Company may be unable to continue as a going concern. The accompanying income tax basis financial statements do not include any adjustments that might be necessary should the Company be unable to continue as a going concern.

* * * * *

Note 4--Going Concern

During 19X3, two tenants accounted for approximately $150,000 of the Company's rental revenue (approximately 60% of total 19X3 revenues). The lease agreements for these tenants expired in 19X2 and were not renewed or replaced. The Company's ability to meet cash flow requirements was adversely affected and, as discussed in Note 2, the Company has defaulted on its mortgage.

These factors create an uncertainty as to the Company's ability to continue as a going concern. Management is pursuing replacement tenants, but it is likely that the lender will foreclose on the rental property. The financial statements do not include any adjustments that might be necessary should the Company be unable to continue as a going concern.

Emphasis of a Matter--Reporting Entity

The following emphasis of a matter paragraph was added to a compilation report on a tax-basis financial statement.

[First two paragraphs standard compilation report]

These financial statements are the financial statements of Paterson Partnership only and do not include the accounts of other related business entities under common ownership or control, as described in Note 1.

* * * * *

Note 1--Related Business Entities

The Partnership is related to other business entities through common ownership or control. These financial statements do not include any other related business entities that are under common ownership or in which the partners have a direct or indirect controlling financial interest. The financial effects of control of two or more business enterprises by common ownership are more appropriately reflected in combined financial statements presented in accordance with generally accepted principles of accounting applicable to consolidations.

Dissolution of the Entity--Compilation

The following paragraph was added after the second paragraph of a standard compilation report accompanying a tax-basis financial statement.

The Partnership sold the property on August 31, 19X3 and filed a final U.S. Partnership Return of Income as of December 31, 19X3. The 19X3 financial statements reflect this sale and the effective dissolution of the Partnership as of December 31, 19X3.

Appendixes

Appendix A

Summary of PCPS Survey

In September 1994, the AICPA surveyed 2,000 PCPS members to determine their current practices for preparing cash- and tax-basis financial statements. We received 390 responses, which have been summarized and presented in the body of this guide.

The size and location of the firms responding were as follows:

Survey Background
Size of Firms Responding

Number of AICPA Members in the Firm	Percent
One	19%
2 - 5	37%
60 - 10	16%
11 - 50	24%
51 - 100	3%
Over 100	1%

Survey Background
Location of Firms Responding

	Percent
New England	5%
Middle Atlantic	13%
South Atlantic	18%
South Central	15%
North Central	20%
Mountain	9%
Pacific	20%

The respondents were asked to estimate, in percentages, the levels of service they provide on all annual OCBOA financial statements. The results were as follows:

Survey Background
Level of Service

	Percent
Audit	7%
Review	8%
Compilation	32%
Compilation with Disclosures Omitted	53%

Appendix B

OCBOA Financial Statements
Engagement Planning and Review
Supplementary Memo

Client ____

Date ____

This memo should be used on all OCBOA engagements to **supplement** your normal engagement planning and review memoranda.

Instructions

(1) Complete part one of the memo prior to the start of fieldwork.

(2) Complete part two of the memo after fieldwork is completed but before distributing the first draft of the report.

(3) Include both parts of the memo with the package you provide the technical review partner.

Part One: Planning

1. Describe the basis of accounting used

   ______ Tax basis

   ______ Cash basis

   ______ Modified cash basis
   Describe modifications ____
   ____
   ____

   ______ Other
   Describe ____
   ____
   ____

2. Will GAAP-basis financial statements also be issued?
   ______ Yes
   ______ No

3. Was the same basis of accounting used in previous year's financial statements?

______ Yes
______ No

4. Level of service

______ Audit
______ Review
______ Compilation
______ Compilation with substantially all disclosures omitted

5. Who are the primary users of these financial statements? What decisions will be made based on the information presented in these financial statements?

____
____
____
____
____

6. What other financial and nonfinancial information is made available to the users? (e.g., interim reports, accounts receivable agings, inventory listings, etc.)

____
____
____
____
____

7. What steps will be taken to ensure that the primary users understand the differences between these financial statements and GAAP financial statements? (e.g., financial statement disclosure, written communication to users, meetings with users, etc.)

____
____
____

Part Two: Significant, Unusual Matters

1. Describe any significant, nonrecurring transactions and how they were accounted for and disclosed.

2. Describe any other significant, unusual accounting matters not anticipated during planning and how these matters were resolved.

3. Describe any significant reporting issues and how they were resolved (e.g., lack of consistency, uncertainties, going-concern, etc.).

APPENDIX C

OCBOA Financial Statements
Disclosure Checklist

Client ____

Date ____

OCBOA financial statements--and the related notes--should be informative of matters that affect their use. In order to determine whether financial statement disclosures are adequate, you must have an understanding of the users and their needs.

For each of the following items determine whether:

Yes: The item is presented or disclosed in a way appropriate for the needs of the users.

No: The item is not appropriately presented or disclosed. Include cross reference to memo describing how this was resolved.

N/A: Not applicable.

	Yes	No	N/A
Financial statement titles are appropriate (AU §623.07).	______	______	______
Significant accounting policies (required disclosure AU §623.10)	______	______	______
Potential adjustments from IRS exams for tax-basis financial statements	______	______	______
Comparative financial statements (ARB 43, Ch. 2A, pars. 2-3)	______	______	______
Items not specifically identified on the face of the financial statements (AU §623.10)			
• Related party transactions (SFAS 57, pars. 2-4)	______	______	______
• Restrictions on assets and owners' equity (SFAS 5, pars. 18-19; ARB 43, Ch. 3A, par. 6)	______	______	______
• Subsequent events (SFAS 5; SAS 1, secs. 560.03-.07 and .09, and 561.01-.09)	______	______	______
• Uncertainties, including going-concern (SAS 59, par. 11; Interpretation No. 11 of SSARS 1)	______	______	______

	Yes	No	N/A
• Nature of operations (SOP 94-6)	______	______	______
• Use of estimates (SOP 94-6)	______	______	______
• Risks and uncertainties (SOP 94-6)	______	______	______
Items that are the same or similar to those in GAAP statements. (AU §623.10) Common items include:			
• Nature and effect of unusual items (APB 30, par. 26; TB 82-1, par. 6)	______	______	______
• Accounting changes (APB 20, pars. 17 and 36-37; SFAS 16, par. 11)	______	______	______
• Business combinations (APB 16, pars. 45-48, 63-96; SFAS 38; SFAS 79, pars. 4-6; TB 81-2, par. 4; FASBI 4)	______	______	______
• Consolidations (ARB 51, pars. 4-5; APB 22, par. 14, SFAS 12, pars. 18-20; FASBI 14)	______	______	______
• Commitments and contingencies (SFAS 5; FASBI 34, pars. 1-3; ARB 43, ch. 4, par. 17)	______	______	______
• Accounts receivable (including allowance for bad debts) (ARB 43, ch. 1A, par. 5 and ch. 11A, par. 40; APB 12, par. 3)	______	______	______
• Financial instruments			
•• Fair value (SFAS 107, pars. 10-15; SFAS 119, par. 8)	______	______	______
•• Concentration of credit risk (SFAS 105, par. 20)	______	______	______
•• Off-balance-sheet risk (SFAS 105, par. 17-19)	______	______	______
• Inventories (ARB 43, ch. 3A, pars. 4 and 9 and ch. 4, pars. 3-16; APB 22, par. 14)	______	______	______
• Property, plant and equipment (APB 12, pars. 5a-5d; APB 22, par. 14)	______	______	______
• Leases (SFAS 13, pars. 13, 16 and 23; SFAS 29, par. 12)	______	______	______

	Yes	No	N/A
• Current liabilities (ARB 43, ch. 1, par. 5 and ch. 3A, pars. 7-8; SFAS 78, par. 5)	______	______	______
• Notes payable and long-term debt (SFAS 5, pars. 18-19; SFAS 47, par. 10b; ARB 43, ch. 3A, pars. 7-8; SFAS 6, par. 15; FASBI 8, par. 3; TB 79-3)	______	______	______
• Income taxes			
•• Explanation if income tax not provided or if unusual relationship between income tax and income before income taxes	______	______	______
•• Amount of tax credit	______	______	______
•• Amount of unused NOL or other tax carryovers and their expiration dates (SFAS 109, pars. 43-46 and 48)	______	______	______
• Pensions, postemployment benefits, and postretirement benefits (SFAS 87, pars. 26, 33, 35-36, 41, 54, 65-66, and 69, SFAS 88, par. 17; SFAS 106, pars. 74, 77-78, 82, and 106; SFAS 112, par. 24)	______	______	______

Note: The checklist has been updated through SAS No. 73, SSARS No. 7, SFAS No. 119, FASBI No. 40, FASB TB No. 94-1, and AICPA SOP No. 94-6.

The checklist should be modified, as appropriate, for subsequent pronouncements. In determining the applicability of a pronouncement, its effective date should also be considered.

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