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# Governmental Accounting Standards Series

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Statement No. 56 of the  
Governmental Accounting  
Standards Board

**Codification of Accounting and  
Financial Reporting Guidance  
Contained in the AICPA Statements  
on Auditing Standards**



Governmental Accounting Standards Board  
of the Financial Accounting Foundation

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## Summary

The objective of this Statement is to incorporate into the Governmental Accounting Standards Board's (GASB) authoritative literature certain accounting and financial reporting guidance presented in the American Institute of Certified Public Accountants' Statements on Auditing Standards. This Statement addresses three issues not included in the authoritative literature that establishes *accounting* principles—related party transactions, going concern considerations, and subsequent events. The presentation of principles used in the *preparation* of financial statements is more appropriately included in accounting and financial reporting standards rather than in the auditing literature.

This Statement does not establish new accounting standards but rather incorporates the existing guidance (to the extent appropriate in a governmental environment) into the GASB standards.

### **How the Changes in This Statement Will Improve Financial Reporting**

The requirements in this Statement will improve financial reporting by contributing to the GASB's efforts to codify all sources of generally accepted accounting principles for state and local governments so that they derive from a single source. This effort is important from the perspective of bringing the authoritative accounting and financial reporting literature together in one place, with that guidance modified as necessary to appropriately recognize the governmental environment and the needs of governmental financial statement users.

Unless otherwise specified, pronouncements of the GASB apply to financial reports of all state and local governmental entities, including general purpose governments; public benefit corporations and authorities; public employee retirement systems; and public utilities, hospitals and other healthcare providers, and colleges and universities. Paragraph 2 discusses the applicability of this Statement.
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March 2009



**Governmental Accounting Standards Board**  
of the Financial Accounting Foundation  
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**March 2009**

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# **Statement No. 56 of the Governmental Accounting Standards Board**

## **Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards**

**March 2009**

### **INTRODUCTION**

1. Certain accounting and financial reporting guidance has been included in Statements on Auditing Standards of the American Institute of Certified Public Accountants (AICPA). The objective of this Statement is to incorporate that guidance into the state and local governmental accounting and financial reporting standards.

### **STANDARDS OF GOVERNMENTAL ACCOUNTING AND FINANCIAL REPORTING**

#### **Scope and Applicability of This Statement**

2. This Statement establishes accounting and financial reporting standards for related party transactions, subsequent events, and going concern considerations. This Statement applies to all state and local governments.

3. This Statement amends paragraph 26 of the National Council on Governmental Accounting (NCGA) Statement 5, *Accounting and Financial Reporting Principles for Lease Agreements of State and Local Governments*.

## Related Party Transactions

4. State and local governments are required to disclose certain related party transactions.<sup>1</sup> If the substance of a particular transaction is significantly different from its form because of the involvement of related parties, financial statements should recognize the substance of the transaction rather than merely its legal form.

5. Examples of transactions with related parties that have features that may indicate that governments should consider whether a *form-over-substance* condition exists include:

- a. Borrowing or lending on an interest-free basis or at a rate of interest significantly above or below market rates prevailing at the time of the transaction
- b. Selling real estate at a price that differs significantly from its appraised value
- c. Exchanging property for similar property in a nonmonetary transaction
- d. Making loans with no scheduled terms for when or how the loans will be repaid.

6. Determining the substance of a related party transaction may pose challenges not present in assessing transactions between unrelated parties. For example, a related party relationship may result in transactions that would not take place between unrelated parties or would be subject to different terms and conditions. In such cases, the substance of the related party transaction may differ from its legal form due to the related party relationship.<sup>2</sup>

7. It may not be possible to determine whether a particular transaction would have taken place if the parties had not been related, or what the terms and conditions would

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<sup>1</sup>NCGA Interpretation 6, *Notes to the Financial Statements Disclosure*, is the source of this disclosure requirement. Financial Accounting Standards Board Statement No. 57, *Related Party Disclosures*, which is applicable to governmental entities (to the extent the guidance therein does not conflict with or contradict GASB pronouncements), provides specific disclosure requirements and examples of related party relationships and transactions.

<sup>2</sup>For example, Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*, includes requirements that affect the basis of assets transferred within the same financial reporting entity. That requirement results in a measurement that is different from what would have occurred in an arm's-length transaction with an external party.



have been. Therefore, it may be difficult to determine whether a transaction was consummated on terms comparable to those that would be present in arm's-length transactions. Furthermore, governments frequently enter into transactions and engage in activities that are driven by societal needs and concern for the "public good." Therefore, it may not be appropriate to compare some governmental programs and arrangements to what might have occurred in an arm's-length transaction in the private sector or with unrelated parties.

### **Subsequent Events**

8. Events or transactions that affect the financial statements sometimes occur subsequent to the statement of net assets<sup>3</sup> date but before financial statements are issued. Some of those transactions and events (referred to as *recognized events*) require adjustments to the financial statements while others (referred to as *nonrecognized events*) may require disclosure in the notes to the financial statements.

9. Recognized events consist of those events that provide additional evidence with respect to conditions that existed at the date of the statement of net assets and affect the estimates inherent in the process of preparing financial statements. All information that becomes available prior to the issuance of the financial statements should be used in evaluating the conditions on which the estimates were based. The financial statements should be adjusted for any changes in estimates resulting from the use of such evidence.

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<sup>3</sup>For purposes of this Statement, the term *statement of net assets* includes the government-wide statement of net assets, governmental fund balance sheet, proprietary fund statement of fund net assets, and statement of fiduciary net assets, which are required to be presented as components of the basic financial statements.

10. Nonrecognized events consist of those events that provide evidence with respect to conditions that did not exist at the date of the statement of net assets but arose subsequent to that date. These events should not result in adjustment of the financial statements. Some of these events, however, may be of such a nature that their disclosure is essential to a user's understanding of the financial statements.

11. Identifying recognized events that require adjustment of the financial statements calls for the exercise of professional judgment and knowledge of the facts and circumstances. For example, a water utility's loss from an uncollectible account receivable as a result of a major customer's deteriorating financial condition leading to the bankruptcy of that customer subsequent to the statement of net assets date may be indicative of conditions existing at the statement of net assets date, thereby calling for adjustment of the financial statements before their issuance. In contrast, a similar loss resulting from that customer's major casualty, such as a fire or flood, subsequent to the statement of net assets date would not be indicative of conditions existing at the statement of net assets date, and adjustment of the financial statements would not be appropriate. The settlement of litigation for an amount different from the liability recorded in the accounts would require adjustment of the financial statements if the event that gave rise to the litigation, such as a personal injury occurring on government property, had taken place prior to the statement of net assets date.

12. Subsequent events affecting the realization of assets such as receivables and inventories or the settlement of estimated liabilities will ordinarily require adjustment of the financial statements because such events typically represent the culmination of

conditions that existed over a relatively long period of time. Subsequent events such as changes in the quoted market prices of securities ordinarily should not result in adjustment of the financial statements because such changes typically reflect a concurrent evaluation of new conditions.

13. Other examples of nonrecognized events that require disclosure in the notes to the financial statements but should not result in adjustment include the issuance of bonds, the creation of a new component unit, or the loss of a government facility as a result of a tornado, fire, or flood.

14. When financial statements are reissued, certain events may have occurred subsequent to the original issuance that require disclosure. Events requiring disclosure are those that are considered essential to a user's understanding of the reissued financial statements. These events, occurring between the time of original issuance and reissuance of financial statements, should not result in adjustment of the financial statements unless the adjustment meets the criteria for the correction of an error or the criteria for prior-period adjustments. That also is the case for events occurring subsequent to the original issuance when financial statements are reissued in comparative form with financial statements of subsequent periods.

15. Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, paragraph 11(h), requires a discussion in management's discussion and analysis (MD&A) of currently known facts, decisions, or conditions that are expected to have a significant effect on the government's financial

position or results of operations. It may be necessary to include a discussion of subsequent events in the MD&A, depending on the facts and circumstances.

### **Going Concern Considerations**

16. Continuation of a legally separate governmental entity as a going concern is assumed in financial reporting in the absence of significant information to the contrary. Information that may significantly contradict the going concern assumption would relate to a governmental entity's inability to continue to meet its obligations as they become due without substantial disposition of assets outside the ordinary course of governmental operations, restructuring of debt, submission to the oversight of a separate fiscal assistance authority or financial review board, or similar actions. Financial statement preparers have a responsibility to evaluate whether there is substantial doubt about a government's ability to continue as a going concern for 12 months beyond the financial statement date. Moreover, if there is information that is currently known to the government that may raise substantial doubt shortly thereafter (for example, within an additional three months), it also should be considered.

17. Indicators that there may be substantial doubt about a governmental entity's ability to continue as a going concern include:

- a. *Negative trends*—for example, recurring periods in which expenses/expenditures significantly exceed revenues, recurring unsubsidized operating losses in business-type activities, consistent working capital deficiencies, continuing negative operating cash flows from business-type activities, or adverse key financial ratios
- b. *Other indications of possible financial difficulties*—for example, default on bonds, loans or similar agreements, proximity to debt and tax limitations, denial of usual trade credit from suppliers, restructuring of debt (other than refundings), noncompliance with statutory capital or reserve requirements, or the need to seek new sources or methods of financing or to dispose of substantial assets
- c. *Internal matters*—for example, work stoppages or other labor difficulties, substantial dependence on the success of a particular project or program,

uneconomic long-term commitments (burdensome labor contracts, for example), or the need to significantly revise operations

- d. *External matters*—for example, legal proceedings, legislation, or similar matters that might jeopardize intergovernmental revenues and the fiscal sustainability of key governmental programs; loss of a critical license or patent for a business-type activity; loss of a principal customer, taxpayer, or supplier; or uninsured or underinsured catastrophe such as a drought, earthquake, or flood.

18. In all cases, the effect of the governmental environment should be considered when evaluating the indicators. For example, the taxing power and borrowing capabilities of governments together with the constant demand for the provision of public services are factors that may diminish the possibility that a government would be unable to continue as a going concern. Some conditions or situations identified in the indicators in paragraph 17 should be assessed differently for governments. For example, recurring operating losses are commonplace for some business-type activities such as transit operations or governmental healthcare organizations. However, quality-of-life considerations and the health and welfare needs and interests of the citizenry may create compelling incentives for those operations to be subsidized to the extent necessary by another governmental entity.

19. If it is determined that there is substantial doubt about a governmental entity's ability to continue as a going concern, the notes to the financial statements should include disclosure of the following, as appropriate:

- a. Pertinent conditions and events giving rise to the assessment of substantial doubt about the government's ability to continue as a going concern for a reasonable period of time, as discussed in paragraph 16
- b. The possible effects of such conditions and events
- c. Government officials' evaluation of the significance of those conditions and events and any mitigating factors
- d. Possible discontinuance of operations
- e. Government officials' plans (including relevant prospective financial information)
- f. Information about the recoverability or classification of recorded asset amounts or the amounts or classification of liabilities.

In addition, Statement 34, paragraph 11(h), requires a discussion in MD&A of currently known facts, decisions, or conditions that are expected to have a significant effect on the government's financial position or results of operations. It may be necessary to include a discussion of going concern issues in the MD&A, depending on the facts and circumstances.

## **EFFECTIVE DATE**

20. The requirements in this Statement are effective upon its issuance.

**The provisions of this Statement need  
not be applied to immaterial items.**

*This Statement was issued by unanimous vote of the seven members of the  
Governmental Accounting Standards Board.*

Robert H. Attmore, *Chairman*  
Michael D. Belsky  
William W. Holder  
Jan I. Sylvis  
Marcia L. Taylor  
Richard C. Tracy  
James M. Williams

## **Appendix A**

### **BACKGROUND**

21. Representatives of the AICPA have requested that the U.S. accounting standards setters consider adopting certain guidance for accounting and financial reporting issues that now reside only in the AICPA's professional auditing literature. In response to this request, a project was added to the GASB's research agenda in December 2007. After conducting research on the subject matter to identify relevant issues, the project was added to the Board's current technical agenda in April 2008. The GAAP hierarchy applicable to governments was originally within the scope of this project. A separate project was established in July 2008 to assist the Board in its efforts to work with the Federal Accounting Standards Advisory Board on issues related to the GAAP hierarchy.

22. In August 2008, the Board issued an Exposure Draft, *Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*. The Board received 32 responses to the Exposure Draft. As discussed throughout the Basis for Conclusions of this Statement, the comments and suggestions from the organizations and individuals who responded to the Exposure Draft contributed to the Board's deliberations in finalizing the requirements of this Statement.

23. In arriving at the conclusions presented in this Statement, the Board considered its own standards and those of the Financial Accounting Standards Board, the International Accounting Standards Board, and the International Public Sector Accounting Standards Board.

## **Appendix B**

### **BASIS FOR CONCLUSIONS**

24. This appendix summarizes factors considered significant by the Board members in reaching the conclusions in this Statement. It includes discussion of alternatives considered and the Board's reasons for accepting some and rejecting others. Individual Board members may have given greater weight to some factors than to others.

25. At the beginning of its deliberations leading to this Statement, the Board evaluated two approaches. One approach considered was to adopt the accounting and financial reporting requirements essentially as they currently exist in the AICPA's auditing literature, modifying the language as appropriate to recognize the characteristics of the governmental environment without affecting the substance of the provisions. The other approach considered was to reexamine the individual issues. The Board recognized that taking the first approach would not significantly affect practice because the accounting and financial reporting requirements would not change, only the source of the guidance. The latter approach, involving significant deliberation, *could* have resulted in changes in practice depending on the extent to which the Board would modify the financial reporting requirements from the way they were stated in the auditing literature. The Board concluded that the transition from the auditing literature to the accounting and financial reporting standards should be as undisruptive as possible; therefore, the first approach was taken.

26. The Board is not aware of any compelling reasons to open any of the individual issues for reexamination at this time. Prior to this initiative to codify the financial reporting requirements, none of those issues were under consideration for inclusion in the



Board's technical agenda. Furthermore, there has been no significant call from constituents for clarification or additional guidance relative to the financial reporting areas covered by this Statement, and the Board is not aware of any evidence that would imply that the requirements, as they now exist, are not appropriate or effective. As a result, this Statement does not establish new financial reporting requirements or modify existing requirements but rather relocates existing accounting and reporting guidance from the professional auditing standards.

### **Scope**

27. The GASB's analysis of the AICPA's professional auditing literature identified three accounting and financial reporting issues addressed in this Statement as significant areas that should be incorporated into GASB standards. The Board also considered the inclusion of guidance regarding the correction of errors in previously issued financial statements that was provided through a Staff Accounting Bulletin of the Securities and Exchange Commission (SEC). The Board concluded that the SEC guidance should not be included in the scope of the Statement because the goal of the project was to address accounting principles that reside in the AICPA's professional auditing literature.

### **Related Party Transactions**

28. The Statements on Auditing Standards (SAS), AU Section 334, *Related Parties*, appropriately attributes the requirement for related party *disclosures* to the Financial Accounting Standards Board's (FASB) Statement No. 57, *Related Party Disclosures*, and acknowledges that “. . . accounting principles ordinarily do not require transactions with related parties to be accounted for on a basis different from that which would be appropriate if the parties were not related” (paragraph .02). That paragraph further states

that “. . . the auditor should be aware that the substance of a particular transaction could be significantly different from its form and that *financial statements should recognize the substance of particular transactions rather than merely their legal form*” (emphasis added).

29. FASB Statement 57 is included among the pre-November 30, 1989, standards that conditionally apply to (a) proprietary funds and business-type activities and (b) governmental activities in the government-wide statements. This Statement does not propose modifications to those disclosures nor does it provide for additional disclosures. Even though the Board did not modify the provision as stated in the SAS guidance, it concluded that the “substance versus form” aspect of assessing related party transactions should be addressed in the context of governmental entities. Accordingly, this Statement acknowledges the difficulty that may be faced in evaluating the substance of transactions in general and in the governmental environment specifically.

30. The comments received concerning related party transactions generally expressed a desire for additional implementation guidance or examples to be added to the final standard. The Board discussed these comments and decided that these issues did not fall within the scope of this project and any additional examples would be considered for inclusion within the Comprehensive Implementation Guide. Suggestions to clarify the related party transaction provisions also were received and changes were made accordingly.

### **Subsequent Events**

31. AU Section 560, *Subsequent Events*, explains that events or transactions that have an effect on the financial statements can sometimes occur subsequent to the statement of net

assets date but prior to the issuance of the financial statements and, therefore, require adjustment or disclosure in the financial statements. It discusses two types of subsequent events that require consideration. *Type one* events require financial statement adjustment, and *type two* events may require disclosure in the notes to financial statements.

32. The Board determined that the financial reporting guidance in the SAS is readily adaptable to the governmental environment with only minor terminology modifications. As a result, the requirements, including examples and illustrations, presented in the Exposure Draft were essentially the same as set forth in the auditing standards.

33. After the Exposure Draft was issued, the FASB issued an Exposure Draft, *Subsequent Events*, with a similar initiative to incorporate AU Section 560 into its literature. The FASB's Exposure Draft proposed changes that, if adopted, would result in some differences from the provisions of this Statement. Many respondents noted that these potential differences existed in the terminology, the time period for evaluation, and the disclosure of the time period for evaluation.

34. AU Section 560 states that there are two types of subsequent events and describes both types; but it does not actually give the definitions of either type a name. The FASB's Exposure Draft named these two types of subsequent events, previously referred to as *type one* and *type two*, as *recognized events* and *nonrecognized events*, respectively. The Board agreed that the terms proposed in the FASB's Exposure Draft better communicate the respective types of events. Some respondents to the Exposure Draft commented that the FASB's Exposure Draft also introduced a different period for evaluating subsequent events and a proposal to disclose the period through which subsequent events were

evaluated. The Board discussed these differences and decided that it was unnecessary to incorporate an “available-to-be-issued” notion into this Statement because the original proposal presented in the Exposure Draft more appropriately reflected the governmental environment in which financial statements are routinely issued upon completion and become part of the public record. Therefore, the issuance of a government’s financial statements appropriately concludes the subsequent events’ evaluation period. Accordingly, the Board also determined that disclosure of the date through which subsequent events are evaluated is not necessary.

35. The original AICPA literature stated that disclosure of nonrecognized subsequent events may be “required to keep the financial statements from being misleading.” This language was carried forward to the Exposure Draft. During redeliberation, the Board concluded that the language in this Statement should be more consistent with Concepts Statement No. 3, *Communication Methods in General Purpose External Financial Reports That Contain Basic Financial Statements*, which uses the term *essential to a user’s understanding* when discussing criteria for disclosing information in the notes to the financial statements.

### **Going Concern Considerations**

36. AU Section 341, *The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern*, states that continuation of an entity as a going concern is assumed in financial reporting in the absence of significant information to the contrary. It indicates that note disclosure is required as it directs an auditor to “consider the adequacy of disclosure about the entity’s possible inability to continue as a going concern for a reasonable period of time” (paragraph .03(c)). The SAS guidance identifies certain

factors that could indicate that there may be substantial doubt about an entity's ability to continue as a going concern and provides examples of information that a preparer might disclose in the notes to financial statements if the conditions warrant such disclosures.

37. Following the general approach taken in this Statement to incorporate the SAS guidance into GASB literature without substantive modifications, the Board agreed that the indicators of going concern issues and the disclosures from AU Section 341 (adapted for governments) constitute the guidance that should be carried forward. The Board concluded that those disclosures—together with the existing MD&A requirement to discuss currently known facts, decisions, or conditions that are expected to have a significant effect on financial position or results of operations—are sufficient for governmental entities, given the relatively low probability of having to consider a governmental entity's ability to continue as a going concern. The Board also concluded that the potential question of whether liquidation basis of accounting (or some other measurement) should be used for a governmental entity when its ability to continue as a going concern is remote should not be addressed in this Statement.

38. Several respondents to the Exposure Draft expressed a need for clarification on the entity level to which the going concern assessment should be applied. The Board concluded that going concern evaluations should not be performed on reporting units that constitute less than a legally separate entity. Those reporting units (for example, funds that are part of a larger legal entity) are accounting and reporting constructs to which a government's management may assign assets and liabilities. Thus, the appearance of a going concern issue can instantly change through reassignment of certain assets or liabilities. The Board agreed that the going concern concept has little, if any, applicability

to reporting units that comprise less than a legally separate entity. As such, this provision was modified to clarify that the focus should be on *legally separate* entities.

39. After the Exposure Draft was issued, the FASB issued an Exposure Draft, *Going Concern*, with a similar initiative to incorporate AU Section 341 into its literature. In the interest of international convergence, the FASB's Exposure Draft proposed a new time horizon over which an entity should evaluate its ability to continue as a going concern that was different from the time horizon in AU Section 341 but similar to that of IAS 1, *Presentation of Financial Statements*. After the Board discussed this possible change, it agreed with the notion of eliminating the bright-line time horizon from AU Section 341. The Board decided to restate the horizon because it would better ensure that any known facts that may affect the going concern assumption, even if slightly beyond the 12-month period, are taken into consideration.

## **Appendix C**

### **CODIFICATION INSTRUCTIONS**

40. The sections that follow update the June 30, 2008, *Codification of Governmental Accounting and Financial Reporting Standards* for the effects of this Statement. Only the paragraph number of the Statement is listed if the paragraph will be cited in full in the Codification.

\* \* \*

### **COMPREHENSIVE ANNUAL FINANCIAL REPORT**

### **SECTION 2200**

See also: [Add the following:] Section 2250, “Additional Financial Reporting Considerations”

.109 [At the end of subparagraph h, insert footnote 11 as follows; renumber subsequent footnotes.] Conditions that are expected to have a significant effect on financial position or results of operations include those that give rise to substantial doubt about a government’s ability to continue as a going concern, as described in Section 2250, paragraphs .113–.116. [GASBS 56, ¶19]

\* \* \*

[Create new section as follows:]

**ADDITIONAL FINANCIAL REPORTING  
CONSIDERATIONS**

**SECTION 2250**

Source: GASB Statement 56

See also: Section 2200, “Comprehensive Annual Financial Report”  
Section 2300, “Notes to Financial Statements”

**Scope and Applicability of This Section**

.101 [GASBS 56, ¶2; change *Statement* to *section*.]

**Related Party Transactions**

.102–.105 [GASBS 56, ¶4–¶7, including footnotes; update cross-references.]

**Subsequent Events**

.106–.113 [GASBS 56, ¶8–¶15, including footnotes.]

**Going Concern Considerations**

.114–.117 [GASBS 56, ¶16–¶19, including footnotes; update cross-reference.]

\* \* \*

**NOTES TO FINANCIAL STATEMENTS**

**SECTION 2300**

Sources: [Add the following:] GASB Statement 56

See also: [Add the following:] Section 2250, “Additional Financial Reporting Considerations”

.106 [Add the following at the end of subparagraph f:] (See Section 2250, paragraphs

.106–.112.) [Add GASBS 56, ¶8–¶14, to sources.]

.107 [Add the following at the end of subparagraph f:] (See Section 2250, paragraph

.102.)



[Add new subparagraph nn as follows:] Conditions and events giving rise to substantial doubt about the government’s ability to continue as a going concern. (See Section 2250, paragraph .117.) [Add GASBS 56, ¶4–¶7 and ¶16–¶19, to sources.]

\* \* \*

## **CLAIMS AND JUDGMENTS**

## **SECTION C50**

See also: [Add the following:] Section 2250, “Additional Financial Reporting Considerations”

.149 [At the end of the first sentence, insert new footnote 19 as follows; renumber subsequent footnote.] A more detailed discussion of subsequent events is included in Section 2250, paragraphs .106–.113.

\* \* \*

## **LEASES**

## **SECTION L20**

Sources: [Add the following:] GASB Statement 56

.124 [Revise current paragraph .124 as follows:] When lease arrangements exist between state and local governments and public authorities, the related party considerations discussed generally in Section 2250, paragraphs .102–.105, and more specifically in FASB Statement 13, paragraph 29, should be considered to determine if there are special reporting and disclosure requirements. [NCGAS 5, ¶26; GASBS 56, ¶4–¶7]