GASB 54 White Paper

Background
At its October 2009 meeting, the TARC committee determined that members of the IGFOA would benefit from the guidance of a white paper, developed by members of the TARC committee, addressing the implementation of GASB Statement No. 54, with specific guidance and direction that fits the practice and legislative rules that exist in Illinois. This white paper is non-authoritative guidance that has been developed to assist IGFOA members in implementing GASB Statement 54, and to help establish consistency in accounting and reporting for Illinois governments.

Introduction

The GASB has recently issued a new statement that provides detailed requirements for reporting fund balance, and re-defines the 5 governmental fund types. Although this statement is fairly straightforward and relatively simple to read, it does require some thoughtful consideration and timely planning in order to achieve a desirable financial statement outcome. Unless you represent a small, non-complex local government, an upfront investment of time reading and understanding the implications of this statement will be time well spent. Small governments with only a few funds and no restrictions or constraints on resource use, will see terminology changes to the financial statements but little else.

Fund Balance Reporting

One unique aspect of this statement is the level of governing body (Board) involvement that will be required to effectively implement this statement. Typically, most (if not all) of the work required to implement a new GASB statement falls to the accounting and finance personnel of an organization, along with some assistance from the auditor. Not so with this statement, governmental organizations will need to get “buy-in” from the governing body. Because finance and accounting personnel have the best understanding of their organization’s accounting and reporting, they are in the best position to educate the governing body (Board), present suggested solutions, and move the process forward. Depending on your organization, the process could take as long as 6 months, or longer if controversy develops.

For those of you who are sufficiently intrigued, let’s break this down. The statement is requiring governmental organizations to report governmental fund balances in 2 broad categories, and 4 sub categories. The broad categories are “spendable” and “non-spendable”. Non-spendable includes resources that are not in spendable form (inventories, prepaids, long-term receivables, and real property held for resale) and resources that are legally required to be maintained in perpetuity (endowments). All other resources are considered “spendable”.

The spendable category is then broken down into 4 sub-categories. The analysis and understanding of these sub-categories is essential for determining the proper reporting of fund balances, and the determination of which fund type should be used to report resources.

The sub-category required for reporting purposes will be based on several factors. One such factor is the level (if any) of action the governing body or parties external to the government have taken to limit the use of the resources. In order to report fund balances at the most restrictive level (Restricted Fund Balance), the governing body will have to limit use of resources in the same legislation which creates the resources. For example, if a municipality creates a new vehicle licensing requirement via ordinance, and within that same ordinance it is stated that fees charged for issuing the licenses can only be used for purchasing public safety equipment, then any unexpended vehicle licensing monies unexpended at the end of the year would be reported as restricted fund balance. This definition is the same definition that is used for restricted net assets in the government-wide statement of net assets. This same category would be used where restrictions on the use of funds are established by parties external to the government, such as restrictions imposed by grantors and within bond indentures.

If a government wants to report other residual amounts separately from what previously was referred to as unreserved/undesignated fund balance, there are two options, however some action on the part of the governing body is required for both.

The first requires the highest level of governing body action (typically a Board of Directors or equivalent). The level of action required will vary from government to government but should include legislation that can only be overturned by new legislation requiring the same type of voting consensus. This type of action creates fund balance that is reported as "committed". An example would be an ordinance approved by the governing body (Board) that commits $2 million in existing available fund balance, for the payment of future self-insured claims. Under this scenario, in the fund balance section of the balance sheet, the government would report $2,000,000 of the total fund balance as Fund Balance - Committed. In order to overturn this commitment and allow the $2,000,000 to be used for other purposes, there would need to be a new ordinance approving such action. The primary difference between fund balance that is restricted versus fund balance that is committed is the ability to redeploy the funds with due process. If the governing body action limiting the use of funds is included in the same action (legislation) that creates (enables) the funding source, then it is restricted. If it is separate from this enabling legislation, then it is "committed".

The least restrictive option for reporting fund balance as something other than "unassigned" (formerly known as unreserved and undesignated) is for the governing body to "assign" fund balance. Although an assignment of fund balance needs to express the governing board's intent, it does not require as formal an action like a resolution or ordinance. Under this option, the governing body may assign the ability of an employee such as the City Manager/ Finance Director, or a committee, such as the finance/audit committee, to assign uses for specific funds, for specific purposes. This approach is particularly useful when considered with the new guidance for reporting certain activities in special revenue funds.

An example: What if a governing body determined that revenues generated from the sale of vehicle stickers should be used for road and street improvements. Let's assume the legislation establishing the vehicle sticker fee was silent on the subject of how the revenues were to be used. An efficient approach to obtaining the desired result would be for the governing body to grant authority to the finance director to assign this specific revenue stream to be used as intended. The Finance Director would then assign the vehicle sticker fee to the Road Construction Fund (capital projects fund type), to be used for road improvement expenditures. To the extent there are unexpended revenues at year end, those revenues would be reported as Fund Balance – Assigned. Documentation of this assignment could be as simple as documentation of the Board's discussion in the Board meeting minutes.

Another broader example would be for the governing body to collectively express at a meeting (such as at an official Board meeting) that all spendable, unrestricted revenue amounts which are assigned to specific funds (other than the General Fund) as evidenced by the formal approved budget/appropriation document, are assigned to be used for the purpose for which the fund was established. Again, documentation of this discussion should be included in the official minutes. Any desired assignments pertaining to the General Fund would need to be more specific as the definition of the General Fund by nature is meant to account for anything that is not reported in the other funds and thus includes multiple activities and purposes.

Any residual spendable amounts held in the General Fund that are not restricted, committed or assigned, are displayed as "unassigned". As a side note, there is one circumstance in which governmental funds other than the General Fund, would report "unassigned" fund balance. The unassigned category would only be used by a special revenue, debt service, capital project or permanent fund type if the fund has a deficit fund balance after considering amounts that are restricted or committed. These fund types would never report a positive "unassigned" fund balance. Additionally, a government cannot make fund balance assignments if it would create a deficit unassigned amount. See the 3 examples below for further clarification of this rule:

Example 1:
Total fund balance for a capital projects fund is $100,000. The fund was established to construct a veteran's memorial and park site. At year end, there are unspent restricted bond proceeds of $75,000 (bonds were issued to construct the building). The government, through a Board approved resolution, has committed a portion of home rule sales tax to be spent on landscaping the park site adjacent to the memorial project and the unspent portion of these taxes at year end is $30,000. Additionally, the Board has assigned any remaining amounts to be used to purchase a statue for the completed site, and for a grand opening ceremony. Fund Balance would be reported as follows:

Restricted	$75,000
Committed	30,000
Unassigned	(5,000)
Total	100,000

Example 2:
Assume all the same facts as stated above, except the unspent bond proceeds at year end were $25,000.

Restricted	$25,000
Committed	30,000
Assigned	45,000
Total	100,000

Example 3:
Assume all the same facts as stated in example 1 above, except the unspent bond proceeds at year end were $60,000, and the Board specifically assigned $20,000 for the statue and grand opening.

Restricted	$60,000
Committed	30,000
Assigned	10,000
Total	100,000

GASB 54 eliminated the common classification of encumbrances as restrictions of fund balance. Significant encumbrances should be disclosed in the notes to the financial statements by major funds and nonmajor funds in the aggregate with the required disclosures about other significant commitments. The government will now include encumbered amounts as the restricted, committed, or assigned purpose as appropriate based upon the appropriate sub-category.

GASB 54 is not entirely unique in that the determination of ending fund balance amounts (by category) requires the application of certain assumptions. Principle of these is the order in which resources are to be used in those circumstances where there are resources with varying levels of restrictions, commitments, and or assignments, available for use. The new spin on this concept is the GASB has added a presumptive policy that the restricted resources will be applied first, followed by committed, assigned and unassigned, in the absence of a formal policy adopted by the government. The policy used (or the presumptive application) must be disclosed in the notes to the financial statements.

To display the components of fund balance in the financial statements, governments are provided a myriad of choices and the GASB statement provides a variety of good reporting examples. Practically, the level of detail that will be presented in the financial statements themselves will probably be a direct function of the amount of room available on the page. If the statements provide summary level reporting (2 broad categories and 4 sub-categories) then the detail that is not provided on the face of the statement can be provided in the footnotes.

The reporting requirements (face of statements or footnotes) are:

1. Components of nonspendable fund balance:
   (a) Not in spendable form and
   (b) Legally or contractually required to be maintained

2. Restricted/committed/assigned fund balance - must distinguish between each of the major restricted purposes, committed purposes and assigned purposes.

In addition to reporting or disclosing the above financial information, the government is also required to disclose the following governing body actions/policies in the notes to the financial statements (NTFS):

1. The government's highest level of decision-making authority (for example an ordinance or resolution)
2. The formal action that is required to be taken to establish (and modify or rescind) a fund balance commitment
3. The body or official authorized to assign amounts to a specific purpose
4. The policy established by the governing body pursuant to which that authorization is given
5. If a governing body has formally adopted a minimum fund balance policy – it should be described in the NTFS

Disclosure of these types of policies is the reason we are recommending that this process is started early in order to ensure governing body actions are established prior to the date GASB 54 is required to be implemented.

Governmental Fund Types

Another major area addressed by GASB Statement 54, is the definition of the 5 governmental fund types. Prior literature on this topic was sparse and subject to various interpretations. As such, the GASB has provided more in-depth guidance for determining the appropriate use of the governmental fund types.

The easiest determination is the General Fund, and the definition for use of that fund has not changed. The General Fund Should be used to account for and report all financial resources not accounted for and reported in another fund.

To understand the appropriate use of Special Revenue Funds, you need a clear understanding of the components of fund balance, which is why that section was addressed first. Special Revenue Funds are used to account for and report the proceeds of <u>specific revenue sources</u> that are:

1. Restricted or committed to expenditure for specific purposes other than debt service or major capital projects, and

2. Must be <u>substantial portion</u> of revenues reported in the fund

Additionally, Special Revenue Funds should not be used to account for resources held in trust.

As underlined above, the GASB has not defined how "substantial portion" should be defined and in all certainty different governments will interpret this in different ways. Webster's dictionary (online version) defines "substantial" as "considerable in quantity", and "significantly great". Other definitions include "material" and "Considerable in importance, value, degree, amount, or extent." Not helpful? Think of that as a positive, it leaves some wiggle room. The IGFOA TARC committee devised the following table. This table is meant to be a guide only and is not authoritative guidance.

Revenue Represents ____ % of the Fund's total revenues:

Less than 50%	50 % to 75%	Greater than 75%
Not signifcant	May be significant depending on facts and circumstances	Significant

Other resources (interest / transfers) may be reported in the Special Revenue Fund if they are restricted, committed or assigned to the specific purpose of the fund. Information on restrictions, commitments and assignments were provided in the first section of this paper.

Governments should discontinue reporting a special revenue fund, and instead report the fund's remaining resources in the general fund, if the government no longer expects that a substantial portion of the inflows will derive from restricted or committed revenue sources. A good example would be the loss of a major grant source and the subsequent closing of the related Special Revenue Fund. In this case, upon closing the Special Revenue Fund, any remaining fund balance would be transferred to the General Fund (or in the case of a fund deficit, the General Fund would provide a transfer to the special revenue fund).

For each of its reported Special Revenue Funds, the government should disclose in the notes to the financial statements, the purpose for each major special revenue fund—identifying which revenues and other resources are reported in each of the funds. Similar information was also required under GASB 34 for major funds, so the existing footnote should only require minor modifications.

The definition of Capital Projects Funds comes as no surprise. Capital Projects Funds are to be used to account for and report resources that are restricted, limited or assigned to expenditure for capital outlays, including construction activities. In the case of Capital Projects Funds that are funded by bond proceeds, little or no action will typically be required by the governing board after the bonds have been issued as most of these issues will be restricted under the terms of the bonds indentures. For other types of capital projects funds however, there may need to be action by the governing body. Some governments for example accumulate resources in a capital projects fund to purchase vehicles, equipment and other capital assets at a later date. Other funds may provide resources via transfers. In this scenario, there needs to be some level of Board action that assigns or commits those transferred funds for capital acquisition purposes. In the first section of this paper, an example of an option was provided to easily accomplish this. The example provided was for the Board to refer to the adopted budget /appropriation ordinance to identify all resource assignments. This would necessitate however that all transfers are budgeted/appropriated.

Debt Service Funds are used to account for and report financial resources that are restricted, limited or assigned to expenditure for principal and interest payments. A Debt Service Fund should be used to report these resources if it is legally mandated to do so (for example if a bond ordinance requires the establishment of a separate debt service fund). Financial resources that are being accumulated for principal and interest maturing in future years also should be reported in debt service funds. Most resources that have traditionally been reported in debt service funds are either restricted (a portion of the bond proceeds) or committed (a specific property tax levy). Other resources reported in the fund such as transfers, other taxes and interest may require an assignment by the governing body.

The last category of government funds is the Permanent Fund. A Permanent Fund is used to account for and report financial resources that are restricted to the extent that only earnings, and not principal, may be used for purposes that support the reporting governments programs. The definition for this fund type was established recently (GASB 34) and there has been no change to this fund-type definition.

Another factor to consider is that a single program of a government may require 2 or 3 fund types to account for it. A great example is a TIF project. When bonds are issued to provide proceeds to fund construction within the TIF boundaries, a capital projects fund will be established to account for both the proceeds and their use on construction type activities. Property or sales taxes collected to retire the debt pertaining to these bonds, as well as the debt service expenditures themselves, will be accounted for in a debt service fund. Excess taxes and other TIF generated revenues that are not restricted or committed to pay construction or debt service expenditures, could potentially be accounted for in a special revenue fund if they are restricted / committed under state law or local ordinance.

Other

GASB Statement 54 also provides authoritative guidance addressing the reporting for stabilization funds – aka "rainy day" funds.

Some governments formally set aside amounts for use in emergency situations or when revenue shortages or budgetary imbalances arise. Those amounts are subject to controls that dictate the circumstances under which they can be spent. These rainy days amounts are considered committed when the formal action that imposes the parameters for spending identifies and describes the specific circumstances under which the need for stabilization arises. Those circumstances should be such that they would not be expected to occur routinely.

Stabilization arrangements that do not meet the criteria to be reported within the restricted or committed fund balance classifications should be reported as *unassigned* in the general fund.

A stabilization arrangement would satisfy the criteria to be reported as a separate Special Revenue Fund only if the resources derive from a specific restricted or committed revenue source. For example - if the State provided a grant to a local government restricted specifically for this purpose, or if a City Board passed an ordinance that contained the specific requirements addressed above.

Conclusion

Implementation of GASB Statement 54 will probably require a fair investment of your time for the year of implementation and beforehand as well. The newly allocated revenue sources may influence fund classifications of revenue sources, and accordingly, the budget process should likewise follow these revenues. As the budget process normally begins in the fiscal year prior to commencement, it is suggested the government consider this standard before the budget process and inform the board of any proposed changes. Additionally, there will be some required maintenance each year going forward to make sure that commitments and assignments remain appropriate and are documented, recorded and disclosed properly.

Government's Fiscal Year (1 year-cycle)	Required implementation (Early Implementation encouraged
April 30	Fiscal year April 30, 2012
June 30	Fiscal year June 30, 2011
December 31	Fiscal year December 31, 2011

It is not always easy to determine the options that are available to your governing body (Board) in terms of deciphering the "highest level of governing body action", and/or other actions they may take to commit or assign resources. An excellent source for that type of information would be the local government's appointed legal counsel.

Appendix of Terminology

Nonspendable Fund Balance: The portion of fund balance that cannot be spent because they are either (a) not in spendable form or (b) legally or contractually required to be maintained intact.

Restricted Fund Balance: Amounts that are restricted to specific purposes, pursuant to the definition in paragraph 34 of Statement 34, as amended by Statement No. 46, *Net Assets Restricted by Enabling Legislation*. Fund balance should be reports as restricted when constraints placed on the use of resources are either:

a. Externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments; or
b. Imposed by law through constitutional provisions or enabling legislation.

Enabling legislation, as the term in sued in Statement No. 54, authorizes the government to assess, levy, charge or otherwise mandate payment of resources (from external resource providers) and include a legally enforceable requirement that those resources be used only for the specific purposes stipulated in the legislation. *Legal enforceability* means that a government can be compelled by an external party - such as citizens, public interest groups, or the judiciary – to use resources created by enabling legislation only for the purposes specified by the legislation.

Committed Fund Balance: Amounts that can only be used by specific purposes pursuant to constraints imposed by formal action of the government's highest level of decision-making authority.

Assigned Fund Balance: Amounts that are constrained by the government's *intent* to be sued for specific purposes, but are neither restricted nor committed. This will not apply to stabilization arrangements.

Unassigned Fund Balance: The residual classification for the General Fund. The classification represents fund balance that has not been assigned to other funds and that has not been restricted, committed, or assigned to specific purposes within the general fund.

General Fund: The general fund should be used to account for and report all financial resources not accounted for and reported in another fund.

Special Revenue Funds: Funds used to account for and report the proceeds of specific revenue sources that are restricted or committed to expenditures for specified purposes other than debt service or capital projects. Special revenue funds should not be used to account for resources, held in trust for individuals, private organizations, or other governments.

Capital Project Funds: Funds used to account for and report financial resources that are restricted, committed, or assigned to expenditures for capital outlay, including the acquisition or construction of capital facilities and other capital assets.

Debt Service Funds: Funds used to account for and report financial resources that are restricted, committed, or assigned to expenditures for principal and interest.

Permanent Funds: Funds used to account for and report resources that are restricted to the extent that only earnings, and not principal, may be used for purposes that support the reporting government's programs – that is, for the benefit of the government or its citizenry.