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GASB 34: A Warning for Budgeteers

GASB 34 contains some provisions that may surprise—and disappoint—budget analysts

by David R. Olson

The new GASB Statement 34 represents a dramatic improvement in governmental financial reporting in many ways, including the new management's discussion and analysis (MD&A) section and government-wide financial statements prepared on the accrual basis of accounting. But people who work with government budgets may not be aware that GASB 34 contains two relatively minor provisions that could significantly reduce the value of the audited financial reports for their work.

Common Terminology & Classification

Regarding budgetary reporting generally, NCGA Statement 1 (issued in 1979) required that

> "a common terminology and classification should be used consistently throughout the budget, the accounts and the financial reports of each fund."

In its Interpretation No. 10 on budgetary reporting (issued in April 1984), the NCGA went further to specifically require for the comprehensive annual financial report (CAFR)

> "individual fund comparisons at the level of budgetary control… and that the CAFR must contain individual fund budgetary comparison statements or schedules with detailed account classifications."

These NCGA reporting standards have been considered generally accepted accounting principles (GAAP) for some time and are codified in GASB *Codification* Sec. 1700; 2400.112. Budget analysts and others have come to rely on these provisions and regard the budgetary comparison statement as an important enforcement mechanism in ensuring that the budget is executed according to the laws and policies adopted by the legislative branch of government.

GASB 34, paragraph 131, modifies current budgetary reporting requirements in an important way by providing governments with an option about the format of the budgetary comparison statement:

> "Governments may present the budgetary comparison schedule using the same format, terminology, and classifications as the budget document, *or using the format, terminology, and classifications in a statement of revenues, expenditures, and changes in fund balances* (emphasis added)"

If a governmental unit chooses to use the operating statement format, the

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Warning for Budgeteers

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value of the budgetary comparison statement for ensuring that the budget is complied with will be significantly reduced or destroyed. Since many budgeteers view the budgetary comparison statement as the most important statement presented in the report and greatly appreciate the value of the audit in reporting on budgetary compliance, budgeteers need to insure that the budgetary comparison statement continues to be prepared using "the same format, terminology, and classifications as the budget document."

Auditor Association

Currently the budgetary comparison statement is a basic financial statement which means that as far as the audit engagement is concerned, the statement receives the highest level of auditor association (i.e., scrutiny). However, GASB 34 no longer requires that the budgetary comparison statement be presented as a basic financial statement. In fact, the new requirement is for the budgetary comparison to be presented as required supplementary information (RSI) but provides governments with the option of presenting the statement as a basic financial statement. An analysis of 12 cities that have early implemented GASB 34 reveals that only three (Overland Park, Kansas; Tracy, California; Lyerly, Georgia) have presented the budgetary comparison statement as a basic financial statement, with full auditor association. The other nine cities present the budgetary comparison statement as RSI; with three cities' auditors taking "in relation to" association (a lower level of association). The remaining six cities' auditors had no association with the budgetary comparison statement. Most budgeteers will probably want the auditor to continue to have the budgetary comparison statement receive the highest level of audit scrutiny and so they need to ensure that the budgetary comparison statement be presented as a "basic financial statement."

Washington, D.C.

The District of Columbia's budget is under the legislative control of the US Congress (according to article 1, section 8 of the US Constitution) and the District of Columbia's elected City Council (according to the home rule statute passed in 1973).
In the past, the Congress (more specifically, the House and Senate Appropriations Committees) was dissatisfied with the way that the budgetary comparison statement had been prepared and audited. During consideration of the District of Columbia Appropriation Bill for FY 2002 (H. R. 2944), the DC Subcommittee reported, and the House of Representatives adopted, a general provision (sec. 123) requiring, in part, that the District's CAFR for FY 2002 include the budgetary comparison statement as a

> "basic financial statement… using the format, terminology and classifications contained in the law making appropriations for the year and its legislative history."

Initially, the Senate did not pass this provision but it was restored in the House-Senate conference, passed in the Senate and became Public Law 107-96.

This will ensure that the budgetary comparison statement that appears in District of Columbia's CAFR follows the format, terminology and classifications used in the appropriations act and that the statement receives the highest level of auditor scrutiny.

Conclusion

GASB 34 is an important step forward in improving governmental financial reporting for state and local governments. And while providing increased flexibility in financial reporting is generally a good idea, it is not clear why GASB 34 contains these two provisions. Governmental budget preparers, reviewers and analysts, particularly those in legislative roles, need to act to ensure that the budgetary comparison statement retains its value and importance for their work.

David R. Olson, Ph.D., CPA, is an associate professor of accountancy at the University of Illinois at Springfield.

GASB Statement 34 Q and A

What are the criteria for reporting major funds?

Non-major funds should be aggregated and displayed in a single column. A government's main operating fund (usually the general fund) should always be reported as a major fund. Other individual governmental and enterprise funds should be reported in separate columns as major funds based on the following criteria:

- Total assets, liabilities, revenues or expenditures/expenses of the individual governmental or enterprise fund are at least 10 percent of the same element (assets, liabilities, etc.) for all funds of that category or type, and
- Total assets, liabilities, revenues or expenditures/expenses of the individual governmental fund or enterprise fund are at least 5 percent of the same element for all governmental and enterprise funds combined.

by Mike McCauley, Corporate Affairs and Research Manager, Florida State Board of Administration; reprinted from the newsletter of the Florida GFOA.

Find more GASB Q and A throughout this newsletter.

TARC and ICPAS Discuss Property Taxes and GASB 33

Summary of Points from GASB 33 Position Paper Meeting

As reported by Irwin Lyons, Director of Government Services, Miller, Cooper & Co., Ltd.

The meeting opened with a discussion regarding the issue of appropriately recording property taxes when a government has two lien dates outstanding at fiscal year end, which many Illinois governments have. The consensus that emerged was that recording more than one levy was an undesirable outcome. The initial guidance that was discussed was to develop specific criteria that could provide guidelines to determine when an entry was required.

If no tax levy has been adopted then the argument can be made that the amount is not determinable. As there in no determinable receivable since a levy ordinance hasn't been passed, then no levy can be recorded on the books. It would be appropriate and in fact is required that the lien date calendar be footnoted so the user of the financial statements is aware that a lien date has passed, but that alone is not sufficient justification for recording taxes receivable and deferred revenue (the balance sheet entry).

Specific guidance

If the lien date has passed and the governing board has enacted the tax levy, then the balance sheet entry recording the property tax levy should be recorded. The intent is to provide a clear cut procedure for consistently determining the action that triggers recording property taxes receivable. That trigger will be the passage of the lien date AND the government passing a tax levy for the lien date tax year. In some cases, adhering to these guidelines could result in no tax levy being recorded on the books (e.g. some counties with a November 30th year end, that enact their tax levy in December.)

The next issue that we discussed was revenue recognition for property tax levies. While the best solution would be to seek a legislative answer, the inability of our group to actually make such a change on our own led us to work on developing some guidelines that could offer solid reasoning and consistent treatment.

The GASB has been made aware of the timing of levy and lien dates that Illinois entities are faced with. Their response has been to "get the legislature to make changes". While the park districts have been successful in getting a legislative change made for them and they no longer have to state what budget their tax levy is intended to finance, such is not the case for the majority of governments in Illinois—they still must state in their tax levies what budget year the levy is intended to finance.

Specific guidance

The matching principle is the appropriate guidance to apply in determining appropriate revenue recognition criteria. The year intended to finance is the appropriate criteria to use and look to the budget/appropriations ordinance for the intent of the entity. If the budget or appropriation ordinance is unclear as to which year the tax levy is intended to finance, then pass a separate resolution to formalize the intent. An alternate approach would be for management to include their intent in the management representation letter.

For the entity wide statements which are prepared using the full accrual basis of accounting, you would first look to whether this year is the year that the tax levy is intended to finance. If the answer is no, then you don't need to evaluate the levy any further—you won't be recognizing any revenue. If however, the answer is "yes," this is the year that the tax levy is intended to finance, then apply the 60-day concept for determining availability. If the taxes will be received within 60 days, then you will recognize those revenues. Intent is the overarching principal which must first be satisfied before any other criteria can be considered.

The final issue that we discussed was derived tax revenues. The idea that emerged was to develop a model policy on revenue recognition.

GASB 34 Training Workshops

Save these dates:

GASB 34: Capital Assets
Thursday, January 30 location: North

GASB 34: Capital Assets
Wednesday, February 19 location: West

GASB 34: Capital Assets
Thursday, March 6 location: South

GASB 34: MD&A
Wednesday, March 19 location: West

GASB 34: MD&A
Tuesday, April 29 location: North

Watch for details soon!

Is Your Auditor Still Independent?

The focus of the changes to the auditor independence standard is to better serve the Public Interest and to maintain a high degree of integrity, objectivity, and independence for auditors of government entities."

David M. Walker, C.P.A.
Comptroller General of the United States.

On January 25, 2002, GAO issued an amendment to GAGAS Amendment 3 modifying the independence standards required on audit and non-audit engagements. The new standards require auditors to be "free both in fact and appearance from personal, external and organizational impairments to independence." The changes being required are not just the responsibility of your auditor; each finance director must continue to ask themselves if the extras related to their audit step over the new independence line drawn by GAO.

When an auditor is requested to perform additional non-audit procedures, an auditor must evaluate the overarching principles:

- Auditors should not perform management functions or make management decisions.
- Auditors should not audit their own work or provide non-audit services in situations where amounts or services involved are significant/material to the subject matter of the audit.

In addition to these two principles, auditors should provide these safeguards as guidelines:

- Personnel who perform non-audit services would be precluded from performing any related audit work.
- The auditor's work could not be reduced beyond the level that would be appropriate if the non audit work was performed by another unrelated party.
- Certain documentation and quality assurance requirements must be met.

So, what does this mean for the government official who requires a GAS audit? That is a gray area. GAO has given vague guidance on what is considered an "independent" audit organization. While it has not prevented the same "organization" from performing non-audit and audit services, there is a fine line which must not be crossed. GAO's guidance is clear that audit personnel is prevented from providing non-audit service, except for those de minimis projects (under 40 hours of service time). GAO is also extremely clear that the audit organization cannot provide management functions, i.e. posting journal entries to the entities' general ledger, supervise entity employees, and develop programmatic policies. However, GAO allows those same audit organizations to calculate and propose cash to accrual entries, assist with making year end closing entries, make recommendations for offers of employment and provide technical advice when it comes to modifying internal controls. When all is said and done, you as a government official and your auditor must evaluate the "materiality" of the nonaudit function being provided to determine if your auditor is still independent.

To help us along, GAO has issued a question and answer response. This Q & A can be downloaded from GAO's website at www.gao.gov. The Q & A is broken down into sections, outlining from transitioning to the new standards to citing specific nonaudit examples to be followed.

Effective for engagements beginning after January 1, 2003, auditors and government officers must begin to evaluate the additional work completed as part of the audits. GAO has made it clear that auditors are to be independent both in substance and in form and they must consider whether a third party would consider the scope of their engagement as independent. Governments, however, have been given a window of forbearance. This window allows governments to maintain contracts for overlapping work entered into prior to June 30, 2002 as long as work related to those contracts is completed before June 30, 2003. However, the new independence standards must be followed if the contract is to extend past June 30, 2003.

By Kelly Zabinski, C.P.A., William F. Gurrie & Co., Ltd.

GASB Statement 34 Q and A

How are major funds reported?

Fund level statements should present the financial information of each major fund in a separate column.

Do major fund reporting requirements apply to internal service funds?

No.

by Mike McCauley, Corporate Affairs and Research Manager, Florida State Board of Administration; reprinted from the newsletter of the Florida GFOA.

Find more GASB Q and A throughout this newsletter.

TARC responds

IGFOA's Technical Accounting Review Committee recently commented on GASB's Exposure Draft No. 207-A "Deposit and Investment Risk Disclosures, an amendment of GASB Statement No. 3." Here are those comments:

The Illinois Government Finance Officers Association (IGFOA) is pleased to provide its comments on the proposed GASB statement on Deposits and Investment Risk Disclosures. The Illinois GFOA is a professional association of public finance officials in the state of Illinois.

We would like the GASB to consider requiring more disclosure defining the quality of collateral. Specifically, to be considered collateralized, the collateral must be supported by a written collateral agreement that meets the requirements of the Financial Institution Resource Recovery Enforcement Act (FIRREA), as amended. We'd like the GASB to consider establishing guidelines for collateral and disclosure of whether the collateral meets the guidelines or does not meet them.

We also applaud the managerial focus of the disclosure requirements as long as they are driven by the individual government's investment policy. We believe that the note disclosure should mirror the individual government's investment policy.

We are concerned that the ED may not be clear enough about the level of detail required for the proposed complex investment disclosure. It is important that such disclosure not be interpreted in such a way as to unduly burden governments with significant positions in such investments. Therefore, we recommend that GASB be urged to clarify that the detail provided in connection with this disclosure ought to be minimized by combining similar types of arrangements. Further, we believe disclosure should be required only if the aggregate position in complex investments exceeds five percent.

We would like to commend the GASB for its inclusion of multiple acceptable alternatives to disclosing information about the interest rate sensitivity of their debt investments. We would also like to strongly encourage the GASB to retain these options in the final draft as they provide the opportunity for governments with fewer resources to use one of the less costly alternatives to meeting this reporting requirement.

If you have any questions or require clarification of any of these points, please contact Rita A. Trainor, Chairperson via email rtrainor@epd.org or voice mail at 630.993.8932.

Grant-Related Internet Web Sites

State

Department of Commerce and Community Affairs:
http://www.illinoistourism.org
To find the following three grant programs, click on "Industry Insights"
Tourism Attraction Development Grants
Tourism Marketing Partnership Program Tourism Private Sector Grant

Department of Natural Resources

Grants-in-Aid Programs
http://dnr.state.il.us/ocd/gaoutnew.htm

Public Museum Grant Program
http://www.museum.state.il.us/programs/musgrants/mgrants.html

C2000 Grant
http://dnr.state.il.us/orep/c2000/ecosystem/

Department of Transportation, TEA-21
http://www.dot.state.il.us/opp/iltep.html

Illinois Arts Council
http://www2.state.il.us/agency/iac/

Federal

Department of Education
http://www.ed.gov

Department of Housing and Urban Development
http://www.hud.gov/

Department of Interior
http://www.doi.gov/non-profit/fax.html

Department of Labor
http://www.dol.gov/oasam/grants/main.htm

Environmental Protection Agency
http://www.epa.gov/epahome/grants.htm

Federal Emergency Management Agency
http://www.fema.gov/

National Endowment for the Arts
http://www.arts.endow.gov

Notional Endowment for the Humanities
http://www.neh.fed.us/

Foundation

The Foundation Center
http://www.fdncenter.org

Philanthropy Journal
http://www.philanthropy-journal.org/

Other

Enhancements Clearinghouse
http://www.enhancements.org/

Land and Water Conservation Fund
http://www.fs.fed.us/land/staff/LWCF/

Reprinted from Illinois Parks and Recreation

GASB 34: A Budget Perspective

by Ronald A. Conrad, CPA

Government budget officers often wear a multitude of hats that reach well beyond budget preparation. GASB 34, more than any other accounting pronouncement, touches on these multi-faceted responsibilities.

The pronouncement's most obvious effects for budget officers are those related to financial statement presentation. In the Management's Discussion and Analysis (MD&A) section, analysis is to be provided for significant variations between the general fund's original and final budget amounts and between the general fund's final budget amounts and actual budget results. The analysis, which could provide some interesting discussion, is to include any currently known reasons for variations that are expected to have a significant effect on future services or liquidity. Budgetary comparison schedules are also to be included, either in the basic financial statements or as supplementary information. At a minimum, these schedules are to be provided for the general fund and each major special revenue fund (as defined) that has a legally adopted annual budget. Additional budgetary disclosures may be provided. Budgetary comparison schedules are to present both the original and final appropriated budgets for the reporting period, as well as actual inflows, outflows, and balances stated on the government's budgetary basis.

In addition to budgetary disclosures, government budget officers are focusing on implications of funds to be utilized upon adoption of GASB 34. One area of focus is the establishment of enterprise funds, which will now be required for activities which contain any of the following characteristics 1) fees are charged at prices designed to recover activity costs, including capital costs; 2) laws or regulations require the cost of providing services, including capital costs, be recovered with fees and charges; or 3) the activity is financed with debt that is secured only by fees and charges of the activity. Another area of focus is whether to continue internal service fund accounting. GASB 34 financial statement presentation of internal service funds is only at the fund-level financial statements, requiring eliminations, reclassifications and reconciliations of internal service fund amounts for entity-wide financial statement presentation. Many governments may find it more beneficial to eliminate internal service funds, instead presenting related activity as general fund departments. Finally, government budget officers may be affected by permanent fund and fiduciary fund definitions of GASB 34. Permanent funds are governmental fund-types to be established when resources are legally restricted and only the earnings on those resources are eligible to support government programs. Fiduciary funds will be divided among four classifications: pension trust, investment trust, private-purpose trust, and agency. These classifications account for pension and other employee benefit plans, the external portion of sponsoring government investment pools, all other trusts, and assets held in a custodial capacity, respectively.

One of the most significant and controversial aspects of GASB 34 centers on the accounting for fixed asset infrastructure. Many budget officers have significant roles in this area for their respective governments. GASB 34 requires the recording of infrastructure on a prospective basis upon adoption and, four years after adoption, requires recording of all major infrastructure acquired in fiscal years ending after June 30, 1980. As an example, a government that adopts GASB 34 in fiscal 2002 would immediately begin capitalization of infrastructure fixed assets. That same government would need to record,

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GASB Statement 34 Q and A

Do the major fund reporting requirements apply to blended component units?

Yes. The concept of blending is based on the notion that certain component units are so closely related to the primary government that they are, in substance, the same as the primary government. The component unit's balances and transactions should be reported in a manner similar to the balances and transactions of the primary government itself. If a component unit were blended into the reporting entity's financial statements as a special revenue fund, for example, it would be evaluated against the major fund criteria with the reporting entity's other governmental funds.

Governments are directed to apply the 10 percent major funds criterion to all funds of that category or type. When should "category" be used and when should "type" be used?

The major fund reporting requirement applies to all funds in the governmental category. Therefore, the 10 percent criterion should be applied to the governmental funds category. Of the proprietary funds, the major fund reporting requirements apply to enterprise funds but do not apply to internal service funds—therefore, the 10 percent criterion should only be applied to the enterprise fund type (rather than the proprietary fund category).

by Mike McCauley, Corporate Affairs and Research Manager, Florida State Board of Administration; reprinted from the newsletter of the Florida GFOA.

Find more GASB Q and A throughout this newsletter.

A Budget Perspective

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by 2006, all major infrastructure subject to retroactive capitalization. Fortunately, only major infrastructure items, defined as networks of at least 10% and subsystems of at least 5% of the 1999 general fixed assets account balance, need be recorded retroactively. Further, there is latitude in defining networks and subsystems, the definitions of which may affect the extent of infrastructure to be recorded. Governments with less than $10 million in revenues during the first fiscal year ending after June 15, 1999 are exempt from the retroactive recording requirement.

GASB Statement 34 Q and A

If an individual governmental or enterprise fund meets the initial 10 percent criterion for one element (total assets, liabilities, revenues or expenses/ expenditures), and meets the five percent benchmark for a different element, is that fund required lto be presented as a major fund?

No. An individual governmental or enterprise fund is required to be reported as a major fund if it passes both the 10 percent and 5 percent tests for the same element.

Is it allowable to report a particular fund as a major fund for only one or two years?

Yes. For example, a Capital Projects Fund may experience uneven expenditure levels and thus exceed the major fund percentages for only a brief time. Governments can choose (primarily for consistency) to report a fund as a major fund even if it does not meet the percentage criteria.

Can a major fund be presented in a combined column with details provided in a combining statement?

No. Each major fund should be presented in a separate column in the fund financial statements.

In applying the major fund criteria to enterprise funds, should the government consider both operating and non-operating revenues and expenses?

Yes. The major fund determination is based on total fund revenues and expenses, which includes both operating and nonoperating categories.

For determining major governmental funds, are other financing sources/uses included in the calculations?

No. Revenues do not include other financing sources and expenditures do not include other financing uses.

by Mike McCauley, Corporate Affairs and Research Manager, Florida State Board of Administration; reprinted from the newsletter of the Florida GFOA.

Find more GASB Q and A throughout this newsletter.

Infrastructure is to be recorded at historical cost or estimated historical cost. The pronouncement provides that historical cost may be estimated by either calculating current replacement cost and deflating that cost back to the year of acquisition or by use of other relevant information supporting project cost. Infrastructure is to be depreciated, similar to proprietary fund fixed assets. Use of a modified approach, which eliminates the requirement to depreciate and capitalize ongoing related expenditures, is permitted for infrastructure assets that are part of a network or subsystem and that are maintained at a certain condition. Adoption of this method requires use of an asset management system with an up-to-date inventory of infrastructure assets, ongoing condition assessments summarized using a measurement scale, and estimates of annual amounts to maintain and preserve eligible infrastructure assets at a condition level disclosed by the government.

Part of the budget officer's role is often to communicate financial information to elected officials, other management, and outside financing agencies. GASB 34 creates significant changes to financial statement presentation which may make this a particularly challenging exercise. Entity-wide financial statements will likely present information not previously seen, including net asset balances influenced by inclusion of fixed assets and long-term debt and operations presented to provide results by program. Entity-wide financial statement revenues will be distinguished among three program categories (charges for services, operating grants and contributions, and capital grants and contributions) and two general revenue categories (taxes by type and other nonprogram revenues). Related expenses will be distinguished by function, with indirect costs either applied to functional categories or separately presented. Once past the entity-wide accrual basis financial statements, however, fund level financial statements will look much more familiar, with the exception that account groups are no longer presented and only the general fund and major funds, as defined, are presented.

Despite all of the changes described, and all of the implementation issues, budget officers should be relieved to know the basic budgeting process remains unaffected. Governmental funds will continue to be accounted for on the modified accrual basis and proprietary funds will continue to be accounted for on the accrual basis. Transactions accounted for throughout the year will continue to be accumulated in fund-level financial statements just as they have been, subject to presentation changes. Rather, the greatest effect on budget officers involves determination of potential fund changes, infrastructure issues, budgetary analysis in the MD&A section, budgetary amounts disclosed, and communication of financial statement information.

GASB 34 changes take a team effort to be successfully implemented. Budget officers, in cooperation with finance department officers, property management personnel and others, are an integral part of this team effort.

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Inside:

Special GASB 34 Issue

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GASB Statement 34 Q and A

Can the budgetary basis of accounting be used to determine major funds?

No. The budgetary basis might be useful in making an initial assessment, but ultimately, the major fund calculations should be done using GAAP bases of accounting. Governmental funds should be evaluated based on modified accrual measurements; enterprise funds should be evaluated using accrual-basis measurement.

For major fund determination, should total assets, liabilities, revenues or expenditures/expenses include the effects of the items in the reconciliation of the fund statements to the government-wide statements?

No. The totals to be used for the major fund determination should be the unreconciled combined amounts.

Are interfund balances and transactions required to be eliminated from the totals in the major fund test?

No. There is no requirement to make any adjustments to the combined totals for assets, liabilities, revenues and expenditures/expenses, although because the major fund criteria focus on assets and liabilities separately, significant interfund balances could influence the outcome of the major fund test. Interfund balances should not be eliminated, but if there are significant interfund receivables and payables, governments may adopt a policy (and use it consistently from year to year) to use a single “net” amount for each fund and for the combined totals.

by Mike McCauley, Corporate Affairs and Research Manager, Florida State Board of Administration; reprinted from the newsletter of the Florida GFOA.

Find more GASB Q and A throughout this newsletter.