WASILLA CITY COUNCIL INFORMATION MEMORANDUM **IM 99-79**

SUBJECT: The GASB'S New Financial Reporting Model.

REQUESTED BY: FINANCE

PREPARED BY: FINANCE **DATE: JULY 21, 1999**

FOR AGENDA OF: AUGUST 09, 1999

SUMMARY:

The GASB (Governmental Accounting Standards Board) issued GASB Statement #34 in June 1999. The enclosed document is an overview of the key features of the new financial reporting model required by this statement. The changes required by this statement will affect every government, large or small. Several departments in each government entity will be severely affected, namely Finance, Public Works and MARS. This will be the third major change in the presentation of accounting data during my career. Each change was to be the guru of accounting.

The Alaska Government Finance Officers Association and the Government Finance Officers Association (International) have been officially opposed to the results of this project. We have lost the battle. The GASB board is made up primarily of academians who lack grounding in the real world. Their overall objective seems to be to convert governmental accounting to the private sector reporting model.

As the new reporting model is implemented, it will be up to elected officials to decide whether they like this new way of presenting governmental financial information. If governments dislike the new reporting model, they need to communicate directly with the GASB.

FISCAL IMPACT: ____No __X_Yes, amount requested: $ -0- The actual amount is unknown at this time.

RECOMMENDED ACTION: Adoption of WR99-27.

MAYOR REVIEW/COMMENT:

Presented with:________________
Date: 8/9/99 **Verified by:** K.

Sarah Palin
Reviewed by: SARAH PALIN, Mayor

GFOA TECHNICAL BULLETIN

The GASB's New Financial Reporting Model: An Overview for Finance Officers

July 1999

For more than a decade and a half, the Governmental Accounting Standards Board (GASB) has been working on a project designed to change the framework of financial reporting (i.e., "financial reporting model") for state and local governments. In June 1999, the GASB marked the completion of this project with the issuance of GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*. Without a doubt, GASB Statement No. 34 represents the most important single change in the history of accounting and financial reporting for state and local governments. The purpose of this technical bulletin is to provide public-sector finance professionals, accountants and nonaccountants alike, with a practical overview of the key features of this new financial reporting model.

What is meant by the term "financial reporting model"?

Accounting systems collect vast amounts of financial data. Naturally, these data must be presented in some organized manner if they are to be useful for decision making. Accountants refer to the format or framework used to organize and present data in external financial reports as the "financial reporting model." In the private sector, for instance, financial data are organized into a balance sheet, an operating statement and a statement of cash flows for purposes of external financial reporting. State and local governments, on the other hand, traditionally have used a financial reporting model substantially different from the one used to prepare private-sector financial reports.

What are the key distinguishing features of the current governmental financial reporting model?

The current financial reporting model for state and local governments differs from its private-sector business counterpart in at least three important ways.

- *Fund accounting.* In the private-sector, even complex businesses generally are presented as a single, unitary entity for financial reporting purposes. In the same way, auditors of private-sector financial reports couch their opinion in terms of the financial statements "taken as a whole." Governmental financial reports, on the other hand, traditionally have focused upon groupings of a government's various "funds" rather than upon the government "taken as a whole." A "fund," for this purpose, is a separate accounting entity used to track resources segregated for specific activities or objectives. Fund accounting historically developed out of the desire to demonstrate legal compliance with internal (i.e., budgetary) and external (e.g., grantor) limitations placed on the use of resources.

- *Spending focus for tax-supported activities.* In the private-sector, the focus of financial reporting is on earnings and other changes in a business's total net resources. This focus traditionally has been shared by the business-type activities of governments (e.g., enterprise funds). Governments have always taken a very different approach, however, in accounting for their tax-supported (i.e., "governmental") activities, focusing on changes in current *spendable* resources rather than on changes in *total* resources. This more limited approach, which in many ways is reminiscent of checkbook accounting, is consistent with the short-term financing focus that typically characterizes the operating budget.

- *Budgetary reporting.* Private-sector businesses adopt budgets, as do state and local governments. However, the role of the budget in the public sector is unique. In the private-sector a budget is simply a financial plan; whereas in the public sector, the budget is at the very heart of the system of "checks and balances" between the legislative and executive branches of government. As a result, demonstrating compliance with the legally adopted budget has traditionally been an integral part of public-sector financial reporting, taking the form of a mandated budget-to-actual comparison statement.

What are the most important changes that the new financial reporting model will make to the current model?

- *Government-wide reporting.* As noted earlier, governments traditionally have focused their reporting on groupings of "funds" rather than on the government "taken as a whole." The new financial reporting model will retain this traditional focus on funds, but at the same time will insist that fund financial statements be accompanied for the first time by financial statements that focus on the overall government (i.e., "government-wide" financial statements).

- *Focus on major funds.* As a practical matter, governments have combined similar individual funds into one of seven groupings or "fund types" (i.e., general fund, special revenue funds, debt service funds, capital projects funds, enterprise funds, internal service funds and trust & agency funds). It is these fund types, rather than individual funds, that have been the focus of the combined financial statements presented in today's financial reports. Under the new financial reporting model, however, governments will focus on *major individual funds* rather than on fund types (with aggregated information presented for the total of all nonmajor funds). Under the specific rules provided in GASB Statement No. 34, a typical government is likely to have anywhere from four to six such major funds.

- *New focus added for governmental activities.* As noted previously, financial reporting for governmental activities traditionally has focused on changes in current *spendable* resources rather than on changes in *total* resources. This traditional focus will be retained for purposes of fund reporting. However, when governmental activities are included with other activities in the new government-wide financial statements, the focus for those activities will be on changes in *total* resources. In other words, *all activities reported in government-wide financial statements will be reported in a manner similar to private- sector accounting.* Accordingly, a reconciliation will be required between the governmental fund financial statements and the government-wide financial statements.

- *Changes in budgetary reporting.* Traditionally, governments have included a budget-to-actual comparison as one of their basic financial statements. The final amended budget has provided the budgetary amounts used for this presentation. The new financial reporting model brings three important changes to current practice. First, budgetary comparisons will henceforth need to present the original budget in addition to the final amended budget. Second, current practice provides for the presentation of budgetary comparisons *by fund type* (e.g., total budgeted special revenue funds). The new financial reporting model will require a budgetary comparison for the general fund and *individual major special revenue funds.* Third, governments will only be required to present the budgetary comparison as "required supplementary information," following the notes to the financial statements, rather than as a basic financial statement in its own right. Required supplementary information (RSI), by definition, is *not* audited. (It should be noted that GASB Statement No. 34 explicitly permits governments to retain the budgetary comparison as a basic financial statement if they wish to do so, thereby retaining it within the scope of the audit).

- *Requirement for a narrative analysis to accompany the basic financial statements.* GASB Statement No. 34 will require that financial statements always be accompanied by a narrative introduction and analytical overview of the government's financial activities in the form of "management's discussion and analysis" (MD&A). Much of the information that will be required in the MD&A is currently presented in the letter of transmittal found in the introductory section of the comprehensive annual financial report (CAFR) for those governments that prepare a CAFR. The new requirement will ensure that narrative analytical information is presented regardless of whether a government elects to publish a CAFR. Of course, information henceforth presented in the MD&A is *not* to be duplicated in future letters of transmittal. The new MD&A will be classified as RSI, which is not within the scope of the auditor's opinion. The auditor will, nonetheless, be responsible for applying certain limited procedures to the MD&A, as is the case for all information presented as RSI.

What are some of the other changes that will come about in connection with the new financial reporting model?

It is impossible in an overview such as this to provide a comprehensive list of all of the changes that will come about in connection with the new governmental financial reporting model. Some of the more important of these other changes, however, are as follows.

- *Limitation on the use of fiduciary funds.* The use of fiduciary funds will henceforth be limited to accounting for resources that are *not* available to support a government's operations and programs. This limitation is expected to result in the nonfiduciary reclassification of numerous expendable and nonexpendable trust funds.

- *Changes in fiduciary funds.* The distinction between expendable and nonexpendable trust funds will be eliminated. Instead, both will be replaced by the newly created "private-purpose" trust fund.

- *Creation of permanent funds.* Endowment-like arrangements available to support the operations or programs of the government (e.g., cemetery perpetual care funds) will be accounted for in a newly created governmental fund type, the "permanent fund."

- *New equity accounts.* While governmental funds will preserve their traditional equity classifications (i.e., "reserved fund balance," "unreserved fund balance"), three new classifications will be used under the new financial reporting model to classify equity for proprietary funds and for the government-wide financial statements. Those three classifications will be 1) "invested in capital assets net of related debt," 2) "restricted" and 3) "unrestricted."

- *Elimination of contributed capital.* Under the current model, the equity of proprietary funds is divided between "contributed capital" and "retained earnings." Under the new financial reporting model, such a distinction will no longer be made.

- *Elimination of account groups.* Now that capital assets and long-term obligations related to governmental activities will henceforth be reported in the government-wide financial statements, there will no longer be a need to report either a general fixed assets account group or a general long-term debt account group.

- *Classification of assets and liabilities.* The new reporting model will require that proprietary funds distinguish current assets and liabilities from noncurrent assets and liabilities.

- *Net expense format for the government-wide statement of activities.* The new government-wide statement of activities is designed to highlight both the *total expense* of each different function and the *net expense* of that same function (i.e., total expense less related revenues such as fees, charges, and restricted grants).

- *Single category for transfers.* Currently, residual equity transfers are distinguished from operating transfers. Under the new governmental financial reporting model, there will be a single "transfers" category.

- *Special items.* The new financial reporting model will create a new category of "special items" to account separately for transactions or events subject to management control that are *either* unusual in nature *or* infrequent in occurrence (i.e., which meet one but not both of the criteria used to define an "extraordinary item").

What are the key implementation challenges of the new financial reporting model?

Although there is much in the new financial reporting model that will be familiar to financial statement preparers and users (e.g., traditional fund accounting for governments), compliance with the new standard will require governments to make a number of important changes. The most significant of these changes are as follows.

- *Infrastructure reporting.* Traditionally, state and local governments have *not* been required to report general infrastructure assets (e.g., roads, bridges, dams) in their financial statements. However, the move to a more private-sector-like focus for governmental activities reported in the newly prescribed government-wide financial statements will change that. Specifically, GASB Statement No. 34 will require that all capital assets, including general infrastructure assets, be capitalized in the financial statements at their historical cost or estimated historical cost. Furthermore, this requirement, as a rule, will apply *retroactively* to major general infrastructure assets that were acquired in fiscal years beginning after June 15, 1980, or that received major renovations, restorations, or improvements since that date.

- *Depreciation accounting.* Although state and local governments traditionally have reported noninfrastructure general capital assets in their financial statements, they have *not* depreciated those assets. Once again, the move to a more private-sector-like focus for all activities in government-wide financial statements will change traditional practice. Governments will be required under the new financial reporting model to report depreciation expense for all of their capital assets, *including general infrastructure assets,* in the government-wide financial statements. Governments, however, can avoid the mandate to depreciate general infrastructure assets if those assets 1) are managed using an asset management system meeting certain specifications set forth in GASB Statement No. 34 and 2) the government documents that those assets are being preserved at (or above) a condition level established and disclosed by the government. To elect this option, a government would have to perform regular condition assessments of its infrastructure assets at least every three years and disclose information on condition levels, as well as anticipated and actual maintenance outlays as RSI.

- *Conversion of data for governmental activities.* As noted earlier, governmental activities will continue to focus on changes in current *spendable* resources in governmental fund financial statements. A different focus will be applied to those same activities when they are reported in the new government-wide financial statements. This change in focus will require that data on governmental activities be converted from the modified accrual basis of accounting to the accrual basis of accounting for purposes of preparing the government-wide financial statements. Some of the principal adjustments involved in making this conversion from modified accrual accounting (i.e., "expenditures") to full accrual accounting (i.e., "expenses") include the following:

    - removing capital outlays from the operating statement (with depreciation expense being reported in its place)

    - removing debt service principal outlays from the operating statement

    - removing the receipt of the proceeds of long-term debt from the operating statement

    - reporting amortizations (e.g., issuance discounts and premiums, issuance costs)

    - reporting interest on debt when incurred rather than "when due"

    - reporting expense in connection with prepaid items (e.g., insurance) and the consumption of inventory

    - reporting revenue that is not yet "available" for spending (e.g., property taxes collected more than 60 days after the end of the fiscal period)

    - reporting expense related to the noncurrent portion of certain liabilities (e.g., compensated absences, claims and judgments)

- *Reporting cash flows from operating activities for proprietary funds.* Proprietary funds are currently required to present a statement of cash flows. Normally, there is a difference between cash flows provided from operating activities in a proprietary fund and "operating income." Under current standards, governments may elect either 1) to present information on specific cash flows (e.g., cash paid to suppliers, cash paid to employees, cash received from customers) or 2) to reconcile the difference between cash flows from operating activities and operating income (e.g., adjustment for noncash expenses, adjustment for changes in receivables and payables balances). In practice, a majority of governments currently follow this second (i.e., "indirect") approach. Under the new financial reporting model, the first method (i.e., the "direct" method) will be required in all cases.

When are governments required to implement the new financial reporting model?

The implementation date for GASB Statement No. 34 will vary depending upon a government's size. Size, for this purpose, will be calculated based upon the total annual revenues of the primary government's governmental and enterprise funds in the first fiscal year ending after June 15, 1999. (Total revenues are *not* to include either "other financing sources" or "extraordinary items.") General implementation of the new standard is scheduled in three phases, as follows.

- *Phase 1.* Governments with total revenue of $100 million or more will be required to implement GASB Statement No. 34 for fiscal years beginning after June 15, 2001 (i.e., starting with the fiscal year ended June 30, 2002).

- *Phase 2.* Governments with total revenues of $10 million or more, but less than $100 million, will be required to implement the new pronouncement for fiscal years beginning after June 15, 2002 (i.e., starting with the fiscal year ended June 30, 2003).

- *Phase 3.* Governments with total revenues of less than $10 million will be required to implement the new financial reporting model for fiscal years beginning after June 15, 2003 (i.e., starting with the fiscal year ended June 30, 2004).

Governments are required to capitalize all *future* infrastructure acquisitions as of these dates (i.e., *prospective* reporting). Different effective dates have been provided, however, for the *retroactive* reporting of infrastructure assets, as follows.

- *Phase 1.* Governments with total revenues of $100 million or more will be required to implement the retroactive reporting of infrastructure assets for fiscal periods beginning after June 15, 2005 (i.e., starting with the fiscal year ended June 30, 2006).

- *Phase 2.* Governments with total revenues of $10 million or more, but less than $100 million, will be required to implement the retroactive reporting of infrastructure assets for fiscal periods beginning after June 15, 2006 (i.e., starting with the fiscal year ended June 30, 2007).

Governments with total revenues of less than $10 million are exempt from the requirement to report their general infrastructure assets retroactively.

Early implementation of GASB Statement No.34 is encouraged, but with the following limitations:

- GASB 34 must be implemented simultaneously by the primary government and its component units

- GASB 34 must not be implemented prior to the implementation of GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*

How will GFOA help governments to implement the new financial reporting model?

The GFOA is committed to helping its members to implement the new financial reporting model. GFOA's current plans include the following:

- *1999 GAAP Update.* The GFOA's annual *Governmental GAAP Update* teleconference, which is scheduled for Wednesday, November 10, 1999, will be devoted entirely to reviewing the requirements of the new financial reporting model and related implementation issues

- *An Elected Official's Guide to the New Governmental Financial Reporting Model.* GFOA plans to issue a new publication devoted to the new governmental financial reporting model in its popular *Elected Officials Series.* This publication, with its simple question-and-answer format, should prove a valuable tool for explaining the new model to elected officials and other interested parties who may not have a technical background in accounting.

- *GAAFR 2000.* The GFOA plans to issue a new edition of *Governmental Accounting, Auditing and Financial Reporting* (*GAAFR*) specifically tailored to the new financial reporting model at its next annual conference in Chicago. This newest *GAAFR* will be accompanied by a series of national training seminars. Governments, of course, should continue to follow the 1994 *GAAFR*, as amended by the *GAAFR Update Supplement*, until they implement the new financial reporting model.

Illustration 1

NEW FINANCIAL REPORTING MODEL: MINIMUM INFORMATION REQUIRED FOR FAIR PRESENTATION IN CONFORMITY WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP)

*Management's Discussion and Analysis**

Government-wide Financial Statements	**Fund Financial Statements**
Statement of net assets Statement of activities	Governmental funds: Balance sheet Statement of revenues, expenditures and changes in fund balances Proprietary funds: Statement of net assets Statement of revenues, expenses and changes in net assets Statement of cash flows Fiduciary funds: Statement of fiduciary net assets Statement of changes in fiduciary net assets

Notes to the Financial Statements

Budgetary Comparisons
Infrastructure condition data (if no depreciation of infrastructure)
*Other required supplementary information***

*Italics are used to designate required supplementary information (RSI). RSI must be presented to conform with GAAP, but is itself unaudited.
**Required in connection with pension trust funds and public-entity risk pools

Illustration 2

TIMETABLE FOR IMPLEMENTING THE NEW FINANCIAL REPORTING MODEL

Size of government*	General provisions (i.e., all except retroactive reporting of general infrastructure)	First affected fiscal year end	Retroactive reporting of general infrastructure	First affected fiscal year end
Over $100 million total revenues	Years beginning after June 15, 2001	June 30, 2002	Years beginning after June 15, 2005	June 30, 2006
Less than $100 million but ≥ $10 million total revenues	Years beginning after June 15, 2002	June 30, 2003	Years beginning after June 15, 2006	June 30, 2007
Less than $10 million total revenues	Years beginning after June 15, 2003	June 30, 2004	Retroactive reporting optional	Not applicable

*For this purpose, "total revenues" are those of the primary government's governmental and enterprise funds in the first fiscal year ending after June 15, 1999.