GASB 34 COMPLIANCE GUIDE

FINANCIAL REPORTING, PART 1

The final three articles in our GASB 34 series will address accounting and reporting issues, as well as the requirements for Management's Discussion and Analysis. This series is **not** intended to be a basic accounting primer and assumes that the readers (presumably those responsible for generating financial reports) have some accounting or finance training or experience. For more basic instruction you should consult the resources listed at the end of each article.

It is important to note that there is a wide range of municipal accounting and reporting practices and skills in Vermont. Where a firm is contracted to do audit work, independent auditors will issue financial statements from the accounting records and trial balances of local officials. Therefore, this reporting component of GASB 34 may be of less concern to those municipalities having regular independent audits. However, this does not apply to Management's Discussion and Analysis (MD&A). The MD&A needs to come from management and generating this report requires a clear understanding of your financial statements.

This month and next, we will outline the types of reports required for compliance and what you need to know to produce them.

Below you will find a discussion of basic reporting concepts behind GASB 34. In March, we'll review the Basic Financial Statements and Notes. We'll finish in April with a guide to the components of the RSI (Required Supplementary Information), including the MD&A.

MEASUREMENT FOCUS

Measurement focus is how you present your financial statements - basically the distinction between business and government sector reporting. There is a clear difference between reporting business-type activities and reporting governmental-type activities: one measures success in profits and capital development, and the other measures how budget obligations are met. In business-type activities the focus is on maximizing revenue, and there is a direct relationship between a service and the price you harge for that service. You are measuring total economic resources, which include your longterm obligations as well as capital assets and infrastructure. By examining the changes in total economic resources, you can better analyze future financial performance, as well as properly measure your current financial position.

In governmental-type activities the focus is on maximizing service and, since there is no direct relationship between service and price, past practice has been to measure changes in current financial resources (only what is needed to support budget obligations). *The major difference between **economic and financial resource measurement** is the way long-term debt and capital assets are recorded and reported.* An ambulance purchase financed by the Vermont Municipal Bond Bank is a good example to help explain this difference.

When you purchase a new ambulance, you will exchange cash of $100,000 for a piece of equipment worth $100,000. You will receive that cash from the Bond Bank, incurring a liability of $100,000. On the balance sheet, if I'm measuring **total economic resources**, I now have an asset worth $100,000 and a long-term bond debt of $100,000. There was no expense and no revenue, so my fund balance didn't change. I incurred a liability but replaced it with an asset.

In future years, I will expense that asset by depreciating it, essentially reducing its value and charging that reduction as an expense, decreasing my fund balance. When I make a payment on the bond, I will be reducing the liability by the amount of the principal payment and charging the interest as an expense, again decreasing fund balance. The bottom line is that I'm financing an ambulance that will be used over the next 20 years by spreading the costs over the life of that piece of equipment, effectively allocating the costs to those who will actually be using it. Business-type activities must report this way in order to assess their long-term financial position and make intelligent capital investment decisions.

With the same transaction, if I use a **current financial resources measurement** approach, I would receive the $100,000 from the Bond Bank and show it as revenue. The liability shows up in the Long-Term Debt Account Group outside of the governmental fund where the operating transactions are recorded. I pay for the ambulance and an expense is incurred. Since there is both an expenditure and revenue, each for $100,000, the fund balance doesn't change.

Transactions for following years would consist of only the principal and interest payments on the bond, both recorded as expenditures in the governmental fund. Debt reduction would be booked in the Long-Term Debt Account Group. The value of the new equipment and its associated debt obligation are not included in the governmental fund, but the debt payments, both principal and interest, are reflected in the operating statement, effectively reducing the fund balance. However, that fund's balance sheet does not reflect the true equity (net worth) because it doesn't include the net value of its capital assets.

With a business-type activity using total economic resource measurement, depreciation and debt interest payment expenses hit the operating statement and decrease the fund balance. In addition, the balance sheet reflects both the value of the depreciated asset and the balance of the outstanding debt. This approach provides more information to the reader about the municipality's management of its capital assets and infrastructure (as well as its long-term debt obligations) than does the current financial resources measurement approach. If the municipality properly records all its assets, the fund balance will truly reflect its equity.

Basis of Accounting

"Basis of accounting" is a term that indicates the method used for the recording of transactions. The difference between **cash, modified accrual and accrual basis** is in the timing of the transactions.

· **Cash basis** accounting records revenue as it is received and expenses as they are disbursed regardless of their relationship to the budget or if the receipts were earned or the expenses incurred.

· **Accrual basis** matches sources of funds to their uses. In other words, revenues are recognized when earned and expenses when a liability is incurred.

· **Modified accrual** is slightly different than accrual in that sources follow uses in the near-term. In other words, revenue is recorded when earned only when it is available to cover the associated liability (appropriation) in the current period. Delinquent tax revenue received six months into the following year won't cover your current year budget expenses. Expenditures are generally recognized when the related fund liability is incurred, except for principal and interest on long-term debt and reductions in long-term liabilities that are recognized as expenditures when they are paid. In general, any revenues received beyond 60 days from year-end are considered new-year transactions for purposes of modified accrual accounting.

Reporting Structure

The reporting for GASB 34 compliance is outlined below, along with the required measurement focus and basis of accounting. (ERMF, ABOA = Economic Resources Measurement Focus, Accrual Basis of Accounting; FRMF, MABOA = Financial Resources Measurement Focus, Modified Accrual Basis of Accounting).

Basic Financial Statements include:

1. Government-Wide Financial Statements (ERMF, ABOA):

a. Statement of Net Assets

✐Governmental Activities (Governmental Funds, Internal Service Fund)

✐Business-Type Activities (Enterprise Funds)

b. Statement of Activities

✐Governmental Activities (Governmental Funds, Internal Service Fund)

✐Business-Type Activities (Enterprise Funds)

2. Fund Financial Statements:

a. Governmental Funds (FRMF, MABOA)

✐Balance Sheet

✐Statement of Revenues, Expenditures and Changes in Fund Balances

✐Budgetary Comparison (optional)

b. Proprietary Funds (ERMF, ABOA)

✐Statement of Net Assets

✐Statement of Revenues, Expenses and Changes in Net Assets
✐Statement of Cash Flows (Cash
Basis of Accounting)
c. Fiduciary Funds (ERMF, ABOA)
✐Statement of Fiduciary Net Assets
✐Statement of Changes in Fiduciary Net Assets

Notes to Financial Statements include:
1. General Disclosures
2. Capital Assets and Long-Term Liabilities
3. Donor Restricted Endowments
4. Segment Information

Required Supplementary Information includes:
1. Management's Discussion and Analysis
a. Analysis of Overall Financial Position and Operations
b. Fund Analysis
c. General Fund Budget Variances
d. Capital Assets and Long-Term Debt Activity
e. Infrastructure
f. Other Potentially Significant Matters
2. Budgetary Comparison Schedules
3. Infrastructure Assets Using Modified Approach

The Government-Wide Financial Statements combine all your funds from governmental activities (all funds except Enterprise and Fiduciary Funds) into one column and all your funds from business activities (Enterprise Funds) into another. They do not include Fiduciary Funds as these are reported separately.

Fund Financial Statements reporting is by major fund type starting with the General Fund, and combining all non-major funds into a column called Other Governmental Funds. A fund is considered major if it is at least 10 percent of either 1) total governmental fund assets, 2) total governmental fund liabilities, 3) total governmental fund revenues, or 4) total governmental fund expenditures, AND it also is at least 5 percent of the combined total of the same for governmental and enterprise funds. In other words, if your Fire District Fund expenditures are at least 10 percent of total governmental fund expenditures AND is 5 percent of total governmental and enterprise fund expenditures, it is considered a major fund.

We will explore these basic financials as well as the required notes to the financials next month. *-Michael Gilbar, Director, VLCT Adminstrative Services*

RESOURCES

✐*GASB Statement 34* (1999) by the Governmental Accounting Standards Board. Tel. 800/748-0659 or visit http://www.gasb.org.
✐*What You Should Know About Your Local Government Finances* (2000) by Dean Michael Mead, available through GASB. Tel. 800/748-0659 or visit http://www.gasb.org.
✐*Governmental Accounting, Auditing and Financial Reporting (GAAFR)* (2001) by Government Finance Officers Association. Tel. 312/977-9700 or visit http://www.gfoa.org.