

What's the Problem? Misunderstood Accounting and Financial Reporting Issues

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Focus of the Session

- Summarization of governmental accounting “half-truths”, as identified by the GFOA in recent issues of *GAAFR Review*
- Clarifications of several technical issues
- Variety of common accounting and financial reporting issues

Governmental Accounting “Half-Truths”

Number of Funds Principle

- Misconception that the “number of funds principle” from NCGA Statement No. 1, *Governmental Accounting and Financial Reporting Principles*, really means “the fewer the funds, the better”
- Better summarization: “use *all* the funds and fund types needed, but *only* the funds and fund types needed – no more, no less”

“Blending” of Fiduciary-type Component Units

- Fiduciary-type component units are aggregated into the fiduciary fund types of the primary government
- Looks and smells like “blending”, although the terms “blending” and “discrete presentation” technically refer to the government-wide treatment
- Governments should refrain from describing such arrangements as “blending”, but rather “including the fiduciary fund statements”

Liabilities in Governmental Funds

- Governmental fund liabilities recognized when “*normally..liquidated with..available resources*”
- GASB Interpretation 6 defines *normally* in the context of general government practice
- Thus, salaries and wages, vendor payables, and similar items that governments generally liquidate when incurred should be reported as liabilities

Operating Subsidies vs. Transfers

- Subsidies between a primary government and its *blended* component units are properly reported as transfers
- The term “transfer” is an *interfund* concept
- Thus, subsidies between a primary government and any *discretely presented* component units should be reported as an expenditure or expense

Special vs. Extraordinary Items

- Extraordinary items must meet *two* criteria (unusual and infrequent) and special items must only meet one of these
- Thus, some have concluded that is all that is needed for a special item
- Additional criteria has to be met for a special item – *subject to management control*

Treatment of Long-term Borrowing in Governmental Funds

- “Outside” long-term borrowing in a governmental fund is treated as an OFS
- “Internal” long-term borrowing is treated as a fund liability in a governmental fund (this distinction applies only to borrowings *within* the primary government)
- Long-term borrowing between a governmental fund and a discretely presented component unit should be treated as “outside”

Transactions with Discrete Component Units

- As a general rule, transactions between a PG and a discretely presented component unit is treated like an outside party transaction. Of course...there is an exception...the sale/purchase of capital assets/financial assets
- With such transactions *within the financial reporting entity*, the transferee (recipient) should be recognized at the transferors carrying value

Application of Refunding Debt Proceeds as OFU

- Applying the proceeds of refunding debt is reported as an OFU
- However, this is only for *advance* refundings, where the proceeds are being placed in escrow
- If it is a *current* refunding, where the proceeds are immediately being applied to refund debt, the use should be reported as an expenditure

Voluntarily Declaring a Fund to be “Major”

- Major fund reporting is appropriate for governmental funds and enterprise funds only
- Within the governmental fund category or the enterprise fund type, any fund may be “declared” to be a major fund
- This option is *not* available for internal service funds or fiduciary funds, where major fund reporting is not appropriate

Interest Capitalization in Proprietary Funds

- Interest capitalization is required in *enterprise funds*
- Although they use the same measurement focus and basis of accounting, interest capitalization is not allowed in internal service funds
- Financing costs must be excluded from functional costs for the governmental activities, thus interest cannot be capitalized for internal service funds that may be allocated therein

Netting Disaster Losses Against Recoveries

- Insurance recoveries are netted against losses, if the loss and recovery occur in the same year (for government-wide, proprietary fund and fiduciary fund reporting)
- FEMA grants, however, are not netted and the loss and receipt of FEMA funds are reported as separate events

Private vs. Public Sector Cash Flows

- Private – operating/financing/investing activities
- Public – operating/noncapital financing/capital financing/investing activities
- Operating for private means anything on the operating statement; for public, it only means the operating category
- Interest is NOT investing in the public sector, but the purchase of capital assets would be

Governmental Funds and Capital Assets

- Governmental funds do not report capital assets
- However, capital assets are only such if used in operations
- Thus, capital assets that are simply being held for re-sale (e.g., foreclosures), should be reported as financial assets in the governmental fund (properly captioned)

Various Technical Issues

Using the term “Deferred Revenue”

- Historically, revenue recognition occurs at a later point because
 - Revenue generation is not complete (e.g., grant eligibility not met)
 - Revenue is associated with a *future* period (e.g., prepaid taxes)
 - Revenue is not yet available

“Deferred Revenue” (cont.)

- If revenue generation is not complete, a liability is reported (e.g., unearned revenue or due to grantors)
- If other situations exist, proper reporting would be *deferred inflow of resources*
- The term “deferred revenue” is acceptable for the latter, but not in situations where the revenue is reported as a liability
- Other options are recommended.....

What Constitutes a Commitment?

- Various questions in past Implementation Guides to deal with question
- Resolution? Ordinance? – The guidance says the “most binding” action.
- Some governments say both are equally binding, and that it is theoretically possible, but highly unlikely (thus, governments should refrain from such references)

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Key Provisions

- Investments reported at fair value
 - Quoted market prices
 - Amount exchanged between willing parties
- Applicable to....
 - Participating interest-earning investment contracts
 - External investment pools
 - Open-end mutual funds
 - Debt and equity securities

Exceptions to Fair Value Accounting and Reporting

- Money market instruments with *original* maturity of one year or less – cost / amortized cost
 - Commercial paper
 - Banker’s acceptances
 - T-bills
 - Does not include asset-backed securities, derivatives and structured notes
- Non-participating interest-earning investment contracts – cost
- SEC-registered 2a-7 funds (NCCMT) – cost / amortized cost
- Pools with legally binding guarantees for share prices (STIF) - cost

GASB Statement No. 31

Specific Reporting Requirements

- Changes in fair value reported when they occur
- NO separation of realized vs. unrealized
 - Exception for external investment pools
 - Separate note disclosure allowed for both
- Operating statement implications
- Note Disclosures
 - Methods/assumptions used to estimate fair value
 - Amortized cost option
 - Definitions of realized vs. unrealized gains/losses

Common Problems

Obsolete Terminology to Describe Fund Balance

- Reserved, unreserved, designated are no longer appropriate fund balance references or classifications
- ALL references should be modified
 - Letter of transmittal
 - MD&A
 - Note disclosures

Inadequate Analysis of Significant Changes in Financial Position

- The MD&A should include an analysis of significant changes in financial position
 - Governmental activities
 - Business-type activities
 - Individual major funds
- MD&A still lacking in any real analysis or reasons for change in the verbiage

Failure to Describe Significant Capital Asset and Long-term Debt Activity

- MD&A still lacking in its description of significant capital asset and long-term debt activity
- Not unusual for it to be completely missing
- The MD&A should be consistent with the type of information that is included in the note disclosures

Incorrect Reporting of Shared Taxes

- *Shared* taxes are technically *not* a tax from the recipient government's perspective
 - *Levied* taxes NEVER reported as program revenue
 - *Shared* taxes are often appropriately reported as program revenue
 - *Shared* taxes that are not restricted but are general revenues should be *intergovernmental* and not part of general tax revenues

Inadequate Disclosure for Encumbrances

- GASB 54 prohibited encumbrances from being reported as a component or subcomponent of fund balance on the balance sheet
- Instead, “significant encumbrances should be disclosed in the notes...by major funds and nonmajor funds in the aggregate...”
- While balance sheets not a major problem, governments still tend to retain their pre-GASB 54 disclosures and not as part of significant commitments or at the required fund level of detail

Inadequate Disclosure for Special Revenue Funds

- “...one or more specific restricted or committed revenues should be the foundation for a special revenue fund.”
- Other resources may supplement but should not supplant
- Disclosure should be made regarding “...which revenues and other resources are reported in each of these funds.”

Failure to Provide Adequate Disclosure for Assigned Fund Balance

- Note disclosures should identify “...the body or official authorized to assign amounts to a specific purpose...” and describe “...the policy established by the governing body pursuant to which that authorization is given...”
- Reviewers are noting significant deficiencies in both requirements

Incomplete Information on Funded Status of Postemployment Benefits

- Governments that offered defined benefit plans (retirement or OPEB) are required to include multi-year trend information on funding progress as RSI
- Also required to disclose funding progress data in the notes
- *Both* require (1) covered payroll and (2) employer's unfunded actuarial liability as a % of covered payroll
- This info is often absent from the RSI and/or notes.

Incorrect Amounts Reported in the Schedule of Direct/Overlapping Debt

- There should be consistency between debt capacity schedules and the basic financial statements
 - Amounts should include discounts, premiums, and other adjustments
 - Deep-discount debt should agree with accreted amounts reported in the basic financial statements