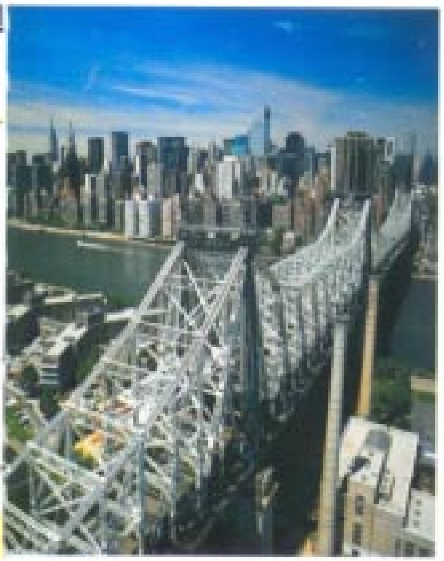
New Look for Government Statements



State and local governments will be disclosing much more information on their financial statements.

By Howard W. Wolosky

Annual financial reports of state and local governments will soon be a gold mine of information for those interested in evaluating a government's financial well-being. The reason is a whole new set of rules in the Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements — and Management's Discussion and Analysis — for State and Local Governments.* They go into effect for larger governments (those with total annual revenue of $100 million or more) for fiscal years beginning after June 15, 2001. Other governments will get an extra one or two years to comply. The statement represents an immediate business opportunity for accountants as many governments will need help in complying with it.

GASB Chairman Tom L. Allen describes it as the "most significant change in the history of governmental accounting. It represents a dramatic shift in the way state and local governments present financial information to the public."

What They Will Show

The new basic financial statements will be preceded by a management's discussion and analysis (MD&A) and followed by the required supplementary information (RSI). Although the MD&A is considered RSI, the decision was made that it should come before the basic financial statements.

MD&A. The MD&A will contain the government's financial manager's analysis of its overall financial position and the results of the previous year's operations. There will be a two-year comparison using government-wide financial information about assets, liabilities, revenues, and expenses. Significant variations in fund-based financial results will be explained and capital asset and long-term debt activity for the year will be described. There will also be a discussion of facts, decisions, or conditions that are expected to have a significant impact on the government's future financial position and operations.

The statements. The annual reports will contain more comprehensive financial information. Government-wide statements will be prepared using full accrual accounting and they will have to be statements of net assets as well as all of the government's activities, not just those that cover costs by charging a fee for services, as currently required. The reporting isn't limited just to current assets and liabilities either, but also includes capital assets and long-term liabilities such as buildings and infrastructure, including bridges and roads, and general obligation debt. By using accrual accounting, all of the revenues and costs of providing services each year will be reported, not just those that are due or paid in the current year, or soon thereafter.

The statement of activities in the government-wide statements will report on the expenses and revenues in a format that focuses on the net cost of each of the government functions. Depreciation expenses will be reported for capital assets, except for infrastructure assets where the government manages those assets using a qualified asset management system whereby it can document that the assets are being preserved at a level established and disclosed by the government in the RSI.

Effect on Tax-Exempt Bond Markets

According to Andrew J. Blossom, partner with KPMG Peat Marwick Kansas City, Mo., member of AICPA's Government Accounting and Auditing Committee and chair of its task force on rewriting its *Government Audit Guide*, the implementation of Statement No. 34 won't initially affect bond markets because "GASB went out of its way to do research about what the users in the financial community need and have retained much of the information that those groups indicated was important to them."

However, he thinks that over time it will have some impact. Blossom explained that bond rating agencies and purchasers will have easier access to information. He gives the example of two similar-purposed bond offerings — one highly leveraged and dependent on debt financing, the other financing its maintenance and construction activity through current user charges. Although Blossom admits you could piece it together from the information that is currently presented, he said it just doesn't jump right out at you.

To qualify for the exception, the government must:

1. Have an up-to-date inventory of the eligible infrastructure assets;

2. Perform condition assessments of the eligible assets and summarize the results using a measurement scale; and

3. Estimate each year the annual amounts to maintain and preserve the assets at the established and disclosed condition level.

A footnote states that "Condition assessments should be documented in such a manner that they can be replicated." The footnote also provides that the condition assessements may be performed by the government itself or by contract.

The statement of activities will have the same level of detail that is in governmental fund statements, generally breaking down the expenses and program revenues by functions, such as public safety. Any overhead and indirect expenses allocated to a particular program must be shown in a separate column; special and extraordinary items must be reported separately from other revenues and expenses.

Statement No. 34 requires governments to continue to present financial statements with information about their funds, but with much more specificity. There are three broad categories of funds for state and local governments, broken down into several types: *Governmental funds*, which relate to the basic activities of the government, include general fund accounts and the special revenue, capital projects, debt service, and permanent funds. *Proprietary funds* spring from activities that are generally financed and operated like private businesses such as enterprise (*e.g.*, fees charged to outside users) and internal service funds. The third fund category is *fiduciary funds* such as pension and other employee benefit and private-purpose trust funds and which cannot be used to support the government's own programs.

Here are a few of the new requirements: Each of the fund statements will have to report separate columns for the general fund and for other major governmental and enterprise funds. Major funds are defined as those whose revenue, expenditures/expenses, assets, or liabilities are at least 10 percent of the total for their fund category or type, whether governmental or enterprise, and at least five percent of the aggregate amount for all governmental and enterprise funds. Additionally, any other fund may be reported as a major fund if government officials believe that the fund is particularly important to financial statement users.

Non-major funds are aggregated in a separate column and internal service funds are also combined in a separate column on the proprietary fund statements. Governmental fund balances are segregated into reserved and unreserved categories and proprietary fund balance sheets must distinguish between restricted, unrestricted assets, current and noncurrent assets and liabilities. Interfund loans and transfers need to be reported separately.

A reconciliation summary must appear to show the interplay between the fund-based and the government-wide financial statements.

RSI. Governments will continue to provide budgetary comparison information in their annual reports in the RSI, but now they will have to provide their original budget as well. This addition to the comparison schedule that already includes the final budget and actual results is to allow for better analysis. Also, the RSI must provide information required by previous GASB pronouncements plus disclosures about the infrastructure assets where the optional method for reporting depreciation is used in the government-wide financial statements.

Effective Dates

The annual revenue of the governmental unit determines the date when it must comply with the new rules. GASB Statement No. 34 is effective for larger governments (total revenue of $100 million or more) in fiscal years beginning after June 15, 2001. Medium-sized governments (total revenue of $10-$100 million) have until fiscal years beginning after June 15, 2002 and smaller governments (total revenue of less than $10 million) until fiscal years beginning after June 15, 2003. The revenue figures that determine which date applies are the government's figures for the first fiscal year ending after June 15, 1999. Earlier implementation is encouraged and specific guidelines are provided.

There is a transition rule for the reporting of infrastructure assets. Prospective reporting of general infrastructure assets is required at the appropriate effective date. Retroactive reporting of all existing major general infrastructure assets is only encouraged at that date. However, larger governments will have to report retroactively all major general infrastructure assets for fiscal years beginning after June 15, 2005 and medium-size government have until fiscal years beginning after June 15, 2006. Smaller governments (those with revenues under $10 million) are encouraged, but not required, to report such infrastructure assets retroactively.

Copies of the new standard can be acquired from the GASB by calling (800) 748-0659.

Impact on Governments

Andrew J. Blossom, partner with KPMG Peat Marwick Kansas City, Mo., member of the AICPA's Government Accounting and Auditing Committee and chair of the AICPA's task force on rewriting its *Government Audit Guide*, sees Statement No. 34 as "moving governments into a realm of reporting activities that they have historically not done."

He pointed out that the financial statements will still retain much of the previous information, so that it satisfies the expressed concerns of the bond markets, but the readers also get additional information reporting on the economic impact of a government's decisions. He uses the analogy that the statements are now more like net worth reports instead of checking account statements under the old rules.

Timothy J. Green, partner in the Monroe, La. accounting firm of Allen, Green & Company, and chair of the AICPA's Government Accounting and Auditing Committee, said the change to full-accrual reporting with depreciation and recording of the infrastructures was the most controversial change in the rules. He sees one of the biggest challenges for some governments is in the reconstructing basis with general purpose ones having the most difficulty. He contrasts this with a school district where the reconstruction is easier.

Although there was a great deal of debate on whether to include the depreciation reporting requirement, Blossom feels that all governments have the ability to do it. He predicted that many large state governments might decide it is best to use the exception and perform periodic condition assessments to show infrastructures as being maintained at a specified level. Green agrees that the larger governments will be the ones that pick this optional method. But, he added some smaller governments might do so if they are adequately maintaining their assets.

The statement of activities might actually change how governments do business, opined Green. He thinks these net cost statements by departments and functions might give governments a lot of heartburn as the numbers for a certain fund may look bad. He gives the example of a police department being funded from an ad valorem tax being collected for general purposes. By the government specifically dedicating the revenue from the ad valorem tax for the police department, the net cost would no longer be as big a negative on the statement of activities since there would now be revenue directly associated with the function.

Certain economic events that have not been historically reported will also show up. Blossom gave two examples. Under the old model, bonds weren't reported as a liability until they became due, while under the new model, the full value of bonds will be shown. The second involves litigation expenses which have to be shown as an expense when the alleged incident is claimed to have occurred, rather then under the old system, when a payout was made.

Green sees the addition of the easy-to-read MD&A as significant. "A nontechnical person can go to the MD&A and get some sense of how the government did and whether it improved or declined during the year, and also if there may be some major events that will impact it long-term."

Some governments might continue keeping their internal books on their current budget basis, while others might keep them on a modified-accrual instead of a full-accrual basis, predicted Green. They would do side calculations and year-end adjustments to convert to full-accrual reporting for their external financial statements, he explained.

Accountant's Perspective

Initially, in adopting to the new requirements, governments may be looking for help. According to Blossom, many will be struggling to get resources as they won't be able to hire full-time staff for a limited project of complying with an accounting standard. He feels accountants can help them through this process. Green also sees accountants playing a prominent role in assisting governments in complying with the new rules.

But everything is not so rosy. Blossom predicted that audits will now take longer while Green said they will be more expensive because of the expanded financial statements and the reporting of depreciation. A particular problem that auditors will face, according to Green, is the evaluation of the government's replicable condition assessments. He points out that if they don't meet the bar under the statement, depreciation reporting could end up being required.

Accountants doing state and local work are at a crossroads. Blossom explained that "We have two accounting standards — one for government and one for all noncommercial entities — as they promulgate more of these rules, the divergence between the two is bound to increase. And as the rules get more and more independent of each other, it will be difficult for accountants to do one or two governmental engagements a year and keep their skills at the appropriate level." Green agreed that "you can't have one foot in and one foot out'" and pointed out there is oversight by the federal government and state regulatory agencies and they can bar an accountant from doing audits.

He also sees the form of the statements themselves as causing greater scrutiny especially the requirement to show the interplay between fund financial and government-wide statements by giving an explanation of why something is shown differently on the two statements. He views them as open books from a liability standpoint increasing exposure and discovery if the auditor or preparer missed something.

New World

Statement No. 34 might produce some interesting results. "Those governments who have planned ahead, are proactive, who try and fund things out of current resources, will show up really well in that regard. For those governments that have historically, through political pressure, tried to keep everything to the last penny and cut corners, some of them will be surprised at where they end up," predicted Blossom. ●