CITY COUNCIL AGENDA ITEM

CITY OF SHORELINE, WASHINGTON

AGENDA TITLE:	Governmental Accounting Standards Board Statement No. 34: Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments (GASB 34)
DEPARTMENT:	Finance
PRESENTED BY:	Debbie Tarry, Finance Director AL Juarez, Financial Operations Manager

PROBLEM/ISSUE STATEMENT:

In June 1999 the Governmental Accounting Standards Board (GASB), which sets "generally accepted accounting principles" (financial reporting rules) for all state and local governments, established a new framework for the financial reports of state and local governments. The new framework or financial reporting model represents the biggest single change in the history of governmental accounting. Known as *Statement No. 34: Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, it represents a fundamental revision of the current financial reporting model, which has been in place since 1979.

The new financial reporting model instituted by GASB Statement No. 34 seeks to improve operational accountability by highlighting the big picture that was sometimes lost in the detail of fund accounting. Some key specific changes in this regard are:

- Introduction of government wide financial statements.
- Expanded focus for governmental activities. In the past, financial reporting for tax supported activities focused solely on near-term inflows and outflows of spendable resources. Governmental activities are now accounted for in the same way as business type activities in the new government wide financial statements.
- Presentation of cost data for both governmental and business type activities.
- Narrative overview and analysis.

The new governmental financial reporting model also seeks to improve fiscal accountability in several important ways:

- Shift in focus to major individual funds.
- Shift in focus to individual fund budgets.
- Inclusion of data from the original budget.
- Infrastructure reporting. The new reporting model requires governments to report infrastructure assets on the face of the financial statements.

For the City of Shoreline the mandatory deadline for implementing the provisions of GASB Statement No. 34 is our fiscal year ending December 31, 2003. Due to the complications associated with the retroactive reporting of infrastructure assets the mandatory deadline for this component of the new reporting model has been established by GASB to be our fiscal year ending December 31, 2007.

This presentation will provide a brief introduction of the new GASB Statement No. 34 reporting model, compelling reasons for implementing the new model, key features of the new model, selected examples of the new model, and the time frame for the City of Shoreline to implement the new model.

FINANCIAL IMPACT:
This action has no monetary financial and/or budgetary implications. It should be noted, however, that many local government entities have experienced financial impact as a result of seeking outside professional services to assist in their implementation process.

RECOMMENDATION

This item is for informational purposes only. No formal action is required.

Approved By: City Manager ______ City Attorney N/A

INTRODUCTION

In June 1999, the Governmental Accounting Standards Board (GASB), which sets "generally accepted accounting principles" (financial reporting rules) for all state and local governments, established a new framework for the financial reports of state and local governments. The new framework or financial reporting model represents the biggest single change in the history of governmental accounting. Known as *Statement No. 34: Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, it represents a fundamental revision of the current financial reporting model, which has been in place since 1979.

After significant discussion with our State Auditors office, local finance professionals, who had convened a committee to analyze the new pronouncement, determined that the following three compelling reasons were justification for local governments to implement these resounding changes:

1. <u>It is Generally Accepted Accounting Principles (GAAP)</u>. This is probably the most compelling reason for implementing the new model. GASB is the acknowledged authoritative body in setting GAAP for local and state agencies. Maintaining citizen confidence in our stewardship of the assets entrusted to us requires credibility and integrity in our accounting and financial reporting system. Preparing audited financial statements in accordance with industry standards is an essential foundation in gaining and sustaining this trust.

2. <u>The new model is supported by a number of users and professional associations</u>. The National Association of State Auditors, Comptrollers and Treasurers, credit rating agencies (the primary "users" of these reports), the Washington Finance Officers Association, and the Government Finance Officers Association have all recommended the implementation of GASB 34. There are many public works' officials who believe the new reporting model will result in a better understanding of infrastructure needs. Additionally a number of municipal finance professionals believe the new reporting model articulates a city's fiscal story much better and is a significant improvement over the current model.

3. <u>Usually required for grants and long-term financing</u>. In most cases, granting agencies and firms who review and monitor long-term financing, require the submission of audited financial statements. Those entities that do not implement GASB 34 will receive a qualified opinion (as opposed to an unqualified opinion) on their financial statements. Such opinions may have a negative impact with respect to grant compliance and long-term financing.

Key Features of the New Model.

Even though the new governmental financial reporting model has deep roots in traditional public sector accounting and financial reporting, it offers many new features. The most important of these new features are:

1. <u>Government-wide financial reporting</u>. For the first time, users of state and local government financial reports have access to government-wide financial statements that provide a clear picture of the government as a single, unified

entity. These new government-wide financial statements complement rather than replace traditional fund-based financial statements.

2. Additional long-term focus for governmental activities. Traditional reporting for tax-supported (governmental) activities has focused on *near-term* inflows, outflows and balances of *spendable* financial resources. The new financial reporting model retains this short-term focus in the governmental fund financial statements while providing a long-term perspective on these same activities in the government-wide financial statements.

3. Narrative overview and analysis. The new governmental financial reporting model provides financial report users with a simple narrative introduction, overview and analysis of the basic financial statements in the form of management's discussion and analysis (MD&A).

4. Information on major funds. It is widely agreed that fund information is most useful when presented for *individual* funds rather than for aggregations of funds (e.g., all special revenue funds – Street Fund, Development Services Fund, and Public Arts Fund). Accordingly, the new governmental financial reporting model presents individual fund data for each of a government's *major funds.*

5. Expanded budgetary reporting. In the past, budgetary comparisons were based solely on the final amended budget. Under the new governmental financial reporting model, information on the original budget also is presented. In addition, the new model eliminates aggregated budget presentations (e.g., totals for all budgeted special revenue funds) in favor of comparisons for the general fund and each individual *major fund.*

6. Infrastructure reporting. The new governmental financial reporting model requires that governments report their infrastructure assets on the face of the financial statements. Infrastructure assets include roads, bridges, tunnels, drainage systems, water and sewer systems, dams and lighting systems. Normally, capital assets including infrastructure must be depreciated. Governments, however, may replace the requirement to depreciate a given network or subsystem of infrastructure assets by promising to maintain the network or subsystem at a condition level predetermined by the government. This alternative approach has been termed the "modified approach."

   The City of Shoreline has determined that the depreciation of infrastructure assets would be more efficient and less costly of the two approaches available and accordingly has elected to utilize this option.

Dual Perspective in Presenting Financial Statements. There will be two distinct sets of financial statements:

1. Government-wide statements. These are consolidated financial statements for all of the agency's operations on a full accrual basis of accounting. They will not be presented on a fund basis; instead, fiscal operations will be organized into two major activities: governmental and business-type.

These statements will have a "net asset" focus, and include a number of interfund eliminations such as internal service and fiduciary funds. Costs will be shown net of related revenues such as fees and grants.

2. Fund statements. In meeting stewardship and accountability concerns, there will be another set of financial statements presented on a fund basis - but not using the same basis of accounting as the government-wide statements.

There will be significant differences between these two financial statements, but they will not be obvious. For this reason, a detailed reconciliation between the two statements will be required.

Additionally, in the "fund section" of the report, statements will focus on major individual funds rather than on fund types.

Required Supplementary Information (RSI). There are two elements to RSI:

1. Management's discussion and analysis (MD&A). It is often difficult for those who are not accountants to know what to look for in a set of financial statements. This problem is especially acute in the public sector because of fund accounting. To ensure that readers do not get lost in the detail, the new financial reporting model requires that financial statements be introduced by a brief narrative overview and analysis, known as management's discussion and analysis, providing management's perspective on the financial picture presented in the accompanying financial statements.

2. Budget reporting. Comparisons of "budget-to-actual" results for the governmental funds will no longer be required as part of the "basic" financial statements, but is required within RSI. Additionally we are required to present both the original and final budget versions.

No Account Groups. General fixed assets and long-term debt will no longer be shown as account groups. They will now be included in the government-wide statements as fund assets and liabilities.

Depreciation for Governmental Activities. Under the current reporting model, depreciation is not recorded for "governmental" capital assets, such as those purchased through the General Fund (i.e. the Shoreline Pool or Police Station). The new model, however, will require depreciation of general fixed assets; and correspondingly, the "government-wide" financial statements will not show capital expenditures (nor will they show the principal component of debt service payments as expenditures), but the fund-based statements will.

Recording Infrastructure as Capital Assets and Expensing Recovery Through the Use of Depreciation. Current accounting principles do not require reporting the historical cost of infrastructure such as roads, bridges and traffic signals as capital assets - not because they aren't major community investments, but because they are immovable, and only of value to the government.

The new reporting model will require that all infrastructure be reported at its "historical" (not current) value, and then depreciated. This requirement means that the City's reportable assets on the balance sheet will increase and conversely the expense to account for depreciation will also increase.

Infrastructure assets, usually treated the same way as other capital assets, initially are capitalized at their historical cost and subsequently depreciated over the estimated useful lives of the assets. Still, governments have the *option* of replacing the requirement to report depreciation expense for networks or subsystems of infrastructure assets that meet the following requirements:

1. The government must have an up-to-date inventory of the assets of those networks and subsystems.

2. The government must perform or obtain condition assessments of those assets and summarize the results using a measurement scale. It is essential that such condition assessment be replicable; i.e., conducted using methods that would allow different measures to reach substantially similar results.

3. The government must make an annual estimate of the amount needed to maintain and preserve those assets at a condition level established and disclosed by the government.

4. The government must document that infrastructure assets are being preserved at or above the condition level established and disclosed by the government.

Governments electing this option (*modified approach)* to infrastructure reporting for one or more networks or sub-systems of infrastructure assets are required to present two types of information regarding those assets. First, the entity must present the *results of the three most recently completed condition assessments* to demonstrate that infrastructure assets have been maintained at or above the condition level established by the government. Second, they must disclose both their estimates of the amount needed to maintain or preserve infrastructure assets at the level established by the government and actual amounts of expense *for each of the past five reporting periods*. The purpose of this second schedule is to allow users of the financial statements to make their own assessment of the government's long-term commitment to maintaining those infrastructure assets.

After careful consideration the City of Shoreline has determined that the depreciation method will provide the City the most efficient and cost effective alternative.

IMPLEMENTATION STATUS

New Reporting Model

The following are comments on each of the required elements of the new reporting model and the City's current status:

ELEMENT	STATUS
Management Discussion and Analysis	This is a new element for our City and will be developed to include all required reporting items for the reporting period ended December 31, 2003.
Government-Wide Financial Statements	A new element.
Governmental Fund Financial Statements	In current reports, but new GASB 34 requirements change the format.
Proprietary Fund Financial Statements	City does not have any proprietary funds.
Fiduciary Fund Financial Statements	In current reports. No significant changes are anticipated.
Notes to the Financial Statements	In current reports, but changes and additions required under the new model.
Required Supplementary Information Other Than MD&A	A new element requiring actual results be compared with both the original and the final amended budget.
Infrastructure Reporting and Depreciation	Not an independent element, but a significant new requirement. The City has adopted the depreciation method and has completed inventories for all major infrastructure components. The valuation process is currently underway.

IMPLEMENTATION TIMELINE

Within the original pronouncement, the GASB outlined an implementation schedule based on the financial size of the agency and it's fiscal year election. Pursuant to this schedule the City of Shoreline will implement the requirements of the new reporting model for the fiscal year ended December 31, 2003. The GASB, however, has also adopted a separate implementation schedule for retroactive reporting of infrastructure assets and applicable depreciation, which is the fiscal year ending 2007. Staff is diligently analyzing our infrastructure asset inventories in order to coordinate an early implementation, phased-in approach to this aspect of the new reporting requirements. Our current goal is to have all infrastructure assets appropriately valued, depreciated and booked no later than the period ending December 31, 2004.

SUMMARY
GASB 34 represents a major change in financial reporting for local and state governments. While there are concerns about the value of some of these changes (most notably infrastructure reporting), there is widespread agreement that cities should implement these changes in order to prepare audited financial statements in accordance with generally accepted accounting principles (GAAP).

The City of Shoreline's Finance Department has been carefully planning and allocating resources for the past year necessary to successfully implement the GASB Statement No. 34 reporting model in the allotted time frame. Although this project has certainly been a challenge for all those involved, knowing that we are shaping the future of local government financial reporting has provided a common element of pride and compassion.

RECOMMENDATION

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