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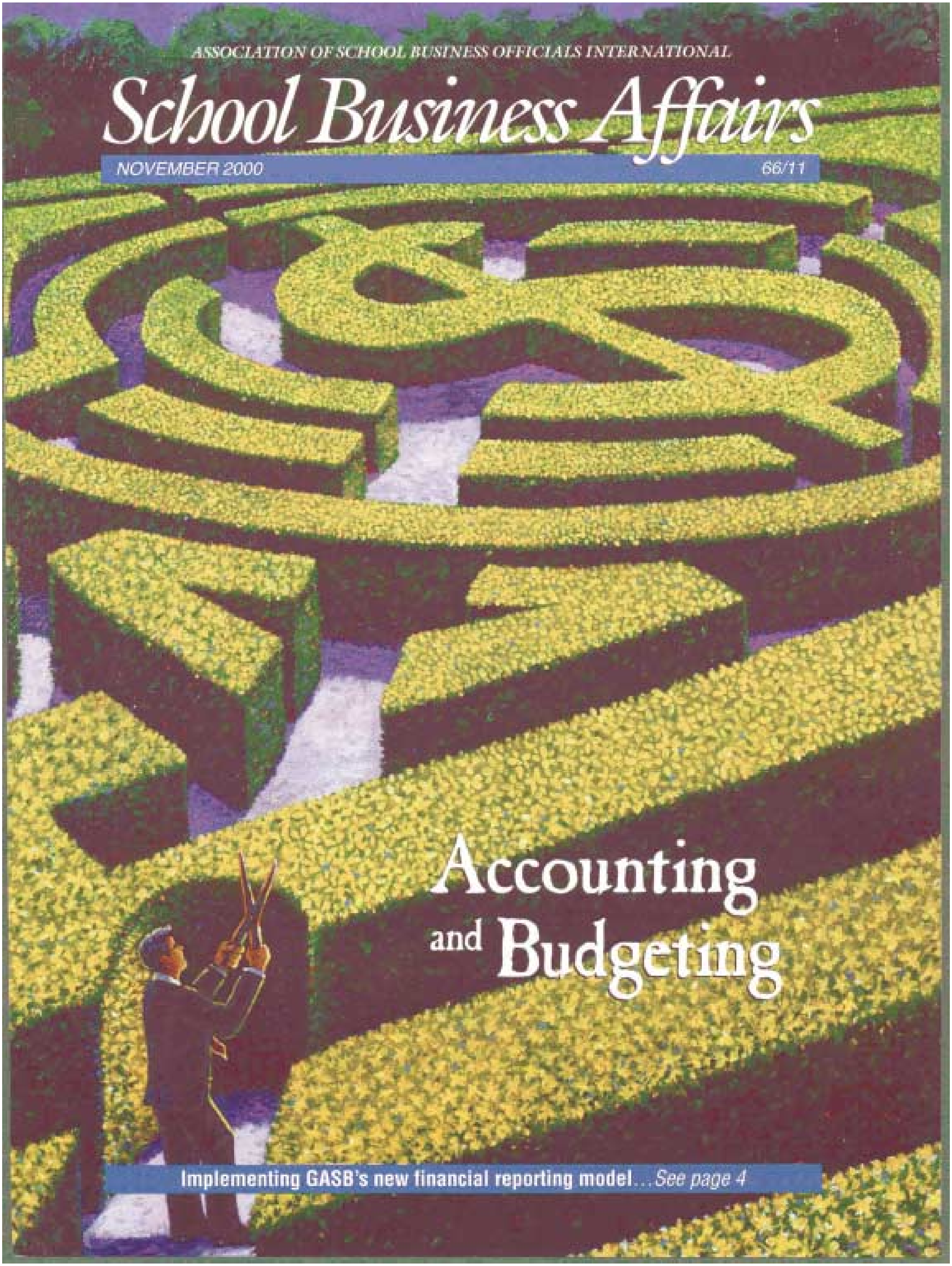


Accounting and Budgeting

Implementing GASB's new financial reporting model... See page 4

Sharpen Your Pencils and Roll Up Your Sleeves: A Case Study in Implementing GASB's New Financial Reporting Model

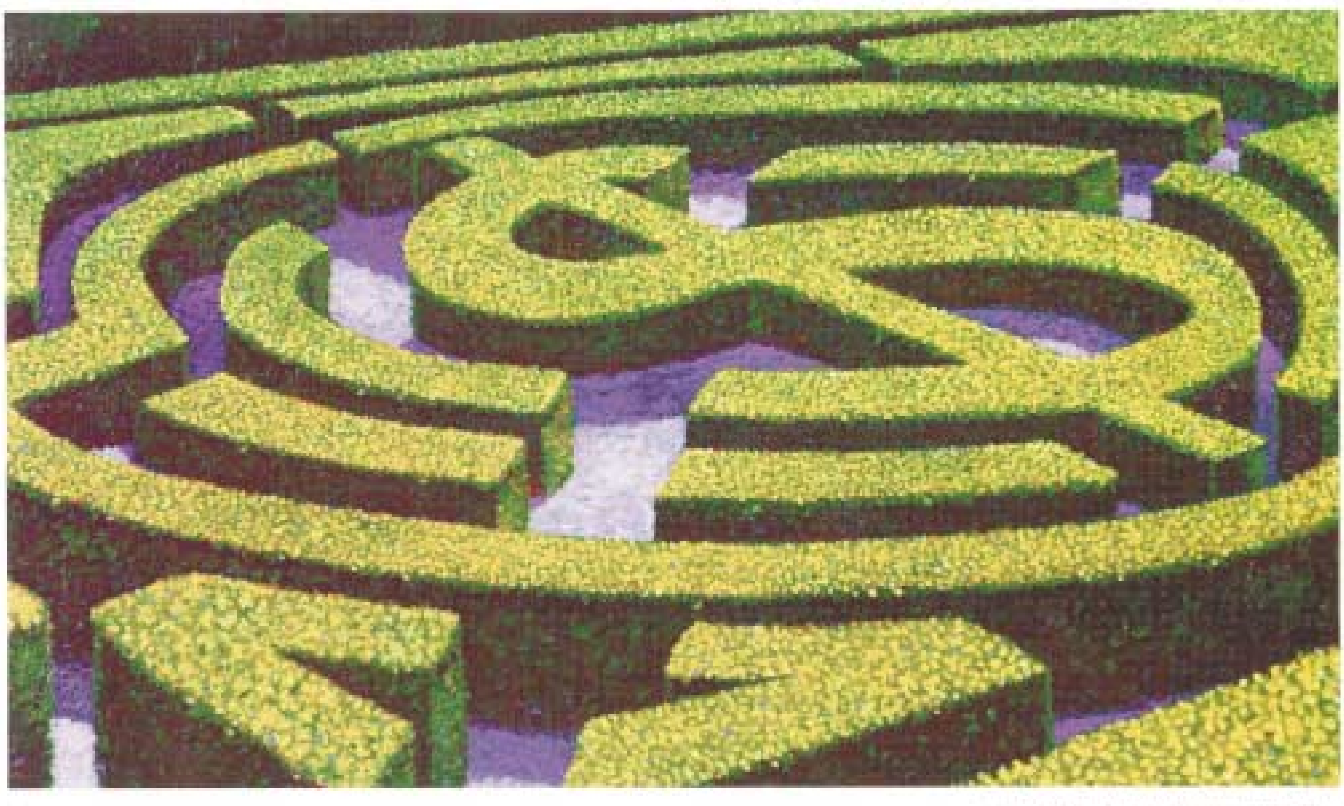
By Tim Green, CPA, Margie E. Williamson, CPA, and William L. Endris, Jr.

The Vernon Parish (Louisiana) School Board (district) early implemented Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments* (GASB 34), for the fiscal year ending June 30, 1999. This article explains that experience and provides a lesson plan for others facing the same assignment. An article in the October 1999 edition of *School Business Affairs* explains the provisions of GASB 34.

Summary of Experience

Implementing GASB 34 was not only mentally challenging, it also required a large, tedious accounting effort. GASB 34 (commonly referred to as the "new financial reporting model") requires that the governmentwide financial statements use the economic resources measurement focus and accrual basis of accounting. The district did not enter the adjustments from modified accrual to accrual in its accounting records. A large part of our implementation challenge concerned capital assets.

The resulting comprehensive annual financial report (CAFR) was more informative yet more daunting than it had previously been. The readers of the district's report



will need time to understand it and to establish benchmarks for grading the district's performance from year to year and for comparing that performance with that of other districts. Both the management's discussion and analysis (MD&A) and the governmentwide financial statement are enlightening and a substantial enhancement to the financial report.

Implementing GASB 34 was a great team effort between the district's department of finance and its independent auditors, with assistance from the Office of the Louisiana Legislative Auditor. The endeavor was hard work but brought pride of accomplishment and fabulous media recognition. Special thanks go to the district's superintendent and board for their support.

Our discussion of the issues we faced and the ways in which we resolved them is intended to be informative only, not directional. Each district will face myriad issues and may need to solve the ones we discuss differently from the way we did, depending on particular facts, circumstances, and materiality.

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Implementing GASB 34 was not only mentally challenging, it also required a large, tedious accounting effort.

Background

The district is the sole public school system in rural Vernon Parish. It has a student population of 10,000, 19 school buildings, and a central office building. The district reports approximately 40 funds in its CAFR, but has no component units or proprietary funds. Allen, Green & Company, LLP, has been the district's auditors for the past 8 years. The district recently received ASBO's Certificate of Excellence in Financial Reporting for its 1999 CAFR.

Reasons for Early Implementation

The district was not required to implement GASB 34 until fiscal year ending 2003. (An individual district's implementation date ranges from fiscal year ending 2002 to fiscal year ending 2004, depending on the amount of its revenues in fiscal year ending 2000 and depending on whether it is a component of another government.) However, the director of finance liked the auditors' suggestion of early implementation. There was appeal in giving back to the school business official profession by providing a report example and communicating to others the issues encountered, thus easing the burden for those who followed. Also, the district might receive favorable recognition for leadership in government accounting and financial reporting and good stewardship of public dollars.

Homework

The district's auditors were familiar with GASB 34, having testified at two of the GASB public hearings on the project. Also, a member of the audit firm had served on the American Institute of Certified Public Accountants (AICPA) Governmental Accounting and Auditing Committee during the last 5 years of debate on GASB 34. That background made implementation less daunting than it might have been for many preparers and auditors. Also, with that background, the district decided to outsource much of the initial implementation work to the auditors, with the district becoming substantially more involved in subsequent years.

Even with a strong background in the particulars of the new financial reporting model, much homework was needed. Our primary chores related to the MD&A, fund classifications, and converting accounting data from modified accrual to accrual.

Developing the district's MD&A involved overhauling the municipal MD&A illustrated in GASB 34 to fit a school district. Since the district's CAFR was issued, illustrative MD&As for school districts have been issued in the GASB staff's *Guide to Implementation of GASB Statement No. 34 on Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Questions and Answers* (GASB 34 Q&A) and ASBO International's *Statement 34 Implementation Recommendations for School Districts.*

We had to evaluate the child nutrition and student activity funds in light of the new definitions included in GASB 34 for enterprise funds and agency funds, respectively. GASB 34 permits any activity that charges a fee to external users to be reported as an enterprise fund. It also requires an activity to be reported as an enterprise fund if the activity's principal revenue source meets any one of the following criteria:

- The revenue source is financed with debt that is secured solely by a pledge of the net revenues from fees and charges of the activity.
- Laws or regulations require that the activity's cost of providing

services, including capital costs (such as depreciation or debt service), be recovered with fees and charges, rather than with taxes or similar revenues.

- The pricing policies of the activity establish fees and charges designed to recover its costs, including capital costs.

The district concluded that its child nutrition program did not meet the definition requiring reporting as an enterprise fund. That was because the amount of reimbursement the district receives from the federal government for each free or reduced meal served is set nationally and federal regulations generally prohibit the district from expending child nutrition funds for land and buildings. In addition, the program's fees and charges are not set to cover equipment, land, or building costs. The program was reported as a special revenue fund.

We also deliberated the more restrictive definition of agency funds. The issue was whether the district's student activity funds should be special revenue or agency funds. Are assets held strictly in a custodial or fiduciary capacity? Does the fund include assets that will be forwarded to another fund of the district? The district concluded that its student activity funds should continue to be reported as agency funds because of certain Louisiana statutory requirements. For example, budgeting is not required for agency funds, whereas all special revenue funds must be budgeted; a separate bank account for student activity funds is required; and the school principals are responsible for the custody and operating practices of the student activity funds. However, in some states, districts collect and disburse student activity funds at the central office and prepare budgets for the student activity funds, and if unused at year-end, the monies revert to the district's general fund. In those situations, the student activity funds may be more appropriately reported as special revenue funds.

We also had to determine the accounting differences between the current resources measurement focus–modified basis of accounting and the economic resources measurement focus–accrual basis of accounting for the activities reported in the government funds. Some differences were fairly obvious: capital outlay versus depreciation expense, principal payments on debt, and interest expense recognized when due versus accrued daily. Other differences were more subtle: revenue recognition when measurable and available versus when earned (or otherwise accruable), liability recognition when due and payable versus when incurred, and gain or loss on the sale of capital assets versus proceeds from the sale. GASB 34 provides examples of the accounting differences between the governmentwide financial statements and the government fund financial statements. The district also implemented GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions* (GASB 33). Beyond the specific examples provided in GASB 34 and GASB 33, we examined other significant revenue and expenditure items by asking ourselves, "Has the revenue been earned or the liability been incurred?" If the answer was yes, we researched whether an additional accrual would be needed for the governmentwide financial statements.

GASB 34 tweaks the traditional fund-based financial statements by replacing the fund type display for government and enterprise funds with columnar displays of the main operating fund (the general fund) and other major funds.

Test Results

Management's Discussion and Analysis

GASB 34, paragraph 11b, requires that the MD&A include certain comparisons of governmentwide financial information from the current year with that of the prior year. This might have been a problem because the district did not have that information for the prior year. However, paragraph 145 of GASB 34 provides that in the first period that GASB 34 is applied, governments are not required to restate prior periods for purposes of providing the comparative data for MD&A. Instead, GASB 34 requires a statement in the MD&A alerting the reader that a comparative analysis of governmentwide data will be provided in future years.

Initially, we were concerned about the overlap of information between the MD&A and the CAFR transmittal letter. In the first draft of the transmittal letter, the district included a sentence alerting readers that in instances of overlap, the details were included in the MD&A. However, as the district further developed its MD&A, it seemed the MD&A was more focused on the governmentwide financial statements, whereas the transmittal letter was directed more toward the fund financial statements. Therefore, the district removed the referencing sentence from the transmittal letter, concluding that the overlap did not merit mention. However, item 7 in the subsequently issued GASB 34 Q&A states that any overlap should be included in the MD&A and that, in areas where overlap could occur, the transmittal letter could refer to the MD&A. Accordingly, the district's future reports will address any overlap using the guidance in the GASB 34 Q&A.

Required Supplemental Information

GASB 34 makes the reporting of required supplemental information

(RSI) a major element of a government's annual report through its requirement for MD&A and a provision that encourages RSI presentation of budgetary comparison information. Previously, districts rarely presented RSI in their annual reports. (See Table 1 for items that may be included in a district's RSI.) This addition raised questions regarding the auditor's responsibility for RSI. Section 558, "Required Supplemental Information," of the AICPA *Codification of Statements on Auditing Standards* provides auditors with RSI guidance. The auditor is not required to audit RSI but must perform certain limited procedures and may need to add information about those procedures and their results to the auditor's report. However, the auditor's *opinion* on the fair presentation of the financial statements in conformity with generally accepted accounting principles (GAAP) will not encompass the RSI or be affected by whether or how the RSI is presented unless the auditor has been engaged by the district to audit the RSI.

Major Funds

GASB 34 tweaks the traditional fund-based financial statements by replacing the fund type display for government and enterprise funds with columnar displays of the main operating fund (the general fund) and other major funds. GASB 34, paragraph 76, requires an individual government or enterprise fund to be reported as a major fund if (1) total assets, liabilities, revenues, or expenditures and expenses of that fund are at least 10% of the corresponding total for all funds of that category or type; *and* (2) the total assets, liabilities, revenues, or expenditures and expenses of that individual fund are at least 5% of the corresponding total for all government and enterprise funds combined. Both percentage criteria must be met for the same element.

The district was concerned that there might be a large number of major funds and about annually reformatting the report should the individual major funds change each year. The district's major funds turned out to be the typically largest funds for a district—the general, child nutrition, and Title I funds. In fact, the child nutrition and Title I funds teetered on the edge of meeting the major funds criteria; ultimately, they did not meet the criteria. However, we speculated that those two funds would probably be close to meeting the criteria each year. Rather than facing the potential of reformatting the report each year, and given that GASB 34 permits districts to report any government or enterprise funds as major, the district decided to display those two funds as major. No other fund came close to meeting the major funds criteria. In hindsight, we believe that many districts may have few major funds because the lion's share of many districts' revenues and expenditures are reported in the general fund. On occasion, capital projects and debt service funds may meet the criteria for reporting as major funds.

Capital Assets

For some districts, capital asset accounting may be the most burdensome part of implementing GASB 34. A companion article, "Asphalt, Fleets, Bricks, and Mortar," which describes the district's experience in implementing the new capital assets standards, is included elsewhere in this issue of *School Business Affairs*.

Accounting and Report Preparation

We were unpleasantly surprised with the large amount of time it took to develop the accounting information and change the report for GASB 34 requirements. Table 2 identifies some of the tasks we faced.

Except for enhancements to the capital asset records, the district made no significant changes in its accounting records when implementing GASB 34. Consistent with past years, the district maintained its accounting records during the year on a cash basis and made year-end adjustments in the general ledger to step up to the modified accrual basis of accounting. The adjustments needed to convert to the accrual basis of accounting for the governmentwide financial statements were made without general ledger entries. Those accrual-based adjustments were calculated after the financial results and balances for all funds had been consolidated, making it unnecessary to identify the effect of those adjustments on each of the district's 40 funds.

GASB 34 dictates the placement of several items, such as the MD&A, the budgetary comparison information, and the financial statement reconciliations. Beyond mandated placements, the district's goal was to make the report format as similar to that of the previous year as possible. We thought that presentation consistency would ease the transition for both the preparer and the users of the financial statements.

Table 1
Annual Report Structure for School Districts

<table>
<tr><td>Required Supplementary Information</td><td colspan="4">Management's Discussion & Analysis (MD&A)</td><td>Outside the Scope of the Audit</td></tr>
<tr><td rowspan="4">Required Reporting in Conformity with Generally Accepted Accounting Principles</td><td colspan="4">Basic Financial Statements</td><td rowspan="4">Included in the Scope of the Audit</td></tr>
<tr><td rowspan="2">Government-wide Financial Statements</td><td colspan="3">Fund Financial Statements</td></tr>
<tr><td>Government Funds</td><td>Proprietary Funds</td><td>Fiduciary Funds</td></tr>
<tr><td colspan="4">Notes to the Basic Financial Statements</td></tr>
<tr><td>Required Supplementary Information</td><td colspan="4">Budgetary Comparison Information
Modified Approach Information (Infrastructure Assets)
Pension Information (for Certain Plan Types)</td><td>Outside the Scope of the Audit</td></tr>
</table>

Table 2
Initial Homework Assignments

- Study Governmental Accounting Standards Board Statement No. 34 (GASB 34) and other research books (see Table 3) and obtain training on GASB 34.
- Determine whether the district qualifies as a special-purpose government engaged in a single program, thus allowing for fewer or modified financial statements. Although possible, it is extremely unlikely that a school district would be engaged in a single program (GASB 34, paragraphs 135–137).
- Determine and quantify the differences between the current financial resources measurement–modified accrual basis of accounting and the economic resources measurement focus–accrual basis of accounting (such as calculating depreciation expense, accrued interest on general long-term debt, and the gain or loss on the sale or other disposition of capital assets).
- Change the layout of the annual financial report. GASB 34 dictates the placement of certain items, such as the management's discussion and analysis (MD&A), other required supplemental information (RSI), and the financial statement reconciliations.
- Draft the MD&A.
- Add the governmentwide financial statements.
- Determine which funds to report as major funds (GASB 34, paragraph 76).
- Format the fund financial statements for major funds display.
- Revise the notes to the basic financial statements to focus on the district's government activities, business-type activities, major funds, and aggregate nonmajor funds; delete obsolete notes; add new notes; and change the terminology in the notes.
- Change the terminology throughout the report.
- Revise and relocate the budgetary comparison information and certain note disclosures to RSI.
- Format the combining statements and schedules to display nonmajor funds only.
- Prepare the reconciliations between the fund financial statements and the governmentwide financial statements.
- Revamp the capital asset inventory listing so that information is available to calculate depreciation.
- Determine the assignment of capital assets to be able to charge depreciation expense to each functional category.
- Determine the reporting of depreciation expense for capital assets used by multiple functions, including functional allocations if appropriate.
- Determine which changes may be necessary for GASB 34's changes in fund definitions.
- Determine the eliminations needed for internal balances and activities (GASB 34, paragraphs 58–62).
- Differentiate program revenues and general revenues.
- Analyze program revenues to identify charges for services, operating grants and contributions, and capital grants and contributions.
- Identify special and extraordinary items.
- Calculate the amounts of the net asset categories.

Incremental Cost

In evaluating the incremental cost of implementing GASB 34, districts should consider both the additional effort of district personnel and the cost of outsourcing. The effort for this district was less than it might have been because it outsourced two major parts of the implementation—the inventory of capital assets and report preparation. With those duties outsourced, department of finance personnel were able to fulfill their job duties, while also providing the information needed for the report preparation.

The district spent approximately $15,000 for a complete capital assets inventory. The new inventory not only served the purpose of GASB 34 but also provided long overdue improvements to the district's capital assets listing. The incremental cost to prepare and audit the report was approximately 25% more than the prior year's audit cost. We anticipate that the second year's cost for auditor services will be lower because the auditors will be less involved with report preparation.

Board and Media Reaction

We discussed the report for over an hour in a regular board meeting. Most board member questions related to the statement of activities. Questions arose because the loss shown in the fund financial statements for the child nutrition program was less than the net cost shown for that program in the governmentwide statement of activities. We explained the differences between the two measures, with depreciation expense in the governmentwide statement being the largest difference.

The report was the first issued in Louisiana that was prepared pursuant to GASB 34. The local, regional, and even statewide media coverage was very positive. The Louisiana legislative auditor confirmed the significance of the accomplishment.

A second round of publicity occurred when a GASB press release praised the district for its courage in early implementation.

Plans for the 2000 CAFR

With the difficult first-year implementation complete and with the addition of another accounting position in the district's department of finance, the district will prepare the 2000 CAFR internally rather than outsource it to the auditors.

We believe that one item could be improved in the 2000 CAFR: the MD&A. Although the first MD&A included all the elements required by GASB 34, the district wishes to enhance the presentation.

The district plans to become engrossed in the details of the accounting and report preparation. With a thorough knowledge of those items, the district can assist other districts with their first GASB 34 implementation.

Cheat Sheet

The benefits of homework have always been an axiom in education. This project is no exception. Obtain and read your research books. (See Table 3 for a list of research books and other sources of information.) You cannot accomplish this project with a 2-hour cram course; it will take some serious book cracking.

Start early. In our case, although the team had a good understanding of the new model, the project was a formidable challenge. Even with an early start, we experienced a small delay in issuing the district's report because of the extent of the effort.

A district should start planning for implementation 12 months before the beginning of the actual implementation year. This period will allow preparers and auditors to concur on the appropriate adjustments that will eventually be necessary to develop beginning-of-the-year account balances for the year of implementation. (Beginning balances for the governmentwide statement of net assets are needed to ensure that the statement of activities is properly stated in conformity with GAAP in the year of implementation.) Determining beginning balances while preparing and auditing the prior year's report will make the transition smoother and enhance the probability of accurate and verifiable beginning balances.

It is never too early to start work on necessary changes to the capital assets listing.

It is never too early to start work on necessary changes to the capital assets listing. (We discuss the tasks that may be needed in the companion article.) Early implementation enhances the probability of good media coverage. The goodwill that can be created by a positive article on good financial stewardship is priceless. The longer a district waits, the less newsworthy the accomplishment will be.

You don't need to change the way the accounting records are maintained. Our approach of making the step-up adjustments to the governmentwide financial statements outside of the accounting records was simple and effective. We plan to repeat this approach for the 2000 CAFR.❑

Table 3
Research Books and Sources of Additional Information

GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*

GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*

GASB Statement No. 36, *Recipient Reporting for Certain Shared Nonexchange Revenues, an Amendment of GASB Statement No. 33*

GASB Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*

Guide to Implementation of GASB Statement No. 34 on Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Questions and Answers

ASBO International's *GASB Statement No. 34 Implementation Recommendations for School Districts*

Louisiana Legislative Auditor's web site (http://www.lla.state.la.us)
1. Two school district reports prepared pursuant to the new reporting model
2. Questions and answers on actual implementation experiences of a city and a school district

Vernon Parish School System's web site (http://www.vpsb.k12.la.us)
1. Fiscal year 1999 comprehensive annual financial report (CAFR)
2. Questions and answers on implementation experience of the district
3. Fiscal year 2000 CAFR (to be posted when available)
4. Annual report of district that includes only the minimum GASB 34 requirements

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