AUDITOR OF STATE BULLETIN 96-013
MAY 1, 1996

TO: ALL COUNTY AUDITORS
ALL CITY AUDITORS AND FINANCE DIRECTORS
ALL IPAS

SUBJECT: COUNTY AND CITY GAAP ISSUES

The purpose of this bulletin is to provide information to cities and counties for use in the preparation of their GAAP financial statements for 1995. The bulletin responds to the more frequently asked questions and addresses issues that have been treated inconsistently in Ohio, as well as identifying recent changes in GAAP. When an issue has more than one acceptable accounting treatment, the options have been identified. The accounting guidelines presented in this bulletin need not be applied to amounts that are considered immaterial.

The Accrual of Property Taxes

Current GAAP states that a receivable for property taxes should be established for taxes that have been levied. Property tax revenue is to be recognized in the year for which it is levied (the year in which it is available for appropriation), provided it is available. Property taxes are considered available if they are due, or past due and received within the available period, and collected within the current period or soon enough thereafter to be used to pay liabilities of the current period. The tax calendar for cities and counties is based on four settlements occurring within the year as follows:

January 1 December 31
[---]
Feb 95 June 95 Aug 95 Oct 95

February and August represent real and public utility property tax settlement dates. June and October represent personal property tax settlements. Taxes are levied and collected on a calendar year basis. 1994 real property taxes were levied by counties and cities in October 1994, and settled in February and August of 1995. 1995 personal property taxes were levied by counties and cities in October 1994, and settled in June and October of 1995. 1994 public utility taxes were levied by cities and counties in October 1994, and settled with real property taxes in February and August of 1995. The following chart for the settlements occurring in 1995 may make this process a little easier to understand.

Settlement	Type of Tax	Tax Year	Levy Date
February 95	Real Property	1994	October 94
	Public Utility	1994	October 94
June 95	Pers. Property	1995	October 94
August 95	Real Property	1994	October 94
	Public Utility	1994	October 94
October 95	Pers. Property	1995	October 94

The chart indicates that each of these settlements meet the revenue recognition criteria and must be recognized as revenue for 1995.

You can also see from the chart that all settlements occurring within a calendar year are levied prior to the beginning of that year. It would be therefore be appropriate to establish a receivable at December 31, 1995, for the 1996 calendar year's estimated settlements. These estimates may be obtained from the official or amended official certificate of estimated resources. It would not be appropriate to recognize revenue at December 31, 1995, for the 1996 calendar year's estimated settlements since the anticipated taxes were levied for 1996 and are not available for appropriation until 1996. The receivable is therefore offset by a credit to deferred revenue.

Entitlements and Shared Revenues

Accounting guidelines for entitlements and shared revenues state that an entitlement or shared revenue may not be recognized as revenue prior to the year it is intended to finance. Counties and cities have asked about applying these guidelines to local government distributions and motor vehicle license and gas taxes received within the available period. Based on guidance provided in "Governmental Accounting, Auditing and Financial Reporting" published in 1994 by the Government Finance Officers Association, the year that an entitlement or shared revenue is intended to finance is based on the year in which it is appropriated by the State (or recognized as a liability) or the year for which it may legally be used to pay current liabilities. Local government, local government revenue assistance and gasoline tax money to be distributed to local governments in January and February are recognized as a liability of the State at year end. Motor vehicle license tax and permissive motor vehicle license tax money to be distributed to local governments in January are recognized as a liability of the State at year end. Counties and cities should recognize these anticipated receipts as revenue to the extent they will be received in the available period.

Estate Tax (cities only)

Since cities record estate tax as a revenue of the general fund, revenue recognition is based on applying the measurable and available criteria. Estate taxes are settled on February 25 and August 20; however, advances are available to a city at any time prior to a settlement. Within five days from making the request, a city is entitled to receive seventy-five percent of the amount collected to its credit. The amount available as an advance at year-end should be recognized as a receivable and revenue. The amount retained by the county that is not available as an advance would be recorded as a receivable and deferred revenue.

Agency Fund Accruals

The State Auditor's Office is aware that generally accepted accounting principles indicate that the modified accrual basis of accounting should be used to account for agency funds. The Office is also aware that in Ohio and in other states agency funds are routinely reported using the cash basis. The Office has decided not to take exception to financial statements in which agency funds are reported using either the cash or modified accrual basis of accounting. If the cash basis is used, amounts that would have been recognized as receivables on a modified accrual basis should be disclosed in the notes to the financial statements. If the modified accrual basis is used, receivables that are measurable as of December 31 should be reported with an offsetting liability.

The largest agency fund receivables occur in counties and represent the property taxes and special assessments to be collected and distributed in the following year. These receivables often include the county's own property taxes and assessments since they are usually collected in the agency funds before distribution to the county's operating funds. In this situation, there has been inconsistency in reporting the nature of the asset and liability between the agency and operating funds. Some counties have reported the receivable, such as taxes, in both the agency fund and the operating fund that will ultimately receive the taxes. Other counties report the receivable and payable as Due to/from Other Funds accompanied by a brief explanation in the summary of significant accounting policies regarding interfund receivables and payables. A third presentation displays the receivable as Due from Agency Funds with sub-accounts identifying the portion that represents taxes, assessments and other amounts to be distributed from the agency fund. The liability is then reported in the agency funds in similar accounts. This approach has the benefit of identifying the nature of the anticipated revenue in the operating funds and is illustrated below.

Operating Fund Accounts	Agency Fund Accounts
Due from Agency Funds:	Due to Other Funds:
Property Taxes	Property Taxes
Special Assessments	Special Assessments
Accounts	Accounts

Any of these presentations would be acceptable for reporting receivables and payables between the operating funds and agency funds when accompanied with adequate note disclosure; however, of the three presentations described, the last two are preferred.

Year-End Accounts Payable

Year-end accounts payable represent goods or services received prior to year-end for which payment has not yet been made. All outstanding year-end accounts payable should be reported as fund liabilities on the balance sheet, not just those paid during the available period. This means that a search for payables that is limited to the available period may not identify all material amounts. Either the search should be continued until you are no longer discovering significant additional payables or some other approach should be used to insure that all material amounts are reported.

Accrued Liabilities

Accrued liabilities are obligations that have been incurred as of the balance sheet date but for which payment is not yet due. In general, accrued liabilities that will be paid from governmental funds are presented as fund liabilities. GASB, however, has specifically identified the following liabilities to which this rule does not apply: claims and judgments, compensated absences, and special termination benefits. These liabilities are to be reported as fund liabilities only to the extent they will normally be paid with expendable available financial resources. The amount that will not normally be paid from available financial resources is to be reported in the General Long-term Debt Account Group. Determining what, if any, portion of these liabilities will be reported as a fund liability is difficult. Although other methods may be considered acceptable, two methods are preferable.

The first method reports the portion of the liability that is paid during the available period as a fund liability. The second method reports the portion of the liability that is "funded" as a fund liability. A liability incurred during the year is funded to the extent that a local government sets aside money in the current budget to pay it. The result of funding liabilities as they are incurred is the accumulation of money that will eventually be used to pay the liability. In Ohio, accumulating significant resources to make payments in future years is only permitted if specifically authorized by state statute. Cities and counties are not currently authorized by statute to accumulate money for the liabilities listed above although legislation has been introduced which grants that authority. If the legislation passes, local governments will be notified in a subsequent bulletin.

Workers' Compensation

Payments made to workers' compensation in one calendar year are to pay for coverage provided for the previous calendar year. Payments made in 1996 pay for 1995 coverage. The liability at December 31, 1995 equals the 1995 contribution rate times 1995 salaries divided by 100. The division by 100 is necessary since the rate is expressed as dollars per hundred dollars of salary. This is an accrued liability that must be reported as a fund liability. The liability should be allocated to the funds that will pay it.

Retrospectively rated workers' compensation programs are covered in the New Pronouncements from GASB section of this bulletin under Statement 10.

Compensated Absences

The liability for compensated absences is now based on guidance provided by GASB Statement 16. The liability for payments to be made from proprietary funds is reported entirely within the proprietary funds. The liability for payments to be made from governmental funds must be allocated between the funds and the GLTDAG. The portion of the liability reported within the governmental funds represents the amount estimated to be paid using current available financial resources. Two methods for calculating the fund liability are identified in the "Accrued Liabilities" section of this bulletin. The first method calculates the fund liability by summing payments made during the available period that reduce the year-end liability. The fund liability under the second method equals the portion of the liability that has been funded.

Obligation to the Police and Firemen's Disability and Pension Fund (cities only)

In 1967, the State established the statewide pension system for police and firefighters. At that time, many cities were operating their own systems (relief funds). The State agreed to give police and firefighters service credit in the State system for the time they had accumulated in a city system and to continue paying benefits to retirees. The assets and liabilities of these systems were assumed by the State. The cities agreed to pay the State the difference between their accumulated assets and the unfunded actuarial pension liability. The amount of this liability was fixed at the time a city joined the State system. Each city has been given until the year 2035 to pay the liability. This is an accounting liability that should be reported in the GLTDAG of the cities that are still making payments.

Contributions to Other Entities

Many governments provide contributions to the operation of other legally separate entities. For accounting purposes, these contributions may be split into three types:

1. Direct contributions of cash by the local government to the legally separate entity;

2. Salary payments made directly by the local government to the employees of the other entity or payments for fringe benefits and salaries made by the local government on-behalf of the employees of the other entity;

3. In-kind contributions, such as the use of land, buildings and other facilities without compensation, or direct payments to vendors by the local government for goods or services provided to the legally separate entity.

GAAP requires that cash contributions be recognized on the financial statements of both the local government and the separate entity. Accounting for the second type of contribution is now addressed in GASB Statement 24 "Accounting and Financial Reporting for Certain Grants and Other Financial Assistance". The Statement requires the employer government to recognize revenue and expenditures/expenses for amounts paid on-behalf of its employees. If on-behalf payments involve two legally separate entities that are part of the same reporting entity, Statement 24 requires that the payments be reclassified as operating transfers. The third type of contributions may either be recognized in the financial statements or reported in the notes to the financial statements. An example of this type of relationship is a county's contributions to an educational service center.

<u>Cost Allocation</u>

"There is no requirement under generally accepted accounting principles that costs be allocated to the specific funds that benefit from those costs...Accordingly, governments are free to allocate costs among individual benefitting funds if they wish, but they are not required to do so." These statements appeared in a recent issue of <u>GAAFR Review</u> published by the GFOA in response to the issue of whether costs incurred for the benefit of activities reported in proprietary funds need to be reported in the proprietary funds.

In the past, this Office has strongly recommended that all significant current operating costs associated with an activity reported in a proprietary fund be reported as an expense of the fund. For example, when salaries or the employer's share of retirement contributions were paid from the general fund for employees providing proprietary fund services, we would ask the entity to record an operating transfer from the general fund to the proprietary fund, and to record the salaries and benefits as an operating expense of the proprietary fund. We will continue to recommend this practice in an effort to provide consistent, comparable financial information from year to year, but will indicate that this approach is not required by GAAP.

Footnote disclosure and an explanatory paragraph in the audit opinion would be appropriate if the allocation of costs was not consistent from year-to-year.

<u>Budgetary Presentation</u>

The budgetary presentation required for governmental financial statements reflects a combination of both accounting and legal guidelines. Numerous questions routinely arise regarding the appropriate application of both. This bulletin will address several of the accounting issues. A separate bulletin is being issued dealing with budgetary legal issues that are of general application to local governments.

<u>Legal Level of Control</u>

The legal level of control is the level at which expenditures plus encumbrances may not legally exceed appropriations. It is the level at which governments must present individual fund budgetary comparison schedules in a CAFR and it is the level that must be disclosed in the notes to the financial statements. In Ohio, it is the level at which the appropriation measure is passed by the legislative body of the government, and it is established either by statute, by administrative code or by the forms prescribed by the State Auditor's Office under the authority of Chapter 117, Revised Code.

Reclassifications

It is common for revenues, expenditures and other financing sources and uses to be reclassified from one account on the budgetary statements to a different account on the GAAP operating statements to reflect differences in accounting treatment. For example, an operating transfer-in on the budgetary statement may become an addition to contributed capital on the GAAP statement.

Reclassifications also occur when an error in classification is detected on the budgetary statements. For example, the government may have recorded the receipt of homestead and rollback reimbursements as property taxes rather than as intergovernmental revenue. Reclassifications due to errors should not be made just to the GAAP statements but should also be applied to the budgetary statements. Significant misclassifications on the budgetary statements may be misleading and serve as the basis for a qualified opinion.

Reporting Entity

Defining the reporting entity under the guidance of GASB Statement 14 is still generating many questions. The most frequent areas of concern include MRDD Workshops, self-insurance pools, regional airport authorities and cash activity that is not on the books of the fiscal officer.

MRDD Workshops

It is the opinion of the State Auditor's Office that the MRDD workshop, in almost all cases, should be included as a component unit of a county, either as a result of the direct application of the specific guidelines of the Statement or through a determination that to exclude the workshop would make the statements of the county misleading. The amount of in-kind contributions or on-behalf payments for salaries and fringe benefits to be recognized by the workshop as revenue and expense is a determination to be made by the workshop, the preparer of the workshop's financial statements and the auditor of those statements using one of the accounting models authorized by GASB Statement 29. It is the position of the State Auditor's Office that if the amount of recognized contributions is limited to those identified as vocational, then the county should disclose as part of a related party transaction note an estimate of the amount of habilitative services provided directly to the workers at the workshop. This approach was discussed in Auditor of State Bulletin 95-009.

Self-Insurance Pools

There are three types of self-insurance pools operating in Ohio. The first is a shared risk pool. A shared risk pool operates like an insurance company. Subject to the terms of the agreement creating the pool, premium payments may be used to pay the claims of any participant. Premium payments made by a city or county are recorded as expenditures/expenses by the government and as revenue by the pool. The pool should issue financial statements that identify the operation and financial condition of the pool as a whole.

The second type of pool is a claims servicing pool. The pool reviews and pays claims of the participants, either directly or through services provided by a third party administrator, and invests available balances. The financial activity related to each participating city or county is kept separate. A city or county's payments to the pool may only be used to pay its own claims, not those of other participants. Most cities and counties report their participation in this type of pool through a self-insurance internal service fund. Revenues of the fund represent payments by the other funds of the city or county. Expenses include claims, administrative charges and the purchase of stop-loss coverage. The fund should also reflect any year-end cash balance held by the pool as "Cash with Fiscal Agent" on the balance sheet.

Some additional comments regarding claims servicing pools may help some cities or counties avoid potential problems.

> The claims expense reported for the year should include the amount of the liability for unpaid claims costs as of December 31. This liability is a year-end estimate, usually provided by the third party administrator, of the additional costs that will be paid for ongoing claims and the cost of claims that have been incurred but have not yet been reported.
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> The annual claims expense in a retrospectively rated worker's compensation plan equals an estimate of the current and future cost of claims that arise during the coverage year. This cost is only limited by the maximums selected by the government at the time it established the plan. The portion of the expense that remains unpaid at year-end will be reported either in the internal service fund or, if no internal service fund has been established, in the GLTDAG.
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> Third party administrators of claims servicing pools are service providers as that term is defined in Statement on Auditing Standards No.70. See Bulletin 95-10, issued by this Office on September 7, 1995.
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> Routinely determine that your stop-loss insurance provider is financially sound either by requesting a copy of the most recent audited financial statements or by checking the company's rating with Best Ratings.
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> Counties and cities are no longer required under Section 9.833, R.C. to establish reserves for their self-insurance programs for health care benefits, and to have the adequacy of the reserves evaluated annually by an actuary. Although no longer required by statute, cities and counties are strongly urged to continue to establish reserves for self-insurance programs and to routinely affirm their adequacy.

The third type of pool is a group purchasing pool. This pool shops for insurance as a group with the intention of securing better rates than if each participant purchased insurance separately. The pool may collect the premiums from the participants for payment to the insurer. Payments to the pool should be reviewed to determine when payment is made to the insurer and the period covered by the payment. Payments to the insurer may represent current expenditures/expenses or they may be a prepaid. Each participant's proportionate share of money still held by the pool at year-end should be reflected on the participant's financial statements.

If you report the activity of a self-insurance program on your financial statements, take care to insure that revenues and expenses are properly matched to the correct fiscal year. This can be difficult if financial information is provided by a third party for use in your report.

Regional Airports

Regional airports may be created by a single county or by two or more contiguous counties. The establishment and operation of a regional airport is determined almost exclusively by the agreements and resolutions entered into at the time of its creation, rather than by fixed statutory guidelines. This discretion necessitates a review of these documents to determine the airport's proper classification under Statement 14. Even a single county regional airport's classification may vary from one county to another. Most single county regional airports have been classified as related organizations, but several have been classified as component units because the county has issued debt on the airport's behalf, even though the airport has the authority to issue the debt on its own.

Cash Off The Books

It is not unusual for GAAP statements of a county or city to include cash that is not on the books of the fiscal officer at year end. Examples include money with a financial institution for servicing debt (except debt that is considered defeased), money held in escrow during construction, money held by a third party administrator providing claims servicing for a self-insurance program, money held in a deferred compensation program under section 457 of the internal revenue code, money held in segregated accounts by other city or county officials who have authority to have separate accounts, money held by a trustee to satisfy the covenants of a bond indenture and money in a payroll account that does not reconcile to zero. In each instance, journal entries should be made to present this money on the balance sheet of the city or county, and may be necessary to correctly present revenues and expenditures or expenses.

As an example, money deposited by the fiscal officer from a debt service fund to a financial institution for debt service or from an internal service fund to a third party administrator of a claims servicing pool does not represent an expenditure or expense. This is merely a balance sheet transaction that changes "Cash and cash equivalents" to "Cash with fiscal agent". The expenditure occurs in the debt service fund when the general long-term debt matures and the expenses in the internal service fund should represent claims and contract services costs for the year. One method to insure proper presentation of cash off the books is to bring the cash activity of the fiscal agent back into the fund that will report the year-end cash. The beginning cash balance plus the cash activity should generate a cash balance that reconciles with "Cash with fiscal agent" at year-end. Then record any necessary GAAP adjusting entries.

New Pronouncements from GASB

GASB Statement 10 "Accounting and Financial Reporting for Risk Financing and Related Insurance Issues" is effective for fiscal years beginning after June 15, 1994 for self-insurance programs. The statement provides that if one fund is going to be used to account for a self-insurance program, it must either be the general fund or an internal service fund. Guidelines identify the proper accounting treatment based on the fund selected. The statement also creates note disclosure requirements for self-insurance programs.

GASB Statement 16 "Accounting for Compensated Absences" was effective last year, but some reports did not indicate that it had been adopted. Statement 16 expanded the scope of the liability for compensated absences to include benefit payments that are probable, rather than just reporting those that are already vested.

GASB Statement 21 "Accounting for Escheat Property" is effective for fiscal years beginning after June 15, 1994. The Statement establishes the fund type in which to report escheat and unclaimed property. Escheat property represents assets that revert to a government because there are no legal claimants or heirs. Unclaimed assets revert to a government due to the failure of the person who is legally entitled to the property to make a valid claim within a certain period of time. Escheat and unclaimed property should be reported in an expendable trust fund or in the fund that will ultimately receive the assets if they are not claimed. Escheat and unclaimed property should be offset by a liability to the extent it is believed the property will be claimed. Payments to the claimants reduce the liability. If escheat property is reported in an expendable trust fund, amounts transferred to the ultimate fund should be reported as operating transfers. Property held for another government should be reported in an agency fund.

The primary effect of this Statement on Ohio local governments will be the reclassification of unclaimed money funds from agency to expendable trust, or the reporting of the property in the general fund, offset by a liability. Reclassification will also generate a perspective difference between budgetary and GAAP reporting that will need to be addressed in the budget to GAAP reconciliation.

GASB Statement 22 "Accounting for Taxpayer Assessed Tax Revenues in Governmental Funds" is effective for fiscal years beginning after June 15, 1994 and establishes that revenue should be recognized in governmental funds for income and sales taxes to the extent they are measurable and available at year end, net of estimated refunds. Available means collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period.

GASB Statement 23 is effective for fiscal years beginning after June 15, 1994 and is entitled "Accounting and Financial Reporting for Refundings of Debt Reported by Proprietary Activities". Refunding involves the issuance of new debt whose proceeds are used to repay previously issued debt. A current refunding occurs when the proceeds are used immediately to repay the debt. An advance refunding occurs when the proceeds are placed in trust and used to pay the old debt at a later time. For current refundings and advance refundings resulting in defeasance of debt reported by proprietary activities, the difference between the reacquisition price and the net carrying amount of the old debt should be deferred and amortized as a component of interest expense over the remaining life of the old debt or the life of the new debt, whichever is shorter. The deferred amount should be reported as a deduction from or an addition to the new debt liability on the balance sheet.

GASB Statement No. 29 “The Use of Not-for-Profit Accounting and Financial Reporting Principles by Governmental Entities” establishes guidelines for governmental entities that use not-for-profit accounting. Governmental entities that have been applying SOP 78-10 or following the AICPA audit guide Audits of Voluntary Health and Welfare Organizations may now follow either the AICPA not-for-profit model or the governmental model as these models are defined in paragraphs 5.a, 5.b and 6 of the Statement. Governmental not-for-profit corporations are prohibited under the provisions of Statement 29 from applying FASB Statements 116, 117 and 124. The effective date for this Statement varies depending on the accounting model used previously.

GASB Technical Bulletin No. 94-1 “Disclosures about Derivatives and Similar Debt and Investment Transactions” is effective for fiscal years beginning after December 15, 1994. The Bulletin defines derivatives and establishes disclosure requirements for governments that have used, held or written derivatives during 1995.

GASB Interpretation No. 2 “Disclosure of Conduit Debt Obligations” is first effective for fiscal years beginning after December 15, 1995 but provides guidance that may be helpful in the preparation of 1995 reports. Conduit debt obligations are defined by the Interpretation as limited obligation revenue bonds, certificates of participation, or similar debt instruments issued by a state or local government for the purpose of providing capital financing for a specific third party that is not a part of the issuer’s financial reporting entity. The key factor in identifying conduit debt obligations is that the city or county has no obligation for the debt beyond the resources provided by a lease or loan with the third party on whose behalf the debt was issued. A city or county that has issued conduit debt must disclose in the notes to the financial statements a general description of conduit debt obligations, the aggregate amount of all conduit debt obligations outstanding as of the balance sheet date, and a clear indication that the government has no obligation for the debt beyond the resources provided by related leases or loans.

Auditor of State Assistance

The Auditor’s Office is aware that the accounting information presented in this bulletin is of a summary nature and may raise additional questions about applying this information to your situation. Questions are welcome and should be directed to the Local Government Services Division at (800) 345-2519 or the Audit Division at (800) 282-0370. Any legal questions raised by this bulletin should be directed to your legal counsel.