You Are Doing WHAT to the Governmental Funds?? – Part 2, The Short-Term Approach

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In our last chapter, *You Are Doing WHAT to the Governmental Funds?? – Part 1, The Near-Term Approach*, we explored one of the three new measurement focus and basis of accounting (MFBA) options being considered for the governmental funds. These approaches are presented in the Governmental Accounting Standards Board's recent Invitation to Comment (ITC), *Financial Reporting Model Improvements – Governmental Funds*. And you thought it was a scary chapter!?? The suspense continues with the second MFBA proposal – the short-term (or working capital) approach. One spoiler alert (but it is for your own good) – each approach goes further away from the current resource measurement focus and modified accrual basis of accounting currently used by the governmental funds. (Just wait until you read Part 3….)

The Short-Term Approach Philosophy

To begin with, the terminology used for both the balance sheet and operating statement elements as described in Part 1 of this fascinating trilogy, *You Are Doing WHAT to the Governmental Funds?? – Part 1, The Near-Term Approach*, remains the same. From there it is downhill. The short-term approach moves the governmental funds closer and closer to accrual-based accounting, yet stops short of actually making the leap. It focuses on the government's full fiscal period (sometimes referred to as the operating cycle) and defines that period as one-year. Thus, inflows of resources (you know them as revenues) would be recognized if collected *within* the fiscal year or during the subsequent year. In other words, the so-called availability period would be one year. This would also mean that liabilities would be recognized in a governmental fund if they are payable at the fiscal year end and are due within the subsequent year. Basically, the "current liability" definition used in the proprietary funds, as well as in the private sector, of 12 months or less would be applicable. This is a significant departure from the current MFBA.

Give it to me straight! What would be reported where?

Assets Reported

- Cash and investments
- Accounts receivable
- Property taxes receivable
- Long-term receivables due within one year
- Prepaid assets
- Inventory

Note – Prepaid assets and inventory have made their way back onto the governmental fund balance sheet, as have the current portion of long-term receivables.

Assets NOT Reported

- Long-term receivables due after one year
- Capital assets

Liabilities Reported

This is where it starts to get even more interesting…..

- Accounts payable/accrued payroll
- Current portion (i.e., within one year) of the following:
  - Accrued interest payable
  - Compensated absences
  - Principal portions of long-term indebtedness
  - Pension and OPEB liabilities *(Note – if paid through a trust, the liability would be the excess of the actuarially determined contribution over amounts actually contributed.)*
  - Asset retirement obligations (refer to GASB Statement No. 83, *Certain Asset Retirement Obligations* and the recent blog post *It is Going to Cost HOW Much to Retire It??*)

Liabilities NOT Reported

- Non-current portion (i.e., due in more than one year) of the following:
  - Compensated absences *(again, how would this be calculated??)*
  - Long-term financing obligations
  - Pension and OPEB liabilities
  - Asset retirement obligations

Outflows of Resources Reported (Think expenditures…)

In general, outflows would be recognized as resources are disbursed during the current fiscal year or as *current* liabilities are incurred. Thus, liabilities incurred for interest on indebtedness, compensated absences, and potentially pension benefits/OPEB payable within one year of the fiscal year end would be recognized. In addition, the following are the more common examples of what would be reported as outflows of resources:

- *Use* of inventories and prepayments
- Interest disbursements during the fiscal year or that which is accrued and due within the subsequent year
- Principal repayments due in the *subsequent* fiscal year
- Capital outlay

Outflows of Resources NOT Reported

- Prepayments
- Purchase of inventory
- Repayment on borrowings during the fiscal year (*Note – Since such liabilities are being recognized basically a year in advance, repayments of principal during the current year were recognized as outflows in the <u>previous</u> fiscal year.)*
- Depreciation

Inflows of Resources Reported (Think revenues…)

- Property taxes levied for a fiscal period and collected within that period or due within the following fiscal year
- Sales tax collected during the period or due within the following fiscal year
- Proceeds from long-term borrowings (e.g., bonds, capital leases, anticipation notes)
- Resources from the sale of any capital assets
- Proceeds from long-term receivables due within the next fiscal year

In general, the availability period becomes one year by default. For example, property taxes in North Carolina are due and payable upon levy. Thus, even if the taxes are not collected during the fiscal period, they are considered due and payable in the subsequent year (and beyond). (Also, we are obviously continuing to deal with the “phantom entry” related to a governmental fund entering into a capital lease. You know how I feel about that.)

One Last Surprise

As was noted in the previous blog post, the near-term approach is the closest to the current governmental fund measurement focus and, as such, there is not a need for a cash flow statement. We have now crossed that line. With the short-term approach, because revenue recognition is not limited to what was collected during the period or within a very short availability period similar to current GAAP (generally does not exceed 90 days), the operating statement ceases to be very similar to a cash flow perspective. Thus, with this approach (and, yes, even as we get deeper into this), there would be the need for a cash flow statement for the governmental funds. Just what we needed.

Finally, it was noted in the ITC that a potential benefit to this approach is that it provides "…conceptually consistent recognition principles for governmental fund financial statements, rather than the existing collection of accounting conventions." Thus, the expansion of the recognition of revenues and liabilities to include the subsequent year could provide opportunities for a better assessment of interperiod equity. Overall, it could paint a clearer picture of the entity's short-term obligations, rather than being limited to what is due and payable immediately.

I am sure you will all sleep better now.