The New Comprehensive Annual Financial Report Format ("GASB 34")

City of Kalamazoo

Updated July, 2004

What is the CAFR?

The Comprehensive Annual Financial Report (CAFR) contains the annual financial statements of the City. The City is required by State statute to publish externally-audited financial statements every year. The CAFR exceeds the State requirements of issuing basic financial statements by including statements for individual funds, as well as a statistical data section. The standards for issuing a CAFR are set by both the Government Accounting Standards Board (GASB) and the Government Finance Officers Association (GFOA). GFOA offers an award program, recognized by professionals in the public finance field, as well as credit rating agencies, for those who meet required criteria. The award is issued annually, and as of the 2002 CAFR, the City has been a recipient of the Award in Financial Reporting Excellence for ten consecutive years.

The format of the 2003 CAFR changed substantially from prior years, due to a change in accounting standards (dubbed "GASB 34") set by the GASB. This report explains the new reporting format of the 2003 CAFR.

The New CAFR Format

The sequence of the new CAFR is as follows (page numbers refer to the 2003 CAFR):

1. **Introductory Section** (pages i-xi) – contains:
   - Transmittal Letter - a brief letter to the Commission and citizenry describing the City
   - Organization Chart and List of City officials
   - Most recent GFOA Award for Excellence in Financial Reporting

2. **Financial Section** (pages 1-42) contains:
   - **Audit opinion**
   - **Management Discussion & Analysis (MD&A)** (pages 3-20) – an analytical overview of the City's financial position, as well as significant events; also serves as Management's message to those external to the organization
   - **Government-wide Statements** (pages 21-22) **–** the consolidated, long-term-perspective financial statements for the City as a whole
   - **Fund Financial Statements** (pages 23-42) – financial statements of the City's funds, with an emphasis on major funds, accounted for using traditional methods (modified accrual, "budgetary" basis for governmental funds; full accrual basis for utilities).
     a. Governmental funds: pages 23-32
     b. Proprietary funds: pages 33-38
     c. Fiduciary funds (including pension): pages 39-40
     d. Component units reported using full-accrual accounting: pages 41-42

3. **Note Disclosures** (pages 44-75) – as in the former reporting model, notes that readers must take into account in reading the financial statements

4. **Required Supplementary Information** (page 76) **–** pension fund schedule of funding progress

5. **Combining and Individual Fund Statements** (pages 77-128) - statements for all funds not included individually in the fund financial major fund section ("non-major" funds), accounted for using traditional methods (modified accrual, "budgetary" basis for governmental funds; full accrual basis for utilities)

6. **Statistical Section** – statistical data for the City; usually providing ten-year historical information

While useful financial information is presented throughout the CAFR, the Management Discussion and Analysis (MD&A) (pages 3-20) provides a financial overview of the various statements in a narrative format.

Reading the Government-wide Statements

The first two financial statements that appear in the new CAFR format are the government-wide statements – the consolidated, long-term perspective financial statements for the City as a whole. They are the *Statement of Net Assets* (balance sheet) and the *Statement of Activities* (income/operating statement). These statements require some explanation to interpret, due to the change in reporting format.

Because of the different funding nature/intent of governmental (the majority of revenues being taxes and state-shared revenues) activities from business-type (self-supporting through user fees) activities, the government-wide statements break governmental-type and business-type activities into separate columns. The two columns are then added together to arrive at balances for the City as a whole. A third column is displayed for units designated as "component units," designated as such because of their separate boards. The City's component units are Metro Transit, KMGA, DDA, the Brownfield Authority, EDC, LDFA, and Hospital Finance Authority.

Within each of the columns, all financial information has been consolidated, as occurs in the private sector. That means that transfers and activity that happens between funds *within each column* are eliminated, so as to not overstate revenues and expenses. *In the two government-wide statements, monies held on behalf of others, private-purpose trust funds and most notably the City's pension fund, are excluded, since those monies are not available for City operating purposes*. Statements for those funds are presented on pages 39, 40, and 106 of the 2003 CAFR.

The **Statement of Net Assets** (page 21 of the 2003 CAFR)

- Serves as the balance sheet of the City
- Format differs slightly from previous CAFRs and from private sector statements in that it uses an Assets – Liabilities = Net Assets format (as opposed to Assets = Liabilities + Equity)

The **Statement of Activities** (page 22 of the 2003 CAFR)

- Serves as the operating/income statement for the City

- Differs substantially both from the prior format and from that used by the private sector. Rather than using a Revenue – Expenses = Change in Equity, top-down format, the statement starts with program expenses, subtracts out revenues derived directly from that program to arrive at a net program cost, which must then be covered by subsidies (i.e. taxes, revenue sharing, interest income, or transfers). In order to be considered a program revenue, the revenue must be specific to that program. In other words, if a certain program were to no longer exist, that particular revenue would no longer be generated.

- Programs include activities across funds. For example, Community Planning and Development include the General Fund CP&D department, as well as special revenue funds, such as the Community Development Block Grant funds; Public Safety includes not only the General Fund Public Safety department, but also KVET (a special revenue fund).

In the following example, taken from page 22 of the 2003 CAFR, the City's Community Development & Planning program shows $5,587,120 in expenses, which are offset by $1,574,513 in fees (mainly inspection-type fees) and $3,033,053 in grants (in this case, CDBG grants) used specifically for Community Development & Planning operations. After the program revenues are subtracted from the expenses, the Community Development & Planning program is left with a *net expense* of $979,554.

		Program Revenues			
Functions/Programs	**Expenses**	**Charges for Services**	**Operating Grants and Contributions**	**Capital Grants and Contributions**	**Net (Expense) Revenue**
Community Development & Planning	5,587,120	1,574,513	3,033,053	-	(979,554)

This net expense is then added together with net expenses of other programs to arrive at the amount that needs to be subsidized by revenues not specific to any programs: property taxes, State revenue sharing, interest earnings, or transfers from other funds. In the following example also taken from page 22 of the 2003 CAFR, the total net expenses of governmental-type activities is $41,395,375:

		Program Revenues			
Functions/Programs	**Expenses**	**Charges for Services**	**Operating Grants and Contributions**	**Capital Grants and Contributions**	**Net (Expense) Revenue**
Governmental activities:					
General government	$ 6,275,945	$ 2,598,972	$ 1,046,133	$ -	$ (2,630,840)
Public safety (combined police & fire)	31,128,037	394,326	1,677,103	80,191	(28,976,417)
Economic Development	1,048,265	3,986	99,746	-	(944,533)
Community Development & Planning	5,587,120	1,574,513	3,033,053	-	(979,554)
Parks	844,727	6,155	303	-	(838,269)
Recreation	1,904,491	298,367	586,469		(1,019,655)
Public Works	6,720,951	275,660	1,528,105	-	(4,917,186)
Streets (maintenance & depreciation)	6,543,652	30,177	6,115,955	10,499	(387,021)
Interest on long-term debt	2,489,721	-	1,787,821	-	(701,900)
Total governmental activities	62,542,909	5,182,156	15,874,688	90,690	**(41,395,375)**

General, or non-program specific revenues of $42,966,063 in the following example taken from page 22 of the 2003 CAFR are then added to the net expense of $41,395,375 to arrive at the total change in net assets (net income) of $1,570,688 for governmental activities:

Property taxes	30,937,165
Grants and contributions not restricted to specific programs (revenue sharing)	11,436,571
Unrestricted investment earnings	488,519
Gain (loss) on sale of capital assets	80,533
Contributions to permanent funds	55,275
Transfers - internal activities	(32,000)
Total general revenues, contributions and transfers	**42,966,063**
Change in net assets (net income)	**1,570,688**

It should be noted that balance sheet and net income information reported in the governmental activities column of the government-wide statements will not equal balance sheet and net income as reported the governmental *fund* financial statements (pages 23 and 25 of the 2003 CAFR), because the government-wide statements are presented on a full accrual basis, where the individual governmental-type fund statements will be presented on the modified accrual ("budgetary") basis and because eliminations have been made in order to consolidate information for the government as a whole. These differences are explained in a reconciliation between the government-wide and governmental fund financial statements (pages 24 and 26 the 2003 CAFR).

Similarly, in the following example also taken from page 22 of the 2003 CAFR, business-type activities (utilities, the Intermodal Transit Center, and Farmers Market) display a net revenue figure of $2,469,162 offset by $4,151,458 loss in general revenues/special items for a negative net income of $1,682,296:

		Program Revenues			
	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Net (Expense) Revenue
Business-type activities:					
Wastewater	20,109,707	19,582,578	105,025	75,665	(346,439)
Water	10,982,741	8,010,662	222,584	5,520,017	2,770,522
Other	192,711	115,912	-	121,878	45,079
Total business-type activities	31,285,159	27,709,152	327,609	5,717,560	**2,469,162**

General revenues:	
Property taxes	-
Grants and contributions not restricted to specific programs	5,035
Unrestricted investment earnings	15,276
Gain (loss) on sale of capital assets	14,912
Contributions to permanent funds	-
Transfers - internal activities	32,000
Special item - loss of sale of capital assets	(4,218,681)
Total general revenues, contributions and transfers	**(4,151,458)**
Change in net assets (net income)	**(1,682,296)**

It should be noted that balance sheet and net income information reported in the business-type activities column of the government-wide statements will not equal balance sheet and net income as reported in the proprietary (business-type) *fund* financial statements (pages 33 and 35 of the 2003 CAFR), because of eliminations made in order to consolidate information for the government as a whole. As with governmental-type funds, these differences are explained in reconciliations (pages 34 and 36 of the 2003 CAFR).

What should I look for in reading the CAFR?

The equity balance displayed on balance sheets, as well as the change to that equity balance from the prior year (shown on the operating statement), are most often used to gauge the financial position of an organization. In other words, at fiscal year-end, did the organization have a gain or loss, and how much did it have left in equity?

The "net asset" or "equity" section of the balance sheets, in both the government-wide and individual fund financial statements, are comprised of restricted and unrestricted amounts. Restricted amounts (termed "restricted", "reserved", and "designated") are amounts that are essentially spoken for; they cannot be used for general operating purposes. The *unrestricted* amount, then, is the balance that is truly available to the organization for spending – an accessible reserve, so to speak.

Of course, information from financial statements always needs to be put into context. For example, unrestricted equity may be 15%, but is that a good or bad thing? Likewise, what lead to the change in equity during the year and was it a good or bad thing? The Management Discussion and Analysis (MD&A) (pages 3-20 of the 2003 CAFR) provides a financial overview of the various statements, and puts the numbers into perspective. The MD&A is therefore an integral tool in assessing and interpreting the financial information found in the CAFR.

Why was the format of the CAFR changed?

Prior to GASB Statement 34, the government-wide statements in the front of the CAFR presented financial information using different methods of accounting for governmental-type (tax-supported) funds and proprietary (utility) funds. While this was in accordance with generally-accepted accounting principals ("GAAP") at the time, the numbers could not be meaningfully combined to arrive at government-wide totals because of the accounting basis differences. Furthermore, because consolidating entries were not made for activities between funds, revenues and expenses for the government as a whole tended to be overstated. Converting the government-wide statements to use only the full accrual basis of accounting and making eliminating entries to consolidate financial information between funds gives the government as a whole a true bottom-line from a long-term perspective.

A logical question is why different bases of accounting are used for different types of funds. There is good reason, and the two methods continue to be used in the *individual fund* statements. With the exception of utilities and a few other services, government services are generally those that can not be provided by the private sector (they do not make a profit—an example being public safety), or if they could be, there is a public preference to ensure that the services are accessible to all (an example being free or reduced-fee park access), or, alternatively, there is a desire to regulate an activity (building inspections).

In the private sector, generally speaking, a company can gauge its success by its profits. If customers do not like a product, or if costs are too high, the company will not make a profit. In other words, there is a fairly direct correlation between the product itself and the company's profits. In the public sector, this is not the case. Because the majority of governmental services cannot, or are preferred not to be, fully self-supporting, governments close the funding gap between program-derived revenues and expenses by levying taxes. While the taxes generate needed revenue, there is only an indirect correlation between the service being provided and the revenue source. If a citizen is unhappy with a particular government service, he or she cannot opt out of paying taxes without legal consequences. If he/she is unhappy with only a particular service, such as leaf pickup, or a few services, he/she is unlikely to move as a direct result; after all, there are a great number of considerations in moving: job location, schools, neighbors, the current housing market, etc. Likewise, a great number of factors need to go wrong before City operations, or lack of, affect housing values, upon which the primary revenue source (property taxes) is based.

As a result of this lack of correlation between revenue sources and program delivery, governments must rely on budgets to keep spending within desired means and on performance indicators/benchmarks to gauge performance. In order to be able to compare to budget, government-type (non-utility) activity must be recorded on what is called a modified accrual ("budgetary") basis. As an example, in the private sector or in the utilities, the purchase of a capital asset, such as a building, would be recorded as a purchase of an asset. The asset does not hit the operating (income) statement, only the balance sheet, so the cost of the building would not reduce the available budget balance. To demonstrate budgetary compliance, in governmental funds, the cost of the asset is recorded as an expenditure, which can then be compared to the established budget.

Because of these different focus/methods of accounting between the utilities and "government-type" activities, the funds in the government-wide statements at the beginning of the CAFR could not meaningfully be added together. As a result, until this new financial reporting standard, the words "memorandum only" appeared in the total columns in the government-wide statements at the front of the CAFR. In addition, the modified accrual basis of accounting does not fully take into account long-term assets and liabilities and therefore does not offer a long-term financial perspective. The new financial reporting model addresses these issues while maintaining budgetary compliance reporting in the individual fund statements.

What does the new reporting format accomplish?

With the changes to the government-wide statements, the new financial reporting format creates a consolidated, long-term financial picture for the City as a whole. *Individual fund statements* for governmental (tax-supported) funds are reported using the modified accrual ("budgetary") method of accounting/financial reporting in subsequent statements within the CAFR, so budgetary compliance reporting is also maintained.

In addition, the new financial reporting model provides:

- **Management Discussion & Analysis (MD&A) -** an analytical overview of the City's financial position, as well as significant events; also serves as Management's message to those external to the organization

- Emphasis on **program expenses/revenues** and the net cost of service provision for the governmental-type (subsidized) as well as business-type (utility) activities;

- Inclusion of **infrastructure** assets (i.e. roads, bridges, sidewalks) in the government-wide statements, which were previously unaccounted for because they are generally immobile and usually can not be sold off

Where can I find out more detail about this new standard?

The GFOA has a short publication called the "An Elected Official's Guide to the New Governmental Financial Reporting Model" which can be ordered either through their website (www.gfoa.org) or by contacting the Accounting Division. In addition, various publications and articles of the Michigan Municipal League, ICMA, and GFOA exist and can be identified by their reference to "GASB 34."