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Local Government Reporting Under GASB 34

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Local government reporting under GASB 34

By Don Rahn, CPA, and Robert Yahr, CPA

Generally accepted accounting principles (GAAP) for local governmental units have changed significantly in the past several years. Governmental Accounting Standards Board (GASB) Statement No. 34 created many of these changes. Some guidelines in the new standard leave little room for judgment, such as the need to depreciate buildings, machinery, and equipment. Other requirements are not handled quite so easily or have given rise to different interpretations.

An example of those latter issues is the proper reporting of the liability many governments have to the State of Wisconsin Department of Employee Trust Funds (ETF). The liability, commonly called the unfunded prior service cost, is owed by about 40% of the 1,400 local units participating in the ETF plan.

Before GASB Statement No. 34 was issued, governments prepared a multicolumn fund-based balance sheet which included two account groups: one for general long-term debt and one for general fixed assets. Common practice in Wisconsin was to report the prior service cost liability in the general long-term debt column, although that method was not universally accepted. Footnote disclosure of this liability was also used in most cases.

As GASB No. 34 is currently being implemented over a three-year period, most governments now prepare two additional financial statements along with the usual fund-based statements. These new statements present a highly summarized overview of the financial position and results of operations of the governmental unit as a whole.

The intent for one of those new statements, the Statement of Net Assets, is to present the true financial position of the entire entity, using the full accrual basis of accounting. Of particular interest here are the liabilities formerly reported in the general long-term debt account group. While liabilities previously reported in that account group generally are required to be reported in the Statement of Net Assets, differing views arose among Wisconsin governments and CPAs about whether or not that requirement applies to the prior service liability.

Some concluded that a government's prior service liability to ETF (which they interpreted to be the government's unfunded actuarial liability) should not be reported as a liability on the face of the financial statements. Looking at the hierarchy of GAAP for governmental units, they found no specific guidance regarding the treatment of unfunded actuarial liabilities in connection with the government-wide Statement of Net Assets in levels A (most authoritative, such as GASB statements and interpretations) through C (certain AICPA pronouncements cleared by GASB). However, they noted what appeared to be relevant guidance in level D (other guidance), in a GASB staff Implementation Guide.

In the newly reorganized Comprehensive Implementation Guide-2003, Question 7.31 asks whether an unfunded actuarial liability (UAL) should be reported as a liability. GASB staff's answer, in part, is "no," because Statement No. 27 requires employers to recognize the net pension obligation rather than the full UAL as a financial-statement liability. Some accountants and governmental officials have used that portion of staff's answer to the question, without considering the rest of the answer, to conclude that the Wisconsin prior service liability should be excluded from the Statement of Net Assets.

In 1997, after reviewing the handling of prior service costs in the Wisconsin plan, the GASB staff concluded, in response to a specific inquiry, that the prior service cost liability has the essential characteristics of pension-related debt. Pension-related debt, as used in Statement 27, refers to a portion of the UAL (actuarial liability) that has been converted to an ordinary liability (analogous to a note payable) of an employer, or employers, to the plan. In this case, what has been referred to as the UAL for prior service costs should be viewed as a series of pension-related debts (ordinary liabilities) of individual employer governments to the ETF, rather than as the UAL or part of the UAL, for recognition purposes in the financial statements.

This distinction is important because, under GASB Statement No. 27 (level A guidance in the GAAP hierarchy), pension-related debt is required to be reported as a liability in the general long-term debt account group. (As noted above, prior to GASB No. 34, this presentation had widespread support.)

When asked whether this liability should now be presented in the new government-wide Statement of Net Assets, GASB staff referred to two directly applicable but previously overlooked portions of the answer to question 7.31 of the Comprehensive Implementation Guide. First, "Statement 34 does not change the measurement and recognition standards in Statement No. 27..." Second, and even more specific, "Liabilities also should be reported in the statement of net assets for short-term differences and pension-related debt as defined in paragraphs 11 and 39, respectively, of Statement 27, as amended."

Therefore, GASB staff's conclusion is that, since the prior service liability of Wisconsin governments constitutes pension-related debt, the liability should continue to be reported, now on the Statement of Net Assets.

Many governments have paid off their prior service liability by issuing general obligation debt. For those governments, the new debt obviously needs to be included. From a consistency standpoint for those governments, it follows that, prior to issuing the new debt, their pension-related debt should have been reported, so that this refinancing simply replaced one type of long-term debt with another. If this were not the case, refunding the pension liability would produce a significant increase in liabilities and a comparable reduction in net assets (a term now used to replace what was previously known as equity).

"Consistency in financial reporting among and between local units of government is important from a credibility standpoint for governing bodies and citizens," says Robert Scott, CPA, director of finance for the City of Brookfield and vice president of the Wisconsin Government Finance Officers Association. "The WRS prior service liability is a significant obligation for many units of government in Wisconsin. Guidance from the GASB indicates it should be recognized in the financial statements of Wisconsin governments."

Promoting understanding and consistency on the accounting for pension-related liabilities is the goal of this article. Individual governments and audit firms must still exercise professional judgment and document their own analysis regarding the application of GAAP.

"The WRS prior service liability is a significant obligation for many units of government in Wisconsin."

Robert Scott, CPA

By applying the guidance described in this article, Wisconsin communities can achieve greater comparability amongst themselves on this issue.

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