Governmental Accounting

City's Finances

February 16, 2012

Tonight I will be focusing on and responding to the Questions and Statements in the following areas:

- Audit
- Unreserved Fund Balance
- Cash & Short Term Investments
- Community Center Funding
- Tax Increment Finance Districts

I will not be addressing the questions on:

- Claremont Development Authority
- What roads will be done with the $1 million in paving
- The City Manager's Salary & Benefit package that was approved by council

Why Is Government Accounting So Different?

- Governments, whether they are large or small, provide more diverse goods and services than most private-sector entities. Claremont provides its citizens with many diverse services such as public safety, public works, sanitation, recreation and planning. It also provides utilities such as water and sewer.

Different types of resources are used to provide these necessary functions and services.

What resources are used?

We have involuntary resources (such as taxes or other revenues not generally related to the operation itself or necessarily in proportion to the service or benefit provided (e.g. police protection).

And we have voluntary resources (e.g. user charges or fees) that are typically used to fund proprietary funds. Those directly benefiting from the provision of the service are the ones paying for it.

Different accounting and reporting mechanisms are needed to account for and report the varying sources and uses of funds. Fund accounting is designed to meet this need.

Reporting Requirements

- So, Governments use two accounting methods to produce two separate but reconciled sets of financial statements. One looks very much like for-profit statements and uses standard accrual accounting.
- The other is less familiar to most and is based on government fund accounting that makes use of a modified accrual approach.

Both accounting methods are accepted practices and required.

Reporting Requirements

- The first set of financial statements are known collectively as the government wide financial reports because they essentially cover all the components of the entity, much as one would consolidate the various divisions of a corporation.
- The second set of financials are known collectively as fund-based statements. These differ from the government wide statements in three major respects. First, they report on the various "divisions" separately; second, they use slightly different rules for recognizing revenue and expenses; third, they combine budgets with actuals.

So Why has GASB been making changes?

- Governments have always taken a different approach than business in that their measurement focus is on changes in current financial resources. It's more like checkbook accounting (actually, funds originally developed out of separate checking accounts!)
- While both governments and private sector businesses adopt budgets, the role of the budget in the public sector is unique. While to the private sector it's simply a financial plan, in the public sector *it plays a critical role in the system of checks and balances between the executive (administration) and legislative (council) branches of government*. So important is the budget that it's traditionally been a critical part of the governmental financial reporting.

Government Wide Versus Fund Based

The GASB Board had long debates regarding the traditional cash basis fund accounting versus a full accrual system similar to systems used by business.

Some of the governmental organizations that were involved in the formation of the GASB were adamantly against switching from the traditional cash basis fund accounting so, when the board issued Statement 34, "Basic Financial Statements---and Management's Discussion and Analysis---for State and Local Governments" it was an attempt to resolve the debate between those who wanted to use a full accrual accounting system and those who wanted to continue to use the traditional cash basis fund system. So what did they do?

Government Wide Versus Fund Based

They resolved it by requiring that both systems be used.

As you can see, using both systems has resulted in annual reports that are very complicated and cumbersome. The first year of implementation of this change was in 2007. These changes make it very difficult to compare reports prior to 2007 with those generated after the changes For now, let's concentrate on fund accounting and specifically, the governmental funds.

Fund Accounting

Fund accounting for state and local governments has its historical roots in the desire of state and local governments to ensure and demonstrate legal compliance with the internal limitations of the budget and the external limitations (usually grantors and creditors) that are placed upon the use of the City's resources.

Fund Accounting

The Governmental Accounting Standards Board (GASB) has defined the term "fund" as follows:

- *…a self-balancing set of accounts recording cash and other financial resources, together with all related liabilities and residual equities or balances, and changes therein, which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions, or limitations.*
- Under governmental GAAP there are eleven different fund types which are categorized into three different activities; governmental, proprietary (i.e. business type) and fiduciary which we'll see on the next chart.

Summary of Changes in Fund Structure after GASB 34 took effect in 2007

Governmental Funds				Proprietary Funds		Fiduciary Funds Trust & Agency Funds				
General Fund	Spec Rev Fund	Debt Service Fund	Capital Project Fund	Enterprise Fund	Internal Service Fund	Expendable Trust Fund	Non Expendable Trust Fund	Pension Trust Fund	Investment Trust Fund	Agency Fund

Governmental Funds (added one)					Proprietary Funds		Fiduciary Funds Trust & Agency Funds (Dropped two and added 1)			
General Fund	Spec Rev Fund	Debt Service Fund	Capital Project Fund	Permanent Funds	Enterprise Fund	Internal Service Fund	Private Purpose Trust	Pension & OEB Trust Fund	Investment Trust Fund	Agency Fund

Fund Accounting

- Cash Basis of Accounting – the method of accounting under which revenues are recorded **when cash is received** and expenses are recorded when they are paid. (What most use at home)

Fund Accounting

- Accrual Basis of Accounting – the method of accounting under which **revenues** are recorded **when they are earned** (regardless of when cash is received) and expenditures are recorded when goods and services are received (regardless if disbursements are actually made at that time). (What most business uses)

Fund Accounting

- Modified Basis of Accounting – the method of accounting under which expenditures (other than accrued interest on general long-term debt) are recorded at the time liabilities are incurred and revenues are recorded when received in cash or when they are measurable and available (i.e. to be collected in the very near term).

Fund Based Statements

- Fund Based Statements are what governments have historically shown. Each major fund is segregated with it's own funding resources and budget. All other non-segregated funds become part of the general fund and this is typically funded by the property tax. Buildings and capital are not depreciated and there is no historical value placed on streets, sidewalks, light posts etc.

So how do Government Wide Statements Differ?

- The Government-Wide statements differ in that the budget is not entered, there is no encumbrance accounting, and the building and the equipment ***are both*** capitalized and depreciated.
- This is where we now value our roads, sidewalks, streetlights etc much like a business does – just in case the state allows us to sell them someday.

An Example of the Complexity

- Because GASB 34 ***requires*** state and local governments to use both the traditional cash basis fund accounting system and the more economic based accrual accounting system, annual reports are cumbersome, and complex.
- As an example, Alabama's 2007 Consolidated Annual Finance Report (CAFR) is 298 pages, and Illinois' is 498 pages.
- As a matter of comparison, the 2006 Consolidated Financial Report of the ***ENTIRE*** U.S. Government was 198 pages. General Electric's annual report for that year was only 104 pages.

Quote from AICPA (June 2010 Report)

American Institute of CPA's

- GASB 34 made major changes in the way fund balances were displayed but they found that there were *"significant variation in how standards are applied..this variation has led to a divergence in practices and confusion over the definition of fund balance. Statement No. 54 Fund Balance Reporting and Governmental Fund Type Definitions goes a long way towards resolving those differences."*

Changes designed to make things clearer?

- For example, to calculate the amounts reported for the consolidated financial statements of corporations, it would be logical to combine the amounts that appear on the parent company financial statements and the amounts that appear on its subsidiaries financial statements.
- To calculate the amounts reported on the federal government consolidated financial statements, a person would combine the amounts that appear on federal agencies' financial statements.

Changes designed to make things clearer?

- Contrary to reason, the amounts reported on consolidated (government-wide) financial statements of state and local governments are not the sum of the amounts reported on all of the funds financial statements.
- This is because some of the funds are accounted for by using the accrual accounting method, while other funds are calculated on the cash basis.

Keeping it Simple with Governmental Accounting

- One distinguishing feature of government accounting is that the budget is entered into the accounts. At the end of the year, when you close the accounts, if actual revenues exceed budgeted revenues there will be a credit balance that will increase fund balance (=equity). If revenues fall short of budget there will be a debit balance that decrease the fund balance account.

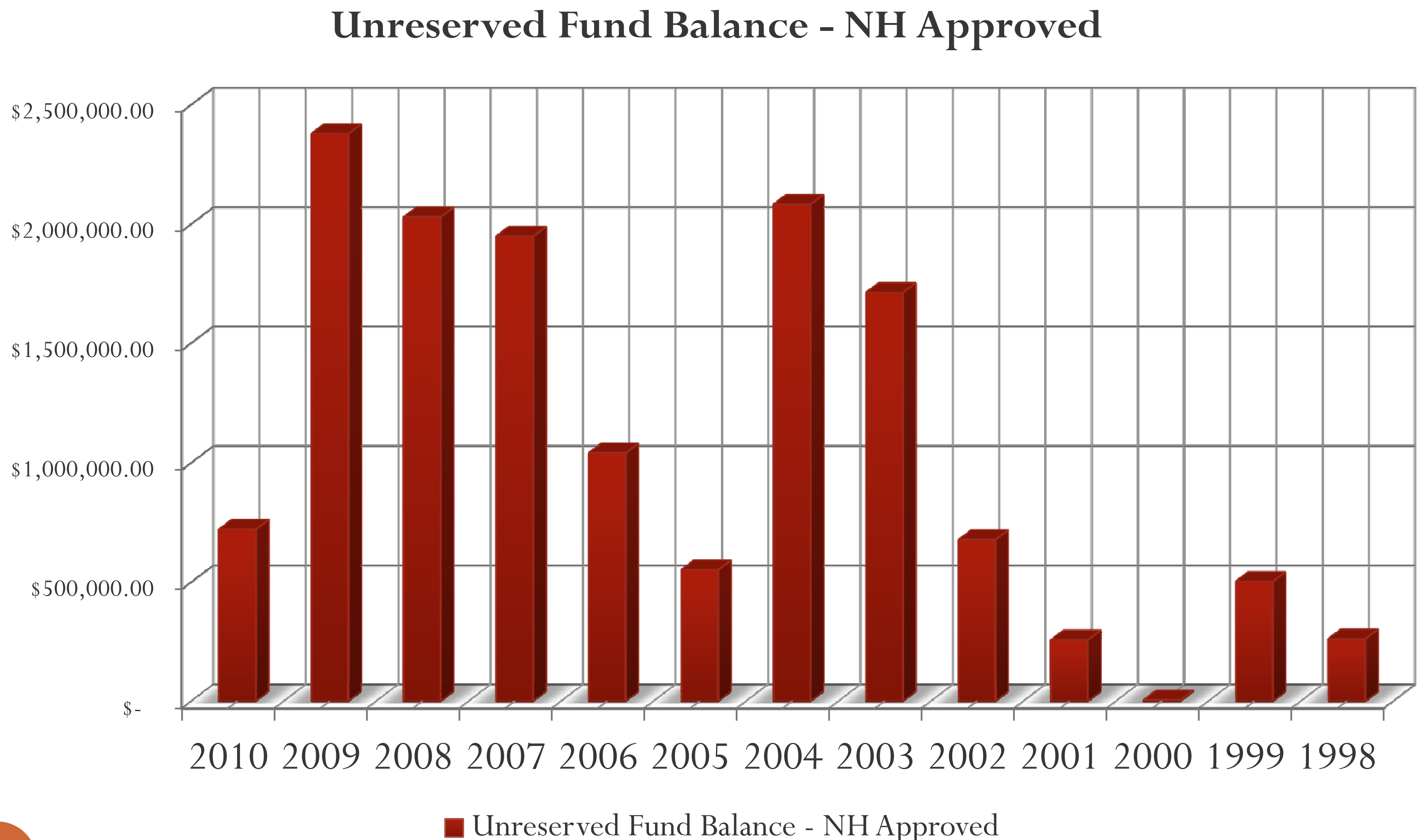
Keeping it Simple with Governmental Accounting

- A similar process is done on the expense side. At the end of the year, when you close the accounts, if actual expenses equal the budget then the expense budget is zeroed out. If not, the balance is transferred to fund balance. If actual expenses exceeded budgeted expenses there will be a reduction in fund balance. Encumbrances are held separately from reserve in a reserved account.

So Why has GASB been making changes?

- Governments, unlike businesses do not ordinarily provide services as a means to an end (i.e. profit) but rather as an end in themselves. In principle then, governments make their financial plans by first determining the types and level of services they need or wish to provide, and then determine how these services will be financed. Some services are partially financed from sources outside of the government itself (i.e. charges for services, grants and contributions). It is this "net program expense" format mandated by GASB 34 that was designed to reflect this unique governmental perspective.

Putting Things In Perspective



Putting Things In Perspective

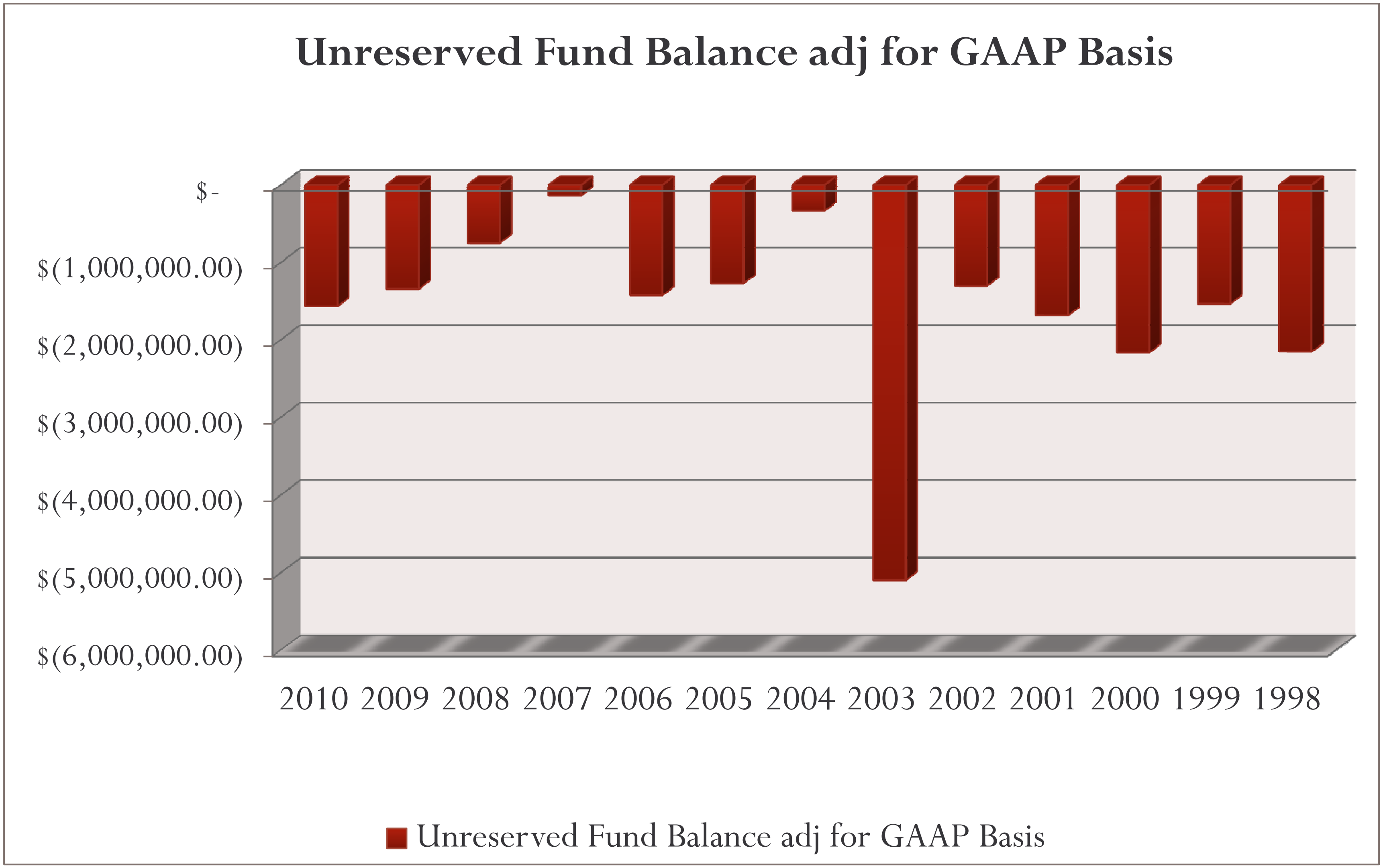
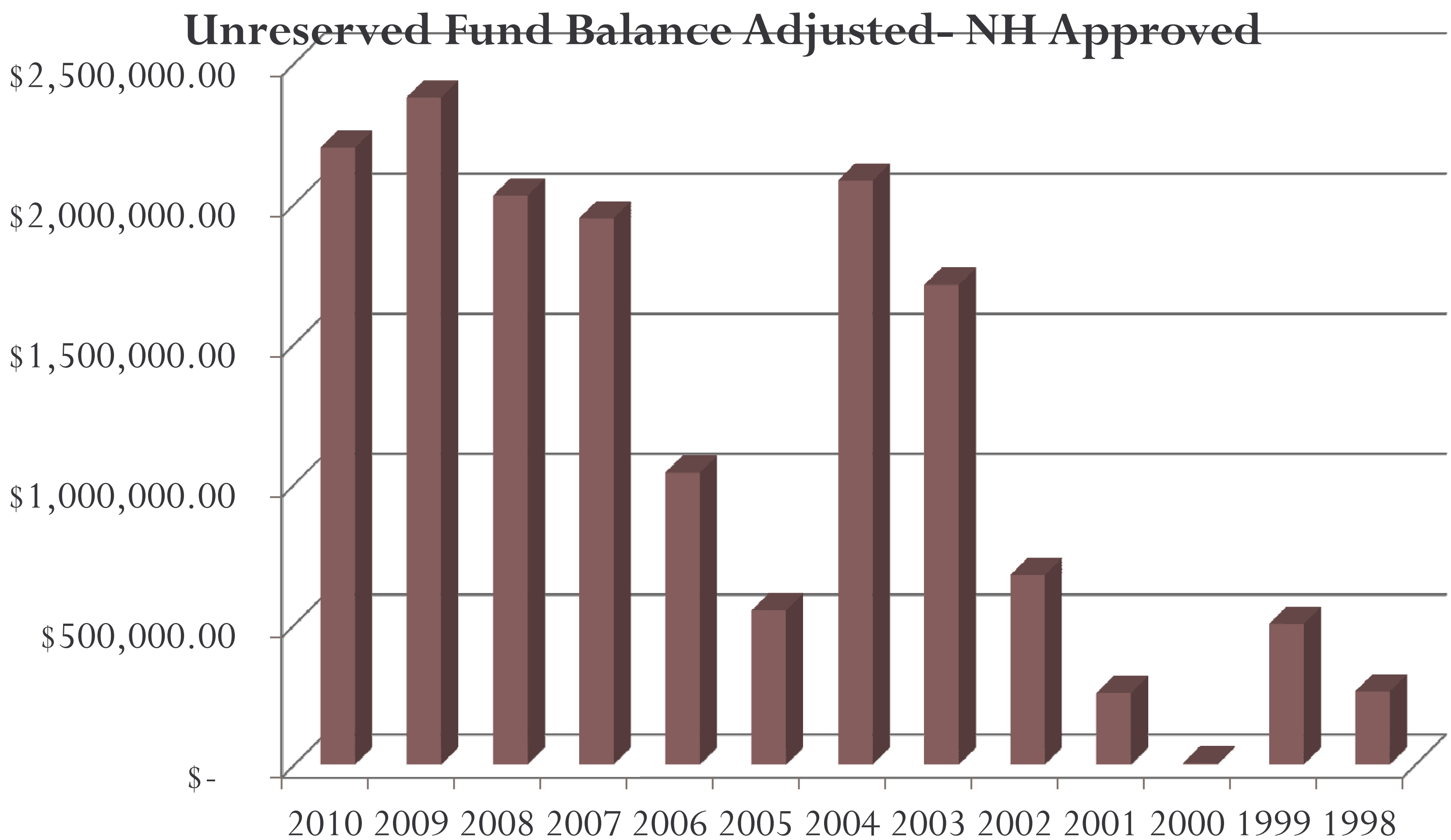


Exhibit A: Graphical Representation of Fund Balance

Typical Fund Balance Accounts:

Fund Balance $1,000,000	Reserved Fund Balance $360,000	Reserved for long-term loans receivable	$ 75,000
		Reserved for encumbrances	$ 20,000
		Reserved for inventory	$ 15,000
		Reserved for continuing appropriations	$250,000
	Unreserved Fund Balance $640,000	Designated for contingencies	$150,000
		Designated for capital improvements	$140,000
		Undesignated	$350,000

With Contingencies As Undesignated



Management Letters

- *Management letters exist as an opportunity to strengthen internal controls and operating efficiency. The goal is always to strengthen internals controls as much as possible so that you prevent potential fraud, theft and misappropriation of funds.*
- *Good internal controls help prevent things like an employee opening night drop bags or having access to vaults by themselves where the temptation for theft is great and embezzlement is the result.*

Management Letters - Quesiton#1

Q. 2008 Management Letter – items were addressed

A. Consider Actuarial Valuation – Due to GASB #45 requiring that municipalities determine the cost of post employment benefits (i.e. health insurance) for current and past employees it was suggested that the city look at doing a cost versus benefit of doing the actuarial valuation. The City did the actual valuation.

Management Letters - Question#2

Q. 2009 Management Letter – have the following items been addressed?

- Gross up accounting records
- Improve Controls over Petty Cash
- Monitor Mill District TIF deficit

A. The items were addressed and answered in the 2009 management letter.

Management Letters - #3

Q. 2010 Management Letter - Where is it? Page 2 of the audit letter states that the management letter was sent separately from the audit on September 28, 2011.

A. The 2010 audit was sent on 9/28/11 and given to the council at the October meeting. The 2010 Management Letter was not part of that package because it had not been received.

Management Letters - Question#3

Q. 2010 Management Letter - Where is it? Page 2 of the audit letter states that the management letter was sent separately from the audit on September 28, 2011.

A. We emailed the auditors after council meeting asking about the management letter since we had not received anything. They sent it out and we received it November 29, 2011 (see receipt next slide)

From: UPS Quantum View [mailto:auto-notify@ups.com]
Sent: Tuesday, November 29, 2011 12:51 PM
To: Patrick Mohan
Subject: UPS Delivery Notification, Tracking Number 1ZF517W80296706902

***Do not reply to this e-mail. UPS and Melanson Heath & Co. will not receive your reply.

At the request of Melanson Heath & Co., this notice is to confirm that the following shipment has been delivered.

Important Delivery Information

Tracking Number: 1ZF517W80296706902
Delivery Date / Time: 29-November-2011 / 12:26 PM

Delivery Location: RECEPTION
Signed by: RICHMOND

Shipment Detail

Ship To:
Mary Walter
City of Claremont, NH
58 OPERA HOUSE SQ
CLAREMONT
NH
03743
US

Number of Packages: 1
UPS Service: 2ND DAY AIR
Weight: 4.0 LBS
Reference Number 1: A10
Reference Number 2: SL10, ML10

Management Letters - Question#3

Q. 2010 Management Letter - Where is it? Page 2 of the audit letter states that the management letter was sent separately from the audit on September 28, 2011.

A. The management letter showed no new reportable conditions that the City was not or had not addressed. The budget had just finished up, reports were due to the state and we had several departments with impending layoffs. The package that was mailed ended up in the storage box with the extra audit reports instead of handed out at December's council meeting.

Management Letters - Question#3

Q. *So what exactly was in this 2010 Management Letter that we did not release?*

A. Establish Fund Balance Goals
- This was done at the December 2011 council meeting as stated.

Prepare for New Accounting Standard GASB 54
- As stated we are preparing for this new standard which takes effect with the 2011 audit.

Audit – Question #4

Q. Deficit balances totaled ($633,314) on page 29 of the audit. The audit states that these deficits will be eliminated through future departmental revenues, bond proceeds and transfers from other funds. Are these accounts cleared up?

A. Actually you were looking at only the Mill District TIF which was $633,314. There were several funds that had deficit balances mostly because of having to pay the expense prior to reimbursement.

Audit – Question #4 continued

A. No, one of the balances involved the SR Pedestrian Bridge and that money did not come in until 2011. When you combine all funds together you are likely to continue to have deficit balances.

As an example, Airport funds show a purchase order on the system (a commitment of funds) but the revenue does not come in until after we have completed the work.

Thus if that project is not concluding until the new year you will have a deficit balance. The same is true of the COPS grant, Drapers Corner, North and Main and many funding sources.

Impacts to Future Budgets

- One obvious example of transactions with future consequences would be pension obligations. A part of the compensation earned by employees during any fiscal year is the present value of a portion of their post-employment benefits. **Employees earn the right to receive these benefits by working now, but they will not collect the benefits until they retire**. Since no cash is due to the worker currently, cash basis budgeting ignores the effects of this and other accruing liabilities. This is an evident deficiency because the obligation is a real, but unrecorded, liability. GASB 45 is allowing us to fund that on a yearly basis but changes in recording the long term liability would negatively impact our fund balance as well.

TIF Districts – Question #1

Q. The city has been borrowing about $300,000 a year for the last couple of years from the River Road TIF to shore up the finances in the Downtown TIF.

A. Yes that is true. You would be hard pressed to find TIFD's that are self-sustaining from day 1. The main reason to even create a TIFD is to invest through bonding which is what the city did.

TIF Districts – Question #1a

Q. What does the city plan to do when the River Road TIF expires?

A. We are going to look at the next chart and see exactly where we are at and what it would take to maintain the Downtown TIF if no other growth occurred anywhere in that district. Technically the city has a couple of options in how it handles the River Road TIFD and that will depend on the governing body's decision.

Downtown TIFD Bond Payments

	2009	2010	2011	2012	2013	2014	2015	2016
Bond Payments	$1,019,690	$992,350	$966,050	$939,750	$912,800	$885,850	$853,900	$825,300
Tax Warrant Revenue generated	$ 643,716	$ 685,700	$ 721,538	$ 721,538	$ 721,538	$ 721,538	$ 721,538	$ 721,538
				Assuming no growth (or loss)				
Short of Bond Payments	$(375,974)	$(306,650)	$(244,512)	$(218,212)	$(191,262)	$(164,312)	$(132,362)	$(103,762)
% Short	-36.9%	-30.9%	-25.3%	-23.2%	-21.0%	-18.5%	-15.5%	-12.6%

TIF Districts – Question #1b

Q. *Where is that money going to come from when the River Road TIF expires?*

A. By the time the River Road TIF expires, the bond payments will be down close to what it brings in in tax revenue.

TIF Districts – Question #2

Q. The River Road TIF also has marketing money budgeted of $40,000 and staffing money of $82,000 from the General Fund.

A. Yes, we do have marketing in the amount of $40,000.

However, staffing money does not come from the General Fund it goes **to the** General Fund.

TIF Districts – Question #2a

Q. What position and what marketing has been done that warrants this expense and what will happen when the TIF expires?

A. The TIF contributes $82,000 to the General Fund as a percentage of support for several staff members (not just planning & development). There is also a percentage of the CM, Legal, Finance including (treasurer, collections, audit, AP/AR), Grant Administration, and IT.

TIF Districts – Question #2b

Q. What position and what marketing has been done that warrants this expense and what will happen when the TIF expires?

- Marketing is not cheap! An average one day - 1/3 page paper ad -- costs between $1,500 and $2,500 dollars
- An average 30 second radio ad running for 13 weeks on 2 radio stations cost $18,000 in 2008.
- Marketing funds will be determined through the budgeting process, just as it is done now.

TIF Districts – Question #2c

Q. Will staffing be cut?

A. Determinations of staffing needs are made on a year to year basis within the budget constraints that the governing body and the city manager set. What we do will depend on the economy at the time and what the council chooses to approve.

TIF Districts – Question #3

Q. The Downtown TIF has almost $8,000,000 that need to be paid. The city is already borrowing $300,000 a year along with whatever revenue the TIF is producing. A couple of large properties have filed for tax abatements and could possibly have their tax assessments reduced. If the city has to reduce those assessments how does the city plan to cover the cost of operating this TIF district without having to take out another bond?

A. As approved by the City Council, an $8 million investment was made to encourage development with an eye towards Claremont's future.

TIF Districts – Question #3 continued

A . We made a decision to build a 3 story versus a 2 story garage (which would have satisfied the city obligation in the short run). However, we believe in the future growth of the city and understood it would be most cost effective to add the3rd floor now.

The City does not intend on taking out another bond. We have little control over whether businesses ask for tax breaks no matter what area of the community they are in and it will be handled the same way as it always is.

We will continue to market the opportunities that exist in Claremont and have no intention of taking out another bond.

Unreserved Fund Balance–Question#1

Q. What is the current balance of the unreserved fund balance as of end of December 2011.

A. There will no longer be reserved and unreserved fund balance. There will be 5 layers of fund balance for the 2011 audit. On a Non-GAAP basis we are estimating it to be approximately $2.2 million. GAAP basis will depend on what is still outstanding at the end of February for unpaid property taxes plus any audit adjustments. However, since it includes unpaid property taxes, deferred elderly liens, outstanding A/R and grant monies spent and not yet received there will undoubtedly be a deficit on a GAAP basis.

Unreserved Fund Balance - Question#2

Q. On page 5, 8, 38 and 39 of the 2010 audit it states that the balance for the General Fund on a GAAP basis was a deficit of ($1,563,223). However, unreserved fund balance on a tax rate setting basis was $720,786.

A. This is a not a question but a statement and is true. If you back out unpaid property taxes and deferred elderly liens you will not have a deficit. Since NH is 100% reliant on property taxes there is less risk than states that depend heavily on income and sales tax with a low dependence on property tax.

Unreserved Fund Balance - Question#3

Q. What obligations have yet to be paid from the unreserved fund balance?

A. City Council approved expenditures from fund balance in 2011 for up to $74,000 (asbestos remediation – City Hall and dehumidifier – GCC). However, ***Unassigned*** Fund Balance for 2011 has not been determined as the books are not even closed.

Unreserved Fund Balance - Question#4

Q. What are the expected revenues not yet received?

A. As of December 2011 there's roughly $6.8 million from the Federal Government for North & Main and Drapers Corner as well as airport funds, COPS grant (total of $218,940), and, for 2012 we've already committed to $3.3 million in sewer upgrades which have, in the past, been spent over multiple years.

Unreserved Fund Balance - #5

Q. Total long term debt for all funds equals $27,269,338 (page 5 & 9 of the audit). This was at the end of 2010. It does not include what was just passed by the city council in 2011.

A. This again is a statement and is true. The rest of the picture is that, at year end, you had $60,936,876 in capital assets. And the break out of the $27,269,338 is as follows:

Unreserved Fund Balance - Question#5

	Debt	Assets
• General Fund	$6,538,810	$15,710,341
• CDA	$1,110,000	$ 2,167,236
• River Road TIFD	$ 500,000	
• Downtown TIFD	$8,855,000	$16,732,800
• Water Fund	$5,729,086	$10,426,901
• Sewer Fund	$4,536,442	$15,899,598
	$ 27,269,338	$60,936,876

This is our debt service and represents debt to be paid through 2027. 38% of this debt is water and sewer which is paid through user fees. Less than 25% is actually on the property tax.

Cash & Short Term Investments

Q. A statement was made regarding RSA 48:16 that made reference to almost $11 million of city funds that would be at risk if the bank failed.

A. What the audit report actually stated was that as of year end $264,675 of the total $11 million was exposed to custodial credit risk. The collateral enhancement we have on the city's funds elevate the classification on our deposits to a "Category One" level of security per GASB 40.

Cash & Short Term Investments – Continued

A. As far as the custodial credit risk for investments (the $14,496,514), the Trustees of Trust Funds hold all of the funds (City, School, Tolles Home, CDA etc.) and these funds are administered by a wealth management firm (under SAS 70) whereby all of the buy and sell transactions are settled on a delivery versus payment basis. No money is exchanged until the wealth management firm takes possession of the purchased security so there is no exposure to any counterparty risk. Further, all of the securities are held off the bank's balance sheet (in a separate account at Bank of NY Mellon) so there is no risk to client funds if Citizens Bank were to fail.

Cash & Short Term Investments – Continued

A. Further, RSA 31:38-a III specifically allows the Trustee of Trust Funds to place securities in the nominee name of a trust department or departments or a brokerage firm to facilitate transfers for such securities. In employing such trust departments, portfolio management departments, or investment advisors, the trustees may enter into contracts or agreements delegating the management of such trust funds to those departments subject to investment guidelines…

Community Center Funding - #1

Q. When the bond was passed for funding the community center bond rating was A1. It has since dropped to A2 by Moody's credit rating (page 9 of the audit).

A. Again, this is not a question but a statement and it is incorrect. The City dropped to an A2 rating in December of 2010 and the governing body approved the bonding for the community center in September of 2011 so we were already an A2 rating. Moody's did an update of our review in December of 2011 and, while they kept us at the same rating, they made several positives comments on the change that we made (and they did know that we had passed a bond and had just received $7.5 million in funding from that bond.)

Community Center Funding - #2

Q. What effect will that have on the bond rate that we can get and how will that rate change the projected cost of the bond? This bond was supposed to be paid through the surplus fund balance for two years which may or may not have adequate funds to cover the cost.

A. We do not go out for bond on our own which is where your individual bond rating comes into effect. We go through the Municipal Bond Bank which has a rating of Aa3 so, once we are approved by the bond bank, we have the benefit of their rating for our bonds. This bond will be paid through the surplus fund balance until the other bonds get paid down.