STATE OF MICHIGAN
DEPARTMENT OF TREASURY

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DATE: June 30, 2011

TO: All Local Units of Government in Michigan and Certified Public Accountants

FROM: Michigan Committee on Governmental Accounting and Auditing (MCGAA)

SUBJECT: MCGAA Statement No. 15 – Implementation of GASB Statement No. 54

Quick Reference

Required Implementation Date: Fiscal Years Ending after June 15, 2011

<table>
<tr><th>Category</th><th>Reason for Limitation</th><th>Deficit Elimination</th></tr>
<tr><td>Nonspendable</td><td>Not spendable form;
Contractually limited</td><td rowspan="2">“Restricted”</td></tr>
<tr><td>Restricted</td><td>Creditors or Legislation</td></tr>
<tr><td>Committed</td><td>Highest Decision of
Governing Body</td><td rowspan="3">“Unrestricted” – Total of three requires elimination plan if negative</td></tr>
<tr><td>Assigned</td><td>Governing Body’s Intent</td></tr>
<tr><td>Unassigned</td><td>General Fund Only; all other</td></tr>
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Overview

Governmental Accounting Standards Board (GASB) Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, makes significant changes to the reporting of fund balance and financial statement classification of various governmental funds. The purpose of this Statement (MCGAA Statement No. 15) is to provide additional guidance on the application of GASB State No. 54 to local units of government in Michigan, and the impact on the current State chart of accounts and the State’s uniform reporting format. This is not a replacement for reading the Statement since this only addresses those items requiring additional guidance applicable to local units of government in Michigan.

Fund Balance Reporting:

The State’s uniform reporting format currently calls for the reporting of fund balance in three categories: reserved, designated, and undesignated (also referred to as unreserved and undesignated). Upon adoption of GASB Statement No. 54, the annual financial statements must report fund balance in the following five categories: Nonspendable, Restricted, Committed Assigned, Unassigned

Fund Deficit

It should be noted that these new categories will have an impact on the definition of a fund deficit. The Department of Treasury Local Audit and Finance Division will consider any negative balance in the unrestricted fund balance to be a fund deficit. In other words, if the total fund balance minus the nonspendable fund balance, minus the restricted fund balance results in a negative amount, this will be considered a fund deficit.

Fund Type Definitions:

Paragraph 30 of the Statement tells us that "Special Revenue funds are used to account for and report the proceeds of specific revenue sources that are restricted or committed to expenditure for specified purposes other than debt service or capital projects. The term proceeds of specific revenue sources establishes that one or more specific restricted or committed revenues should be the foundation for a special revenue fund." Paragraph 31 also requires that "The restricted or committed proceeds of specific revenue sources should be expected to continue to comprise a substantial portion of the inflows reported in the fund."

Applying these criteria will require knowledge of various statutes that currently require specific funds to be created to demonstrate accountability for specific revenue sources. The following considerations should be utilized in assessing special revenue funds:

1. In many situations, a local unit will supplement the restricted resources with its own (unrestricted) resources; it should be noted that providing local resources does not necessarily negate the ability to meet the definition of a Special Revenue fund. Any activity that is engaged in as a result of legislation that requires a restricted or committed revenue sources should meet the criterion of a "foundation for a Special Revenue fund."
2. Occasionally, the local unrestricted contributions cause the specific restricted or committed revenue sources to fall below 50% of the total funding source. In applying paragraph 31's test that "the restricted or committed revenue source… should… comprise a substantial portion of the inflows," the test period should encompass more than a single year. In other words, special circumstances in a single year should not cause a fund to be eliminated, and then recreated the next year. Judgment will be required to appropriately apply this requirement.

In addition, the requirement that "the restricted or committed revenue source… should… comprise a substantial portion of the inflows" is a test that should encompass more than a single year. In other words, special circumstances in a single year should not cause a fund to be eliminated, and then recreated the next year. Judgment will be required to appropriately apply this requirement.

Local units will also need to change the fund type category of the following funds (currently these funds are all listed in the State chart of accounts as special revenue funds):

- Fund 221 - The Health Department/District Health fund: This fund is used in counties and may be used in cities to account for the operations of a health department or district health department. The fund's primary revenue is transfers in from the General fund, state and federal grants, appropriations from other participating counties, charges for services, gifts, grants, bequests or other contributions restricted for health functions by the donor. As long at the primary revenue source is not transfers in from the General fund and continues to be from other sources as listed above, it may remain a Special Revenue fund. The fund is required by the public health code (MCL 333.2413).

- Fund 222 - The Mental Health fund/District Mental Health fund: This fund is used in counties and may be used in cities to account for the operations of a mental health department or district mental health department. The fund's primary revenue is transfers in from the general fund, state and federal grants, appropriations from other participating counties, charges for services, gifts, grants, bequests or other contributions restricted for mental health functions by the donor. As long at the primary revenue source is not transfers in from the General fund and continues to be from other sources as listed above, it may remain a Special Revenue fund. The fund is permitted by the mental health code (MCL 330.1201 to 330.1246) and is required by the Department of Treasury.
- Fund 245 - Public Improvement fund: This fund should now be reported as a Capital Projects fund because its resources are restricted by MCL 141.261 to be spent on public improvements or buildings (which are capital outlay items).
- Fund 246 - Improvement Revolving fund: This fund should now be reported as a Capital Projects fund because its resources are restricted by MCL 41.722 to be spent on capital type special assessment projects.
- Fund 257 - Budget Stabilization fund: This fund no longer qualifies as a Special Revenue fund under GASB Statement No. 54 and should be reported as part of the General fund. However, MCL 141.443 does not allow a return of resources to the General fund without a 2/3 approval of the governing body and only to meet budgetary needs. Therefore, the general ledger that reports these resources should <u>not</u> be eliminated. It would be appropriate to continue to maintain a separate general ledger for this fund, but to report it in the annual financial statements as a component of the general fund. Please refer to the discussion at the end of this paper regarding maintaining separate general ledgers, but not reporting as a fund in the financial statements. [Alternative**]** Because MCL 141.443 requires a two-thirds vote of the governing body to appropriate or transfer money in the fund and the GASB requires the fund's dissolution, the governing body of each local unit with a such a fund must vote by a two-thirds majority to transfer the remaining fund balance into the General fund. The governing body should research the statement to determine what category is warranted in the General fund of the transferred amount.
- Fund 258 - Disaster Contingency fund: The Disaster Contingency fund (MCL 30.419) was used to account for money provided by the legislative body of a local unit for the specific purpose of mitigation of disaster related expenses that represent an extraordinary burden on a county or municipality in relation to its available resources. Because the resources are internally generated, it will no longer qualify as a special revenue fund. This fund should be folded into the General fund.

In addition, we have evaluated the following funds, and determined that no changes are required from the current requirement to report as Special Revenue funds:

- Fund 256 - Register of Deeds Automation Fund: Under MCL 600.2568, this fund receives external revenues ($5 of the total fee collected for each deed recording). Therefore, it would still qualify as a Special Revenue fund. The law permits the resources to be used for operating expenses as well as capital outlay related to automation. Consequently, a Special Revenue fund continues to be more appropriate than a Capital Projects fund.

- Fund 285 - County Revenue Sharing Reserve fund: This fund was initially funded through property taxes that were legally restricted. Even though property taxes do not continue to comprise a substantial portion of the inflows reported in the fund, this fund continues to qualify for special revenue treatment because there are no new resources replacing those property taxes, so all spending is coming out of fund balance (other than interest earned on the fund balance) and the spending of this fund balance continues to be legally restricted.
- Fund 290 - Social Welfare fund: The foundation for this fund is grants from the Michigan Department of Human Services which are supplemented by General fund appropriations and Federal grants. This fund is required by MCL 400.73a and continues to meet the definition of a Special Revenue fund.
- Fund 292 - Child Care fund: This fund is required by MCL 400.117a and has as its foundation restricted service charges from Probate court and grants from the Michigan Department of Human Services. This fund continues to meet the definition of a Special Revenue fund.

<u>Reporting a Fund in the Financial Statement, Versus Maintaining a Separate General Ledger</u>

In order to comply with all State legislation as well as GASB Statement No. 54, it is important to understand that it can be possible to have a different fund structure for purposes of budgeting and general ledger maintenance than the fund structure reported in the annual financial statements. As discussed above, there are some instances where GASB Statement No. 54 does not allow the reporting of a Special Revenue fund and may require certain activities to be reported in the General fund. At the same time, however, there may be legislation that requires separate funds to be maintained. These two requirements can in fact be reconciled if one understands the GASB requirements to apply only to external financial statements presentation and State statutes to apply to budgeting and general ledger recordkeeping.

The most conspicuous example of this will be the Budget Stabilization fund. While State law does not require any local unit to create such a fund, once a governing body takes the steps to create a Budget Stabilization fund, then MCL 141.443 provides specific requirements for how the resources may be used including a requirement that the resources <u>not</u> be returned to the General fund without a 2/3 approval of the governing body and only to meet budgetary needs.

Both requirements can be met if one continues to maintain a separate general ledger for the Budget Stabilization fund, and continue to budget for it, in order to demonstrate our compliance with state law. However, when preparing the annual financial statements, the general ledger for this fund would be included with the general ledger for the General fund, and the two should be presented as a single “General Fund” with the fund balance coming from the Budget Stabilization fund being reported as fund balance restricted for the stabilization arrangement.

If this alternative is chosen, passing a separate budget and keeping a separate ledger, the budget for this “book only” fund would need to be displayed in the audit report with a reconciliation to the General fund to comply with the new standard.