



PHA GAAP FLYER

GASB's New Financial Reporting Model

PURPOSE

The GASB issued Statement No. 34 in June 1999. This standard redefines accounting and reporting requirements for state and local governments, and other special-purpose governments. The purpose of the new financial reporting model is to provide more understandable and useful financial reports to a wider range of users than did the previous model. The Statement applies to the audited financial statements of all state and local governmental entities, including Public Housing Authorities (PHAs).

The purpose of this GAAP Flyer is to provide Public Housing Authorities (PHAs) with accounting guidance that will assist them in the implementation of Governmental Accounting Standards Board (GASB) Statement No. 34, Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments (GASB 34, the Statement, or the new reporting model). The information contained in this GAAP Flyer has been developed by staff of the U. S. Department of Housing and Urban Development (HUD) Real Estate Assessment Center (REAC) in consultation with a national accounting firm. During implementation, management will need to make certain decisions with respect to allowable alternatives. Some of these decisions are subject to interpretation and factor in the concept of “materiality”.

Consequently, it is important that PHA management consult with their independent auditors to obtain concurrence on such implementation decisions that will materially affect the PHA’s financial statements.

IMPLEMENTATION DATES

GASB Statement No. 34 is effective in three phases for the following dates based on the total annual revenues of the PHA.

Phase	Total Annual Revenues in the First Fiscal Year Ending After June 15, 1999	Implementation Required for Periods Beginning After June 15
1	\$100 million or more	2001
2	\$10 million < \$100 million	2002
3	Less than \$10 million	2003

An example of the above implementation schedule would be if a PHA had \$105 million dollars in total revenue for its Fiscal Year ending 6/30/1999, the required implementation for GASB #34 would be its Fiscal Year ending 6/30/2002.

For this purpose, revenues include all revenues (not other financing sources) except for extraordinary items (which will be discussed later in the Flyer). A component unit is required to implement the statement in the same year as its primary government. This is a critical factor for PHAs that are component units of larger “phase 1” primary governments. PHAs should coordinate the implementation of the Statement with their primary governments. Although the

implementation of the Statement is not required until financial statements for fiscal years 2002 or later, financial statement preparers and auditors need to keep in mind that implementation affects the first date of that fiscal year. For example, as of July 1, 2001, financial statement preparers of phase 1 governments with June 30 fiscal year ends have to capture beginning balances using the new standards; and their auditors have to audit those beginning balances.

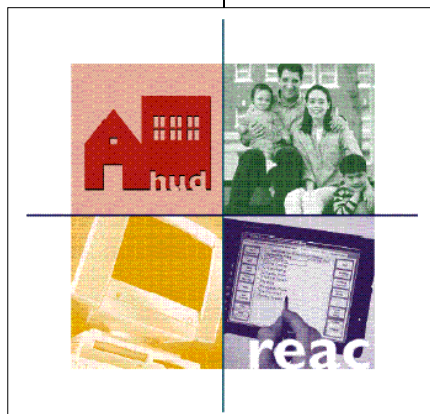
REPORTING MODEL OPTIONS

GASB 34 was written from the perspective of general-purpose governments (i.e., states, cities, counties, towns, and villages). However, there are many other governmental entities, including PHAs, that are not general purpose governments but are special-purpose governments that provide a limited (or sometimes a single) set of services or programs. The financial reporting requirements under GASB 34 for special-purpose governments engaged only in business-type activities are substantially less than those for special-purpose governments engaged in a combination of governmental and business-type activities or only governmental activities.

Under the new reporting model, PHAs have essentially two reporting options: the governmental model and the “business-type activity” or enterprise model. For entities that choose the governmental model, GASB 34 will cause sweeping changes in the information provided by and presentation of financial statements. The new model adds a highly aggregated set of government-wide financial statements. These new statements (statement of net assets and statement of activities) are designed to provide information about cost of services, operating results, and financial position of the government as an economic entity. The statements are presented using a flow of economic resources measurement focus and the accrual basis of accounting. This measurement focus is generally the same as that used by commercial entities and by those PHA’s who

currently are using the enterprise model. Both long-term assets and liabilities are reported on the statement of net assets. The government-wide statement of activities focuses on economic activity and the effects on operations of consuming or using goods or services, rather than the effects of acquiring them. The governmental model continues to include fund-based financial statements, but with significant changes. Finally, the fund-based statements must be reconciled to the government-wide statements.

The enterprise model is very similar to a commercial entity’s financial statements. The statements are prepared on a full accrual basis of accounting. A statement of net assets; statement of revenues, expenses and changes in net assets; and a statement of cash flows are presented. For those PHAs that have converted to the enterprise model under current GAAP, this model will look very familiar.



HUD REAC’s records reflect that approximately 96% of PHAs, reporting financial activity to HUD REAC via the Financial Data Schedule (FDS), are currently accounting for their activities using the enterprise fund model. Consequently, in this GAAP Flyer, we will focus our discussion on the implementation issues that full accrual PHAs will need to address. PHAs that converted from the HUD

“Under the new reporting model, PHAs have essentially two reporting options:

- ***The Governmental Model***
- ***The Enterprise Model (Business-Type Activity)”***

basis of accounting to the enterprise model greatly reduce the impact of the more onerous aspects associated with GASB 34 implementation. For those PHAs who did not previously convert to the enterprise

model when implementing the requirements of 24 CFR Part 5, et al., which required all PHAs to prepare financial statements in accordance with GAAP, the implementation of GASB 34 will provide you with a second opportunity to convert to the enterprise model.

HUD REAC may at a later date issue guidance that addresses GASB 34 implementation issues for PHAs that account for their activities using the governmental model.

CRITERIA FOR USING THE ENTERPRISE MODEL UNDER THE NEW REPORTING MODEL

The inaugural edition of HUD REAC's PHA GAAP Flyer, Volume 1, Issue 1, focused on the use of governmental vs. enterprise fund accounting. The REAC, in consultation with some of the nation's largest accounting firms, concluded that in most, if not all instances, PHAs could follow enterprise fund accounting. The GAAP Flyer delved into the basis for REAC's position, along with identifying compelling reasons why PHAs should use enterprise fund accounting. While not specifically identified in this Flyer, GASB 34 implementation requirements are one of the most compelling reasons for PHAs to use enterprise fund accounting.

The determination of how to report a PHA's activities is a critical early step in implementing GASB 34. A PHA must first identify its separate activities and determine if they meet the GASB 34 definition of a business-type activity. Business-type activities are defined as activities that are financed in whole or in part by fees charged to external parties for goods and services. We believe that the nature of a PHA's revenue stream is such that a PHA should be considered a business-type activity.

It should be noted that an activity could consist of one or multiple funds. This issue is clarified by question 161 of GASB's Guide to Implementation of GASB Statement 34 on Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments (the Implementation Guide). The issue is important because PHA's may have an existing fund structure that is "legally" established and therefore is not easily changed. For example, many PHAs have a legally adopted fund that is used to account for Section 8 program activities. This fund's revenue stream typically consists of Section 8

subsidies from HUD to fund housing assistance payments to landlords and program administrative fees. As special-purpose governments engaged only in business-type activities, we believe it is appropriate for PHAs to report all of their activities in single columnar format and then, if necessary, present combining financial statements to reflect the activity of individual funds.

ENTERPRISE MODEL FINANCIAL STATEMENT FORMATS

PHAs engaged only in business-type activities following the enterprise model must present the following basic financial statements and Required Supplementary Information (RSI):

- Management's discussion and analysis (MD&A)
- Enterprise fund financial statements
 - Statement of net assets or balance sheet
 - Statement of revenues, expenses, and changes in net assets
 - Statement of cash flows
- Notes to the financial statements
- RSI other than MD&A, if applicable



MANAGEMENT'S DISCUSSION AND ANALYSIS

Historically, for PHAs that prepared comprehensive annual financial reports (CAFRs), the letter of transmittal, preceding the general purpose financial statements, focused on the future initiatives of the PHA and provided the users of the financial statements with a limited analysis of the PHA's financial activities. Under GASB 34, MD&A will precede the basic financial statements and is required supplementary information to the basic financial statements.

It is also noted that a letter of transmittal continues to be a requirement for PHAs that prepare CAFRs. MD&A is intended to provide the users of the financial statements with an objective, easily readable analysis of the PHA's

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- ***Management's Discussion & Analysis***
 - ***Enterprise fund financial statements***
 - ***Notes to the financial statements***
 - ***RSI other than MD&A”***
-

financial activities based on currently known facts, decisions, or conditions. MD&A provides financial statement preparers with the opportunity to present both a short- and a long-term analysis of the PHA's activities. The MD&A requirements established by GASB 34 are general rather than specific to encourage financial statement preparers to report the most relevant information.

MD&A should discuss the current-year results in comparison with prior year, with emphasis on the current year. This fact-based analysis should discuss the positive and negative aspects of the comparison with the prior year. The use of charts, graphs and tables is encouraged to enhance the understandability of the information.

MD&A must include the following as described in paragraph 11 of GASB 34:

- A brief discussion of the basic financial statements, including the relationships of the statements to each other, and the significant differences in the information they provide.
- Condensed financial information derived from the financial statements comparing the current year to the prior year. At a minimum, PHAs should present the information needed to support their analysis of financial position and results of operations required in the following bullets, including these elements, as applicable:
 - Total assets, distinguishing between capital and other assets
 - Total liabilities, distinguishing between long-term liabilities and other liabilities
 - Total net assets, distinguishing among amounts invested in capital assets, net of related debt, restricted amounts, and unrestricted amounts
 - Operating revenues by major source
 - Operating expenses by major cost category
 - Non-operating revenues (expenses)



“Under GASB 34, MD&A will precede the basic financial statements and is required supplementary information to the basic financial statements”

- Income (loss) before capital contributions, special and extraordinary items, and transfers
- Capital Contributions
- Special and extraordinary items
- Transfers
- Change in net assets
- Ending net assets

- An analysis of the PHA's overall financial position and results of operations to assist users in assessing whether financial position has improved or deteriorated as a result of the year's operations. The analysis should include reasons for significant changes from the prior year, not simply the amounts or percentages of change. In addition, important economic factors, such as changes in intergovernmental revenues (federal and state grants), which significantly affected operating results for the year, should be discussed.

- A description of significant capital asset and long-term debt activity during the year, including a discussion of commitments made for capital expenditures, changes in credit ratings, and debt limitations that may affect the financing of planned facilities or services.
- A description of currently known facts, decisions, or conditions that are expected to have a significant effect on financial position (net assets) or results of operations (revenues, expenses, and other changes in net assets).

Because MD&A is RSI, the PHA's auditor must apply certain limited procedures to MD&A. The auditor must add an explanatory paragraph to the report on the audited financial statements if one of these four circumstances described in SAS No. 52 (AU sec. 558.08) exists:

- The RSI is omitted,
- The auditor has concluded that the measurement or presentation of the RSI

departs materially from prescribed guidelines,

- The auditor is unable to complete the prescribed procedures, or
- The auditor is unable to remove substantial doubts about whether the RSI conforms to prescribed guidelines.

Because the RSI does not change the standards of financial accounting and reporting used for the preparation of the entity’s basic financial statements, the four circumstances described here do not affect the auditor’s opinion on the fairness of presentation of such financial statements in conformity with GAAP.

NET ASSETS

Under the current reporting model, the difference between assets and liabilities in an enterprise fund is known as “equity”. Enterprise fund equity is itself divided into “contributed capital” and “retained earnings” to distinguish equity resulting from the provision of goods and services (i.e., retained earnings) from equity obtained from other sources (e.g., capital grants).

Under GASB 34, the difference between a PHA’s assets and liabilities is net assets. Net assets should be displayed in three components – invested in capital assets, net of related debt; restricted (distinguishing between major categories of restrictions); and unrestricted.

Invested in Capital Assets, Net of Related Debt

This component of net assets consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. If there are significant unspent related debt proceeds at year-end, the portion of the debt

attributable to the unspent proceeds should not be included in the calculation of invested in capital assets, net of related debt. Rather, that portion of the debt should be included in the same net assets component as the unspent proceeds – for example, restricted for capital projects.

Restricted Net Assets

Net assets should be reported as restricted when constraints placed on net asset use are either:

- Externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments
- Imposed by law through constitutional provisions or enabling legislation.

Unrestricted Net Assets

Unrestricted net assets consist of net assets that do not meet the definition of “restricted” or “invested in capital assets, net of related debt.”

In the PHA environment, net assets are sometimes designated to indicate that management does not consider

them to be available for general operations. In contrast to restricted net assets, these types of constraints on resources are internal and management can remove or modify them. As described in the preceding paragraph, however, enabling

legislation, typically enacted for the reporting PHA by its primary government, should not be construed as an internal constraint. Designations of net assets should not be reported on the face of the statement of net assets, but may be reported in the notes.

Financial statement preparers need to develop processes to classify net assets into the three components. Many may find it possible to classify net assets during their financial reporting process rather than by revising account codes in their financial accounting system.



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FINANCIAL ACCOUNTING AND REPORTING FOR CAPITAL ASSETS

When most government officials think about the changes required under GASB 34, the changes in accounting for capital assets, specifically, identifying infrastructure assets and depreciating governmental fund assets are considered the most substantial changes required by the standard.

PHA GAAP Flyer, Volume 1 Issue 2, *Accounting for Fixed Assets*, (Flyer Issue 2) provides guidance on accounting for fixed assets and corresponding depreciation of those assets under GAAP. GASB 34 does not alter the accounting and reporting requirements for the types of fixed assets discussed in that GAAP Flyer.



As used in GASB 34, the term capital assets includes fixed assets; (e.g., land, improvements to land, easements, buildings, building improvements, vehicles, machinery, equipment) as well as works of art, historical treasures, infrastructure, and all other tangible or intangible assets that are used in operations and that have initial useful lives extending beyond a single reporting period. Infrastructure assets are long-lived capital assets that normally are stationary in nature and normally can be preserved for a significantly greater number of years than most capital assets. Examples of infrastructure assets include roads, bridges, tunnels, drainage systems, water and sewer systems, dams, and lighting systems. Buildings, except those that are an ancillary part of a network of infrastructure assets, should not be considered infrastructure assets.

Most PHAs do not own works of art, or historical treasures. Additionally, infrastructure owned by a PHA would more than likely have been capitalized in conjunction with the capitalization of purchased or constructed buildings. Such infrastructure items typically include sidewalks, parking lots, etc. Therefore, PHAs that have adopted the enterprise fund model and implemented the guidance in GAAP Flyer 2 should be substantially in compliance with GASB 34's capital asset accounting and reporting

requirements. PHAs should perform any necessary procedures to ensure that they have previously recorded infrastructure assets, works of art, or historical treasures. Such procedures could include a physical inventory of assets owned by the PHA, and a legal examination to determine ownership of assets and classes of assets whose legal title is in dispute. If a determination is made that the PHA owns previously uncapitalized infrastructure assets, works of art, or historical treasures, the additional requirements and options in GASB 34 should be addressed.

STATEMENT OF CASH FLOWS

A reporting requirement, mandated by GASB 34, that may necessitate a change for certain PHAs is that governments present a statement of cash

flows for enterprise funds based on the provisions of GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*. The direct method of presenting cash

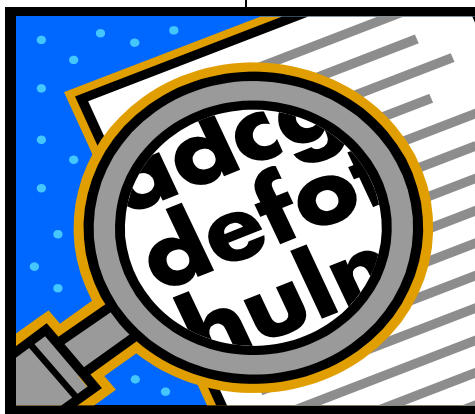
flows from operating activities (including a reconciliation of operating cash flows to operating income) is used. PHA financial statement preparers that previously used the indirect method will need to establish policies and procedures to gather the necessary information in order to present the statement in accordance with the requirements of the direct method. Additional guidance on the preparation of the statement of cash flows using the direct method can be found in GASB's Implementation Guide for Statement No. 9 and the GASB 34 Implementation Guide.

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FINANCIAL STATEMENT FOOTNOTE DISCLOSURES

Guidance pertaining to existing disclosures is found in NCGA Interpretation 6, as amended. PHAs should provide these additional disclosures (if applicable) in their summary of significant accounting policies (SOSAP):

- 1) The policy for applying FASB pronouncements issued after November 30, 1989 (if not included in the SOSAP as part of the conversion from HUD basis accounting to GAAP).
- 2) The policy for capitalizing assets and for estimating the useful lives of those assets.
- 3) The PHA's policy for defining operating and non-operating revenues (component unit PHAs engaged only in business-type activities are not required to distinguish between program and general revenues even though that information is displayed in their primary government's statement of activities).
- 4) The PHA's policy regarding whether to first apply restricted or unrestricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available.
- 5) Information presented about major classes of capital assets should include:
 - a) Beginning- and end-of-year balances, with accumulated depreciation presented separately from historical cost
 - b) Capital acquisitions
 - c) Sales or other dispositions
 - d) Current-period depreciation expense
- 6) Information about long-term liabilities should include both long-term debt (such as bonds, notes, loans, and leases payable) and other long-term liabilities (such as compensated absences, claims and judgments). Information presented about long-term liabilities should include:
 - a) Beginning- and end-of-year balances
 - b) Increases and decreases (separately presented)
 - c) The portions of each item that are due within one year of the statement date



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- 7) Certain information may be presented either on the face of the financial statements or in the notes to the financial statements. Disclosures in the notes to the financial statements is needed only when the information required to be disclosed is not displayed on the face of the financial statements.
- 8) In their disclosure of significant violations of finance-related legal or contractual provisions, PHAs should identify the actions taken to address such violations.
- 9) PHAs should disclose the following details of debt service requirements to maturity:
 - a) Principal and interest requirements to maturity, presented separately, for each of the five subsequent fiscal years and in five-year increments thereafter. Interest requirements for variable-rate debt should be determined using the rate in effect at the financial statement date.
 - b) The terms by which interest rates change for variable-rate debt.
- 10) PHAs should disclose the future minimum payments for each of the five subsequent fiscal years and in five-year increments thereafter for their obligations under capital and noncancellable operating leases.
- 11) PHAs should provide details in the notes to the financial statements about short-term debt activity during the year, even if no short-term debt is outstanding at year-end. Short-term debt results from borrowings characterized by anticipation notes, lines of credit, and similar loans. Details should include:
 - a) A schedule of changes in short-term debt, disclosing beginning and end of year balances, increases and decreases.
 - b) The purpose for which the short-term debt was issued.

Additionally, in June 2001, the GASB issued Statement No. 38, Certain Financial Statement Note Disclosures, which revises certain financial statement footnote disclosures. The revisions and clarifications included in GASB 38 that will affect most PHAs follows:

- 12) Balances of receivables and payables reported on the statement of net assets (balance sheet) may be aggregations of different components, such as balances due to or from tenants, HUD, other governments, vendors, and employees. However, PHAs should provide details in the notes to the financial statements when significant components have been obscured by aggregation. Significant receivable balances not expected to be collected within one year of the date of the financial statements should be disclosed.

TRANSITION

For most PHAs, adjustments because of GASB 34 are treated as prior-period adjustments, and any prior-period financial statements that are presented require restatement unless impractical. If such restatement is impractical, beginning fund balance (or fund net assets) is restated for the cumulative effect of applying the Statement for the earliest period restated (which generally is the current period). The nature of the restatement and its effects are disclosed in the first period the Statement is applied.

As a practical matter, a PHA that has undergone the conversion from HUD basis accounting to enterprise fund GAAP should not have any restatements when implementing GASB 34. For such PHAs, in the year of implementation, beginning of year net assets is the total equity amount, as reflected in the prior year financial statements under the existing reporting model. End of year net assets must be disaggregated into the three required equity components: invested in capital, net of related debt; restricted; and unrestricted. □



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