NEWSLETTER NO. 50

FUND ACCOUNTING
- THE CASE FOR AND AGAINST

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You may have seen the headline: "Implementing PS 3150 is the death knell for fund accounting." But is it?

From the earlier discussion on budgeting and PS 3150, you may well continue to have an operating budget and a capital expenditure program or a capital investment plan for each fiscal year. However, your accounting for capital assets will change from a fiscal year orientation to one reflecting the life cycle of the asset, with the expenditures on tangible capital assets being reported as the acquisition of assets on your Consolidated Statement of Financial Position or balance sheet. You will account for the consumption of tangible capital assets as amortization expense in your operating accounts, or the Revenue Fund, so what will be the future role of the "Capital Fund", if any?

You currently prepare an operating budget and a capital budget, and finance each one in full. You typically account for them separately but in parallel, recording sources of financing as revenues, and disbursements as expenditures. For financial reporting, you consolidate these parallel streams into a single statement of operations, split into current operations and capital, by transferring financing and expenditures to the other fund, when and where applicable. As a result, the reporting on Capital Operations, or Capital Fund, will include expenditures and financing that originated in Operations or the Revenue Fund, and occasionally vice versa.

In short,

Operations (Revenue Fund) + Capital (Capital Fund) = Consolidated Operations

Starting in 2009, tangible capital assets will be capitalized, so that acquisition costs will no longer be an expense, save those costing below your capitalization thresholds. Thus the equation will become:

Operations (Revenue Fund) + Non-capitalized Assets (expensed) + Capital Revenues
= Consolidated Operations

As before you will still have a single Statement of Operations, but now it will only include the financing and expense of your current operations, along with those asset acquisitions in the year which will not be capitalized, and therefore expensed. If those acquisitions will be charged against operations, which they will be, what is the point of having two separate funds for accounting purposes?

Revenues received from outside parties for funding capital acquisitions will also be included as revenues in the Statement of Operations.

Let us explore the arguments for and against keeping fund accounting.

What is Fund Accounting?

For those who are not familiar with the term or concept, fund accounting is like maintaining separate ledgers or books for current operations and for capital operations. There may be other funds set up for specific planning, financing and reporting purposes.

As noted in the preamble, current and capital operations are budgeted, financed and reported on separately, with each being subject to requiring a balanced budget. As previously noted, they are consolidated for financial reporting. There will be many linkages between the two sets of books, such as when staff time is charged to a capital project, or an asset is purchased out of current funds. Disbursements will likely be paid from a single bank account in a single cheque run, and not segregated by origin.

Fund accounting is primarily a very useful budgeting and management control tool, and assists current financial reporting segregated by Fund, such as in the Statement of Operations and the Ontario Financial Information Return (up to and including the FIR for fiscal 2008), which requires reporting by fund.

The 2009 FIR does not require this type of reporting, nor does the Public Sector Accounting Handbook. This raises the question as to whether you should continue to use fund accounting or not.

The Case for Retention

You will still have an operating budget and a capital investment plan, with a need to track sources of financing and expenditures for each. Fund accounting is an easy way to monitor what is happening in each area, and facilitates good management control over the utilization of financial resources.

There will still be annual reporting on current operations, and on capital operations, including acquisitions, disposals and write-downs, similar to what is currently required, so that the requirements of full accrual accounting can probably be accommodated by tweaking your current accounting system, rather than requiring major changes.

Perhaps the best argument for retention is that capital expenditures are not like current ones, because they typically extend over two or more fiscal years. Accounting for them separately makes it easier to retain this history, which can be retained indefinitely, it necessary, even after capitalization, such as by using a contra-account for recording the capitalized value.

And staff are familiar with the current approach.

The Case Against Retention

If capital operations are no longer being reported as income and expenditures, but as the acquisition of non-financial assets, then the accounting should reflect that, especially if you are implementing asset accounting software to handle your TCA accounting. Having a separate fund isn't really useful, as you are no longer going to be reporting on a fund basis.

Capital transactions will now be reported as the exchange of financial assets in return for acquiring a non-financial asset, a TCA, so that these are balance sheet rather than income statement transactions. This does mean that the budgeting and financing will be separate from current operations, but that is planning on how to use financial assets. The reporting will be of the non-financial assets themselves. Gains or losses on disposal and write-downs will be reported as revenues or expenses on the Statement of Operations as non-cash transactions.

Accounts accumulating revenues and disbursements for capital acquisitions can be flagged for rolling over balances to the next fiscal year, if required, so that while a separate ledger may be convenient for on-going accumulation, it is not necessarily required.

What does this mean?

Fund accounting will continue to be useful for budgeting and financing, as you will almost certainly continue to prepare and implement separate budgets for current and capital operations. For financial reporting, it has questionable utility, as you will be reporting on current operations in the Statement of Operations, and capital expenditures will be reported as the acquisition of non-financial assets on the Statement of Financial Position. At the same time, if you do have segregated accounting using the two funds, it will be relatively straightforward to report what needs to be reported on the respective statements.

Last but not least, there will be costs and effort to move to a single set of accounts, just as there will be costs and effort required for financial reporting under full accrual accounting if you retain fund accounting. There will be conversion costs either way.

Summary

You will probably opt for what will appear to be the lesser of two evils – retaining or moving away from fund accounting. In going through your future financial statements, your auditor will be concerned with the destination you reached, not how you get there, - as long as the route taken was reasonable.

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Our next and final set of newsletters will have a different theme, namely the end result or final product of moving to full accrual accounting. They will address various aspects and issues of financial statements and reporting resulting from the changes to PS 1000, PS 1100, PS 1200 and PS 3150 in the Public Sector Accounting Handbook. Here is what the series will look like:

- Government Financial Reporting - Concepts and Objectives
- (1) The Consolidated Statement of Financial Position
- (2) The Consolidated Statement of Operations
- (3) The Consolidated Statement of Change in Net Debt
- (4) The Consolidated Statement of Cash Flow
- Municipal Surplus or Accumulated Surplus
- Notes to the Financial Statements
- Presenting Comparative Data
- The 2009 FIR
- What will I have to prepare for the 2009 financial reports?

These newsletters will be a warm-up for a more detailed look at financial reporting to be provided at the 2009 Spring Workshops.

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For more information and resources regarding tangible capital asset management, go to PSAB/Asset Management or contact:

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