

From: Phil Koen
Sent: Thursday, January 09, 2020 7:55 PM
To: Marcia Jensen ; BSpector; Marico Sayoc; Rob Rennie
Cc: Laurel Prevetti; Arn Andrews ; Jak Van Nada
Subject: Background Information for Priorities Setting

Dear Honorable Mayor and Council Members,

Attached please find a summary schedule of the 2019 Statement of Activities which has been prepared from the recently approved 2019 CAFR and a “users perspective” published by GASB which discusses the Statement of Activities financial statement.

At the December 2019 meeting when the Council approved the 2019 CAFR, there was no discussion of the Statement of Activities. As the GASB “user perspective” states, the government-wide statement of activities brings the financial activity together in one place and reports accrual-based economic resources information. This is an extremely important financial statement and I would encourage the Council to read the user perspective so each of you are fully informed.

The summary schedule I have attached shows the trend from 2015 through 2019 for “net total governmental expenditures”. As the schedule shows, the Town has experienced a 72% increase in such expenditures since 2015. This has been driven by materially increases in pension and OPEB expenses as well as salary increases.

As a result, the Town is now faced with the reality that at the current levels of government-wide expenditure and general tax revenues, there is no longer a surplus of tax revenues over expenditures. In 2015 the Town had a \$7.6m surplus. As of 2019 this surplus was only \$118,000. The only reason the Town recognized an increase in “net change of assets” in 2019 was due to “non-cash” mark to market investment income and \$1.9m in one time cash proceeds from the sale of Town property.

I am bringing this to your attention so you are fully aware of the current financial condition of the Town and the erosion of financial flexibility over the past 4 years. As the Town Manager correctly states in her cover memo to the Council, the “Council’s identification of strategic priorities is a critical step in the budget process for the fiscal year and ensures that Town resources are directed to these priorities”. However, without sufficient financial flexibility the Town maybe severely limited in its ability to finance incremental expenditures arising from the adoption of incremental priorities.

I would suggest that you have the Staff address the Statement of Activities and make sure the Council fully understands the results as reported and the recent trend in net total government expenditures. I would also suggest that as part of the priority setting discussion the Council discuss with the Staff how any priorities that require incremental expense will be funded.

Thank you.

Phil Koen

THE USER'S PERSPECTIVE

MAY 2007

Touring the Financial Report, Part II: The Statement of Activities

The preceding article in this issue examined the statement of net assets, one of two accrual-based financial statements introduced by GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*. These statements are significant because they bring together information that previously had been spread among various funds and reported on different accounting bases. This article explores the statement of activities, its unique design, and the information it contains.

Overview

As described in the article on the statement of net assets, the government-wide financial statements overcome many of the comparability problems encountered by users of the fund financial statements. (**See that article** for a more detailed discussion of what is covered in this overview.) These problems resulted from the fund financial information being spread among multiple financial statements and reported using different bases of accounting. For example, the proprietary and fiduciary funds report information use an accrual basis and economic resources measurement focus, including all economic transactions and presenting both long- and short-term consequences. But the governmental funds report information use the modified accrual basis and current financial resources measurement focus and generally do not include assets lasting more than one year (such as infrastructure) or liabilities that are not due and payable (such as bonds).

The government-wide statements bring the financial activity together in one place and report accrual-based economic resources information. The government-wide statements organize information by whether it relates to *governmental activities* or *business-type activities*. The fiduciary funds (such as pension trusts and agency funds) are *not* included in the government-wide statements, because the resources they account for do not belong to the government. The governmental and business-type activities combine to represent the total *primary government*. Additionally, discretely presented component units—legally separate entities for which the primary government is financially accountable—are shown on the face of the government-wide statements but are not included in the total for the primary government.

The Statement of Activities

A traditional income or change statement is a fairly straightforward affair. It lists revenues and expenses or expenditures, and often calculates the difference between them. It may then show other changes that are not revenues, expenses, or expenditures (such as capital contributions or other financing sources and uses), before presenting a total change in net assets, fund balance, or some other measure of financial position. All of this is typically done on a single page, running from top to bottom. As you shall see, the government-wide statement of activities is anything but a traditional income statement. (If you check management's discussion and analysis, the narrative section preceding the financial statements, you will find summarized information from the statement of activities presented in a more traditional format.)

The Design of the Statement

The statement of activities runs from left to right along the top and the proceeds downward on the right-hand side. (See Figure 1.) It begins with *expenses* in the upper left-hand corner and presents *program revenues* to the immediate right. The upper right-hand corner calculates *net expenses* or *net revenues*—the difference between expenses and program revenues. The lower section then presents taxes and other *general revenues*, as well as other changes in net assets.

The statement of activities accomplishes the tasks of more recognizable income statements—revenues, expenses, and other changes in net assets are presented, allowing the reader to see how net assets changed during the year. But the arrangement of the statement of activities also provides previously unavailable detail that focuses on how a government finances its services. As this article will describe, the statement compares the costs (expenses) of a government's functions and programs with the resources those functions or programs generate themselves (program revenues). **To the degree that functions or programs cost more than they raise, the statement shows how the government chose to finance the difference (principally general revenues).**

Expenses

The financial statements of state and local governments include several measures of the outflows of resources, including cash (in the proprietary funds statement of cash flows) and current financial resources (in the governmental funds statement of revenues, expenditures, and changes in fund balances). **Accrual-basis expenses more comprehensively measure the cost of providing services and operating a government.** Expenses include costs that have been incurred during the year regardless of whether cash actually changed hands. (Likewise, accrual-basis revenues will be reported even if a government has not yet received cash.) For example, expenses include (a) retirement benefits that were earned during the year but will not be received by the employees until the future and (b) the depreciation of capital assets. (See **the companion article** for a more complete description of depreciation.)

The expenses in the upper left of the statement are presented by major function or program, beginning with the governmental activities, then the business-type activities and the total for the primary government. The expenses of discretely presented component units—legally separate entities for which the government is financially accountable—are shown below the primary government total. **These are direct expenses that are clearly attributable to each function or program.** Governments are not required to allocate indirect expenses to the functional or programmatic categories, but if they do, they will present an additional column, immediately to the right of the expenses, that shows how the indirect expenses were allocated among the categories.

Program Revenues

Like direct expenses, **program revenues are directly linked to the functions or programs listed to the left.** One type of program revenue is *charges for services*. Charges for services may include a variety of fees, such as garbage collection fees, museum admissions, ball field permits, and parking fines. Most *grants and contributions*, the other type of program revenue, are intergovernmental aid for specific functions and programs, like education aid, but also may include amounts provided by not-for-profit organizations and other nongovernmental entities. Grants and contributions for operating purposes and capital projects are shown separately. Together, **program revenues represent resources that are generated in the process of providing a particular service or operating a particular part of a government.** It should be noted that program revenues are generated by the associated function or programs; however, those revenues are not always restricted to use in those programs.

Net Cost of Services

Although some governmental functions are self-supporting, raising enough revenue on their own to cover their costs, **most traditional services are not—they depend upon tax revenues to make up the difference.** The upper right-hand portion of the statement of activities reveals the degree to which the functions and programs presented are self-financing.

Figure 1. Sample Government-wide Statement of Activities

Functions/Programs	Program Revenues			Net (Expense) Revenue and Changes in Net Assets			Component Units
	Expenses	Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions	Governmental Activities	Primary Government Business-type Activities	
Primary governmental activities:							
General government	\$ 9,706,509	\$ 3,333,285	\$ 843,617	\$ —	\$ (5,532,627)	\$ —	\$ (5,532,627)
Public safety	34,782,144	1,190,855	1,307,683	65,300	(32,213,286)	—	(32,213,286)
Engineering services	10,131,928	850,000	—	2,252,615	(7,029,313)	—	(7,029,313)
Health and sanitation	1,299,645	704,793	—	—	(594,852)	—	(594,852)
Cemetery	6,705,675	5,512,267	575,000	—	(516,408)	—	(516,408)
Culture and recreation	735,896	212,496	72,669	—	(450,661)	—	(450,661)
Community development	11,534,045	3,965,199	2,450,000	—	(5,098,846)	—	(5,098,846)
Education (payment to school district)	2,994,389	—	—	2,590,000	(414,389)	—	(414,389)
Interest on long-term debt	21,893,273	—	—	—	(21,893,273)	—	(21,893,273)
Total governmental activities	6,242,893	—	—	—	(6,242,893)	—	(6,242,893)
Business-type activities:							
Water	106,029,307	15,906,675	5,248,959	4,694,915	(79,878,578)	—	(79,878,578)
Sewer	3,643,315	4,159,350	—	1,158,909	—	\$ 1,675,944	1,675,944
Parking facilities	4,906,885	7,170,533	—	486,010	—	2,746,658	2,746,658
Total business-type activities	2,824,368	1,449,012	—	—	—	(1,375,356)	(1,375,356)
Total primary government	11,377,595	12,779,895	—	1,645,919	—	3,047,246	3,047,246
Component units:	\$ 117,406,635	\$ 28,685,770	\$ 5,248,959	\$ 6,540,834	\$ (79,878,578)	—	\$ (76,831,332)
Landfill	\$ 3,382,157	\$ 3,657,858	\$ —	\$ 11,397	—	—	\$ 487,098
Public school system	31,186,488	705,795	3,937,063	11,397	—	—	(26,543,650)
Total component units	\$ 34,568,655	\$ 4,363,653	\$ 3,937,063	\$ 11,397	—	—	\$ (26,056,552)
General revenues:							
Taxes:							
Property taxes, levied for general purposes					51,893,573	—	51,893,573
Property taxes, levied for debt service					4,726,244	—	4,726,244
Franchise taxes					4,055,505	—	4,055,505
Public service taxes					8,989,867	—	8,989,867
Payment from Samolo City					—	—	21,893,273
Grants and contributions not restricted to specific programs					1,457,820	—	1,457,820
Unrestricted investment earnings					1,895,455	619,987	2,505,442
Miscellaneous					894,907	—	894,907
Special item—gain on sale of park land					2,663,468	—	2,663,468
Transfers					501,409	(501,409)	—
Total general revenues, special items, and transfers					76,608,268	116,578	76,946,866
Changes in net assets					(3,150,290)	3,165,624	15,534
Net assets—beginning					126,080,689	82,531,442	208,624,141
Net assets—ending					\$ 122,942,409	\$ 85,697,266	\$ 208,639,675

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negative number (shown in parentheses in Figure 1) means that expenses exceed program revenues, and the function or program requires additional funding from taxes or other sources. It is called a *net expense*. For example, the public works function for this illustrative government had expenses of about \$10.1 million, charges for services of \$850,000, and over \$2.2 million in capital grants and contributions. Public works expenses exceeded program revenues by \$7,029,313, which can be seen in the governmental activities column under the “Net (Expense) Revenue and Changes in Net Assets” section. This type of result is not unusual in that most government activities by their nature are not intended to break even.

On the other hand, it is not unusual for business-type activities to generate close to or more than enough program revenues to cover their expenses—in other words, to produce *net revenues*. The water and sewer functions in Figure 1 both were net contributors to the government’s resources, with program revenues that exceeded expenses by \$1,675,944 and \$2,746,658, respectively.

General Revenues and Other Changes in Net Assets

The net (expense) revenue section identifies the degree to which the various programs and functions rely on taxes and other general revenues for their funding. The section below on the right-hand side then explains how that need for funding is met. All taxes are presented in the general revenues section, usually by type. This includes taxes that are dedicated to particular purposes—although these revenues may be legally constrained to a specific program or function, they are not grants, contributions, or charges for service and therefore do not qualify as program revenues. General

revenues also will include unrestricted aid from other governments—grants that are provided for general support and are not tied to a particular program. Investment earnings typically will be found here as well.

The general revenues are followed by other items that also cause net assets to rise and fall. *Transfers* of resources between the governmental and business-type activities and the discretely presented component units will be shown on their own line. Other changes in net assets that are required to be shown separately are contributions to term and permanent endowments and permanent fund principal, special items, and extraordinary items.

Extraordinary items are increases or decreases in net assets that are both (a) unusual in nature and (b) infrequent in occurrence. Extraordinary items, as their name implies, do not appear in the financial statements very often. *Special items* are either unusual or infrequent and are within the control of the government, whereas extraordinary items seldom are. A special item might be the gain or loss on the sale of a capital asset for a government that does not commonly sell capital assets. Special and extraordinary items are set apart because they are not a part of the usual inflows and outflows of the fiscal year. Showing them separately helps the reader to assess whether a government is covering its routine costs with routine resources, or if it is resorting to other means.

Change in Net Assets

The general revenues and other changes in net assets are totaled and added to the net (expense) revenue totals to produce the total change in net assets for the period covered by the statements. Governments will show the amount of net assets as of the beginning of the year, add or subtract the change in net assets for the year, and then present the ending net assets. The ending amount will agree with what is shown in the statement of net assets.

Pertinent Note Disclosures

The notes to the financial statements contain disclosures helpful in understanding information in the statement of activities, including:

- ▶ Types of transactions included in program revenues
- ▶ Policy for allocating indirect expenses
- ▶ Interest expense included in the direct expenses of the functions and programs
- ▶ Property tax calendar
- ▶ Amounts of *on-behalf* payments made by other governments for salaries and fringe benefits.

Further Reading

- ▶ *An Analyst's Guide to Government Financial Statements*
- ▶ *What Else You Should Know about a Government's Finances: A Guide to Notes to the Financial Statements and Supporting Information*

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Trend Analysis of Excess Tax Revenues Over Governmental Expenditures	2015	2016	2017	2018	2019	2019 change from 2015	
						\$	%
Total Governmental Expenditures	34,271	34,417	39,290	41,833	44,236	9,965	29.1%
Less: Program Revenues and Grants	16,485	13,571	12,445	14,236	13,672	(2,813)	-17.1%
Net Total Governmental Expenditures	17,786	20,846	26,845	27,597	30,564	12,778	71.8%
Less: All Tax Revenue	25,412	25,519	28,398	28,565	30,682	5,270	20.7%
Excess Tax Revenue over Expenditures	7,626	4,673	1,553	968	118	(7,508)	-98.5%
Plus:							
Motor Vehicle in Lieu	0	12	14	16	14	14	
Investment Earnings	428	698	192	333	1,809	1,381	
Miscellaneous/Disposal of Assets	813	598	528	622	2,407	1,594	
Net Position	8,867	5,981	2,287	1,939	4,348	(4,519)	