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COMPTROLLER'S MEMORANDUM NO. 2005-19

TO: Heads of Departments

SUBJECT: Financial Statement Reporting

This memorandum supercedes Comptroller's Memorandum No. 2004-27 on financial statement reporting. Significant changes include the following:

- Included definition of restricted net assets. (Departmental Financial Statements Section)
- Clarified that general fund allotments should not be accrued. (Departmental Financial Statements Section)
- Clarified that the additional amount accrued for vacation pay liability (salary-related payments) should be limited to the employer's share of social security and medicare taxes. (Compensated Absences Liability Section)
- Deleted sections that are no longer applicable.

FINANCIAL STATEMENTS

Statewide Policies

All departments that issue financial statements shall comply with Governmental Accounting Standards Board (GASB) Statement No. 34, except for the Employees' Retirement System and the University of Hawaii. As necessary, the Department of Accounting and General Services (DAGS) will issue policy statements on specific accounting issues that impact all departments.

Accounting issues that affect only one or two departments will be addressed on a case-by-case basis with the affected department(s).

Component Unit Financial Statements

DAGS will use the financial statement format in the Guide to Implementation of GASB Statement 34 on Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments (Implementation Guide) in preparing the State of Hawaii's basic financial statements in the Comprehensive Annual Financial Report (CAFR). Component units of the State, including the Housing and Community Development Corporation of Hawaii, the Hawaii Hurricane Relief Fund, and the Hawaii Health Systems Corporation, should also follow the Implementation Guide. DAGS will inform departments of any deviations from the sample financial statement format in the Implementation Guide that DAGS determines are necessary to more appropriately present the financial statement.

Departmental Financial Statements

Each department shall accumulate the financial information necessary to prepare its financial statements, and present the financial information in the correct financial statement format.

Departments should prepare department-wide (government-wide) financial statements consisting of a statement of net assets and a statement of activities that display information about the department as a whole. Assets and liabilities should be presented in the statement of net assets in the order of their relative liquidity in three categories: (1) invested in capital assets net of related debt; (2) restricted; and (3) unrestricted. Net assets shall be reported when constraints placed on their use are either externally imposed by creditors, grantors, contributors, laws or regulations of other governments or imposed by law through constitutional provisions or enabling legislation. At the departmental level, the statement of activities should be presented in a format that reports net revenue (expense) of individual functions.

In addition, departmental financial statements should include "governmental fund" financial statements that consist of a balance sheet and a statement of revenues, expenditures, and changes in fund balances. If applicable, "proprietary fund" statements should consist of a statement of net assets, a statement of revenues, expenses and changes in fund net assets, and a statement of cash flows.

Departments should not accrue general fund allotments as revenues. Only general fund allotments that are recorded in the reporting period should be reflected as revenues on the statement of revenues, expenditures, and changes in fund balances.

The department-wide (government-wide) financial statements should be preceded by management's discussion and analysis (MD&A). MD&A provides financial managers with the opportunity to share their insights on the department's financial performance for the year.

Certain other data should be presented by departments as "required supplementary information" (RSI).

CAPITAL ASSETS

Except for proprietary funds, capital assets have historically been unaudited at the departmental level. However, with the implementation of GASB Statement No. 34, the capital assets of departments are to be audited by departmental external auditors.

Reporting of Capital Assets

The State's reporting policy is based on asset ownership. The department/agency holding title to a capital asset should report the capital asset. When the State rather than a specific department/agency holds title to a capital asset, the department/agency with the greatest asset usage will report the capital asset. When ownership is unclear, the department with the responsibility for managing the asset should report it.

Under this reporting methodology, capital assets such as buildings, land and works of art, are to be reported as follows:

Buildings

- Cost of all buildings shall be reported in the departmental financial statements of the user department/agency.

- Cost of a building occupied by more than one department/agency shall be allocated proportionately to the individual departments/agencies. The allocation of the cost of buildings in the Civic Center will be provided by DAGS.

Land

- Land owned by the State shall be reported by the user department/agency.

- Land used by a department/agency but owned by the counties shall not be reported by the user department/agency.

Works of Art

- All works of art acquired and owned by the State Foundation on Culture and the Arts (SFCA) shall be reported by the SFCA.

- Any works of art acquired by a department/agency and not transferred to the SFCA shall be reported by that department/agency.

The allocation of capital assets, such as land and buildings, that are shared by several departments for financial reporting purposes will differ from the treatment of those assets for inventory control purposes. For example, in the Civic Center, the buildings that are occupied by more than one department are reported in the property inventory reports of the DAGS Central Services Division. Consequently, departmental external auditors will not be able to trace those assets to the user departments' property inventory reports. They will, therefore, need to confirm the asset costs allocated to user departments with the DAGS Accounting Division.

Capital Asset Cost and Depreciation

Capital assets should be recorded in accordance with generally accepted accounting principles (GAAP). Under GAAP, capital assets are recorded at cost as of the date purchased or date of installation. If the capital asset was donated, it is recorded at fair market value as of the date of the gift. Depreciation is calculated using the estimated useful life of the capital asset. To assist departments, DAGS will provide the cost and related accumulated depreciation of each department's capital assets.

For reporting purposes, see the attached matrix on the new statewide capitalization policy.

Works of Art, Historical Treasures, or Similar Assets

Works of art, historical treasures, or similar assets should be recorded in accordance with GAAP. Under GAAP, works of art are recorded at cost as of the date purchased. If the works of art, historical treasures, or similar assets were donated, they are recorded at fair market value as of the date of the gift. No depreciation is calculated on works of art, historical treasures, or similar assets.

Land in General

Land or interest in land, which is acquired through purchase or condemnation, shall be reported at cost. Cost includes the purchase/condemnation price and any costs incurred to finalize the purchase/condemnation, such as legal title, appraisal, negotiation, survey fees, closing and other overhead costs. Where historical cost is unavailable, land or interest in land shall be reported at estimated cost. Donated land shall be reported at fair market value at date of receipt.

Crown Lands and Government Lands

Much of the land owned by the State consists of crown lands and government lands, which were initially passed on from the Kingdom of Hawaii to the Republic of Hawaii upon the overthrow of Queen Liliuokalani; from the Republic of Hawaii to the Territory of Hawaii upon the annexation of Hawaii by the United States of America; and finally from the Territory of Hawaii to the State of Hawaii upon the admission of Hawaii to the Union. There is no map or listing of these lands and no value has been placed on the lands since the Great Mahele of 1848, which divided the lands among the king's family (crown lands), the chiefs (konohiki lands), the government (government lands), and the commoners (maka'ainana lands). These lands are to be reported at the nominal value of $1.00, pending the preparation of a complete listing and appraisal of the lands.

Infrastructure Assets

- The DAGS State Procurement Office's Inventory Management Branch has issued instructions on the recordation of infrastructure assets by departments. Those instructions are set forth in Procurement Circular No. 2001-6, dated June 27, 2001.

- Land underlying roads, highways and bridges are to be reported in conformance with the State's valuation policy.

Depreciation

DAGS will provide departments, except the Department of Education, with information on the cost and accumulated depreciation of the capital assets, except infrastructure assets, applicable to governmental funds that are to be reported in departmental financial statements. The information provided will incorporate the new statewide capitalization policy, and will include the cost and accumulated depreciation as of July 1 of each fiscal year and the current year's depreciation and net cost as of June 30 of each fiscal year of each department's capital assets by asset category. DAGS will provide the above capital asset information from the data included in the departments' property inventory reports that are submitted to the DAGS Inventory Management Branch. To ensure the accuracy and completeness of this information, departments shall submit correct quarterly information to the DAGS Inventory Management Branch on a timely basis.

Departments with proprietary fund financial statements should make a determination as to the net effect of complying with the new statewide capitalization policy with respect to the capital assets that have been previously capitalized and depreciated for financial statement purposes. If the net effect of the change in capitalization amounts is determined by a department and its external auditor to be immaterial to the proprietary fund financial statements, those capital assets that are less than the new capitalization amounts should continue to be depreciated and reported in the proprietary fund financial statements, and the new statewide capitalization policy should be applied prospectively to only the new capital assets acquired by the department.

The Department of Education currently maintains its own detailed property inventory records. That capital asset information is not in the property inventory database of the DAGS State Procurement Office's Inventory Management Branch. Accordingly, the Department of Education must provide the DAGS Inventory Management Branch with summary information on the cost and accumulated depreciation as of July 1 of each fiscal year and the current year's depreciation and net cost as of June 30 of each fiscal year of its capital assets by asset category, for inclusion in the State's CAFR. This information should be provided annually, and should incorporate the new statewide capitalization policy.

Useful Life Guidelines

There is an apparent wide disparity in the useful lives of capital assets between governmental and proprietary funds in the attached matrix on the new statewide capitalization policy. For example, for governmental funds, a specific asset life is given for the different categories of capital assets (e.g., 7 years for furniture and equipment) while for proprietary funds, a range of asset lives is given (e.g., 1-25 years for furniture and equipment). The useful lives are presented in a range of years for proprietary funds because they encompass a wide range of activities that may utilize capital assets that are unique to their operations. An example would be medical equipment used by hospitals that may have a very short useful life because of rapid technological changes. The asset lives are presented in a range of years to allow proprietary funds to use the asset lives most appropriate for the types of capital assets used in their operations. Such is not the case for governmental-type operations, which generally use the same types of capital assets.

MANAGEMENT DISCUSSION AND ANALYSIS (MD&A)

Within the MD&A data elements specified in GASB Statement No. 34, each department shall determine the information that should be presented in the MD&A that precedes its department-wide financial statements. Because of their detailed knowledge about their department's financial operations, departmental financial managers are in the best position to provide financial statement users with insights as to their department's financial position and results of operations in the MD&A.

Departmental external auditors have asked whether departments may exclude MD&A from their audited financial statements if there would be no significant impact on the State's CAFR. Departments are encouraged to include the minimum MD&A required by GASB Statement No. 34, as part of their audited financial statements. This will help DAGS obtain information from departments for the MD&A that will be included in the State's CAFR. DAGS will communicate to departments its information requirements for MD&A purposes on an individual basis. Departments that were not asked to provide such information had the option of excluding MD&A from their FY 2002 audited financial statements. Thereafter, all departments are required to include MD&A as part of their audited financial statements.

NET INVESTMENT IN CAPITAL ASSETS

DAGS will provide information on the outstanding debt that is associated with the capital assets of departments if it can be obtained from the Department of Budget and Finance.

COMPENSATED ABSENCES LIABILITY

DAGS has not conducted any studies or surveys to determine the amount of the compensated absences liability that is payable within one year. Accordingly, each department must estimate that amount based on its own experience.

Until a system is developed for the capture of the actual number of days of vacation leave that is taken each year by state employees, departments should use the following methodology for calculating the current portion of the accrued vacation pay liability:

1. Divide the total hours of vacation leave used by all employees during the current year by the total hours of vacation leave earned by all employees during the current year plus the total hours of vacation leave accumulated by all employees as of July 1 (beginning balance).

2. Calculate the total hours of vacation leave used by all employees during the current year by adding the total hours of vacation leave earned by all employees during the current year to the beginning balance, and subtracting the total hours of vacation leave accumulated by all employees as of June 30 (ending balance).

3. Multiply the dollar amount of the ending balance by the percentage calculated in step one above. This represents the current portion of the accrued vacation pay liability for financial reporting purposes.

Limit the additional amount accrued for salary-related payments to the employer's share of social security and medicare taxes.

BUDGET

The State plans to present the budgetary comparison schedules as part of the basic financial statements. This is a change from its initial plan to present those schedules as RSI.

Departments should use the amount in the appropriations act, as amended by the supplemental appropriations act, as the original budget amount in the budgetary comparison schedules.

This memorandum is provided to facilitate consistency in financial reporting at the State and departmental levels. Departments may encounter circumstances under which a different treatment may be more appropriate. In those instances, departments should consult with their external auditors, and if necessary, with DAGS, to arrive at the best solution.

Questions on the above may be directed to the DAGS Accounting Division, at 586-0600.

Russ K. Saito

RUSS K. SAITO
State Comptroller

STATE OF HAWAII
NEW STATEWIDE CAPITALIZATION POLICY
March 1, 2001

ASSET TYPE	CAPITALIZATION AMOUNT	DEPRECIATE YES OR NO	USEFUL LIFE Governmental	USEFUL LIFE Proprietary	SALVAGE VALUE
Furniture and equipment	Greater than $5,000	Yes	7 years	1-25 years	None
Motor vehicles	Greater than $5,000	Yes	5 years	5-10 years	None
Land	All	No	N/A	N/A	N/A
Land Improvements	Greater than $100,000	Yes	15 years	5-100 years	None
Buildings	Greater than $100,000	Yes	30 years	5-100 years	None
Works of Art	Greater than $5,000	No	N/A	N/A	N/A

Note: This policy, which is effective for the fiscal year ending June 30, 2002, is for financial statement reporting purposes only and is applicable for governmental and proprietary funds.