

Relationship Between Budgetary and Financial Statement Information

The original recommended practice was developed by the Government Finance Officers Association (GFOA). Some aspects of the practice have been revised by the Financial Management Capacity Building Committee (FMCBC) for use by Nova Scotia municipal governments. The original GFOA recommended practice is *Relationship Between Budgetary and Financial Statement Information* approved by the GFOA in 1999. Other sources used are footnoted in the text.

Recommendation

The GFOA recommends that a local government's budget document should clearly define the basis of accounting used for budgetary purposes. If the budgetary basis of accounting and the generally accepted accounting principles (GAAP) basis of accounting are the same, then this fact should be clearly stated. If the budgetary basis of accounting and the GAAP basis of accounting are different, major differences and similarities between the two bases of accounting should be noted. The description of the differences between the GAAP basis of accounting and the budgetary basis of accounting should be written in a manner that is clearly understandable to those without expertise in either accounting or budgeting.

Purpose

By explaining the major differences found in GAAP and the Canadian public sector accounting board (PSAB) with the basis of accounting used by a municipality, stakeholders and residents better understand and interpret the numbers presented in budget documents and financial statements. By providing greater clarity to stakeholders and the public, a municipality becomes more transparent and accountable.

Background

The basis of accounting used for the purposes of financial reporting with GAAP/PSAB is not necessarily the same basis used in preparing a local government's budget document. For example, governmental funds are required to use the modified accrual basis of accounting in GAAP/PSAB financial statements, but the cash basis of accounting may be used in those same funds for budgetary purposes. Differences between GAAP/PSAB and the budgetary basis of accounting often occur because regulations governing budgeting may differ from GAAP/PSAB.

Considerations for Policy Development

When municipalities wish to explain the differences between their budgetary and financial statement documents, some considerations should be made. The following is a description of some components that municipalities should consider when developing a document explaining the relationship between its budgetary and financial statement documents.

- Municipalities should explain the principles of GAAP/PSAB.
- Municipalities should explain the guidelines that they have followed, if they differ.
 - This may involve including the Financial Reporting and Accounting Manual and legislations from the Municipal Government Act.
- A description of the differences and how they differ should be included.
 - They should be explained in an understandable and readable format.
 - If there are difficult accounting terminologies, they should be defined.

In order to have a clearer understanding of these recommendations, see *Appendix I* for an example of how these differences have been described in the City of Scottsdale, Arizona.

In addition to explaining the differences between budgetary and financial statement documents, municipalities should also consider changing its accounting practices to become more aligned with GAAP/PSAB principles. *Appendix II* includes a summary of the PSAB principles that are particularly applicable to municipalities. Furthermore, *Appendix III* is the Province of Nova Scotia's identification of areas where accounting reporting is not fully GAAP compliant, and thereby identifying the areas where it intends to become fully GAAP compliant. If a municipality wishes to make the transition to become fully GAAP/PSAB compliant, *Appendix IV* includes a description of how the Province of Manitoba became GAAP/PSAB compliant. This can act as a helpful guideline for municipalities wanting to make the same transition. Lastly, *Appendix V* is a financial report from the City of Mississauga, which provides a model of a GAAP/PSAB compliant municipality.

Appendices

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Appendix I: Example of Stated Differences between Budget and Financial Statement

The following is an example of how a municipality may word and format a document explaining the differences between its budget and financial statement with the GAAP/PSAB principles.

Scottsdale, Arizona's budget has been prepared on a cash basis of accounting for all fund types, where certain transactions are recognized in the budget on a basis other than GAAP. GAAP is the basis used to prepare the City's Comprehensive Annual Financial Report (CAFR). The following are the significant differences between the budgetary document and GAAP basis.

- Certain revenues, expenditures, and transfers are not included on the budget basis, but are accrued and reported on the GAAP basis. For example, increases or decreases in compensated absences are not reported for budget basis purposes, but are presented as revenues or expenditures on the GAAP basis.
- Indirect administrative cost allocations (including in lieu property tax and franchise fees) charges to the Enterprise Funds are accounted for as transfers in or out on the budgetary basis, but are recorded as revenues or expenses on the GAAP basis.
- Capital outlays in the Enterprise Funds are presented as expenses for the budget basis, but are recorded as assets along with associated depreciation expenses on the GAAP basis.
- Debt service principal payments in the Enterprise Funds are accounted for as expenses for budget purposes, but are reported as reduction of long-term debt liability on the GAAP basis.
- Certain debt service principal and interest payments are accounted for as expenses in the General Fund for budget basis purposes, but are reported as expenses in the Debt Service Fund on the GAAP basis.
- For budget purposes, the Risk Fund presents claim expenditures on a cash basis, while on a GAAP basis the claim expenditures reflect an accrual for 'incurred but not reported' claims.

All actual amounts in the budget document were shown on the budgetary basis to facilitate meaningful comparisons. Budgeted funds include the General, Special Revenue, Debt Service, Enterprise, Internal Service, Grant & Trust, and Capital Improvement Plan.¹

¹ City of Scottsdale, Arizona, Fiscal Year 2005/06 Budget. [How to Use this Book](#).

Appendix II: Nova Scotia's Steps to GAAP Compliance

The Province of Nova Scotia released this document to indicate the changes that should be made in order to become more GAAP/PSAB compliant. This could also act as a guide to municipalities when stating the differences between their budgetary and financial statements, as well as a guide to working towards become fully GAAP/PSAB compliant.

The Province of Nova Scotia follows PSAB for the public sector to the extent necessary to provide an unqualified opinion, however, there are certain specific requirements not yet being fully met. For example, the following are identified areas where government should consider fuller GAAP compliance in the future.

- The consolidated financial statements do not include budget amounts for the line items on the Statement of Operations and Statement of Change in Net Direct Debt. This disclosure is required by the CICA's PSAB. Related to this, government does not yet prepare or present its budget on a basis fully consistent with that used for the consolidated financial statements.
- PSAB requires that expenses be disclosed at gross value. However, there are various user fees, chargeables, and recoveries that are netted against expenses on the Consolidated Statement of Operations. The financial statement provides some disclosure of the amounts netted against expenses but does not provide a breakdown of gross expenses by line item on the Statement of Operations. The expenses are disclosed on a net basis to be consistent with the budget, which is correspondingly presented on a net basis.
- There are federal transfer payment revenues recorded as recoveries and netted against expenses. The Province identified \$161.6 million in federal payments that were recorded as recoveries. The impact of this accounting treatment is an understatement of revenues and expenses with no impact on the surplus balance. The Province was informed that these revenues were treated as recoveries to be consistent with treatment in the budget.
- When consolidating the tangible capital asset balances of entities included in the reporting entity, those balances are not adjusted to comply with the government's Tangible Capital Asset accounting policy requirements for such facts as thresholds, amortization rates, and useful life expectancy. Management has indicated that there would be practical challenges in implementing this requirement and that the costs of doing so would exceed the benefits.
- A number of smaller crown entities and government partnership agreements are not yet fully and appropriately accounted for in the consolidated financial statements. The impact of this is an understatement of net assets and an overstatement of net direct debt of approximately \$24.1 million.

- Derivative transactions are recorded between consolidated fund, the sinking fund, and the public debt retirement fund of the Province. These are inter-entity transactions that should be eliminated. The impact of these inter-entity transactions not being eliminated during consolidation is an overstatement of the current surplus of \$7.4 million, an understatement of liabilities of \$13.2 million, and an understatement of opening net direct debt of \$5.8 million.

Recommendation

The Province of Nova Scotia recommends that steps be taken to ensure that the Province complies more fully with generally accepted accounting principles, especially with regard to disclosing GAAP compliant budget information in the financial statements.

It is important to acknowledge that the accounting standards and pronouncements that make up GAAP continue to evolve. There are new accounting pronouncements and some in process that will have an impact on the government's future financial reporting. For example, the following are more significant matters that PSAB has recently released final pronouncements or is developing new or revised pronouncements:

- Liabilities, contingent liabilities, and contractual obligations;
- Generally accepted accounting principles;
- Government transfers; and
- Financial instruments.

New formal recommendations or guidance in such areas could require changes to government's financial reporting in the future. Further, government should disclose the nature and impact of required or planned accounting changes as soon as practical, ideally no later than during the presentation of the budget for the fiscal year that the changes will take effect.²

² Province of Nova Scotia. Government Financial Reporting. December 2005.
<http://www.gov.ns.ca/audg/Dec2005/ch2%20dec2005GovFinRept.pdf>.

Appendix III: Public Sector Accounting Board Principles Relevant to Municipalities

Municipalities in Nova Scotia should be aware of the PSAB principles that are most applicable to municipalities. The following is a list of the PSAB summaries that are particularly relevant to municipalities:

PS 1300 – Financial Reporting Entity

This section defines the scope of the reporting entity in terms of the organizations whose financial affairs and resources should be accounting for in a government's financial statements and recommends how to account for the financial affairs to those organizations in the government's financial statements. This statement also recommends how to account for long-term investments and trusts under administration.

PS 1700 – Objectives of Financial Statements: Local Government

This section identifies primary users of local government financial statements and their information needs; sets out the objectives of local government financial statements based on those needs; and recommends general reporting principles for the disclosure of information in local government financial statements.

PS 1800 – General Standards of Financial Statement Presentation: Local Government

This section completes the framework of generally accepted accounting principles and financial reporting standards appropriate for local government by recommending general standards on the financial statements that local governments should prepare, the information that should be reported in those statements and when to record revenues and expenditures.

PS 2100 – Disclosure of Accounting Policies

This section deals with the disclosure of accounting policies adopted by an entity in the preparation and presentation of its financial statements. Accounting policies are the specific accounting principles used by a reporting entity and the methods for applying those principles.

PS 2120 – Accounting Changes

This section pertains to the accounting treatment of a change in an accounting policy, a change in an accounting estimate, and a correction of an error relating to prior period financial statements.

PS 2400 – Subsequent Events

This section defines two types of subsequent events: those that provide further information of existing conditions at the financial date and those conditions that arose subsequent to the financial statement date. Adjustments to financial statements only when additional information relates to items already recognized.

PS 2500 – Basic Principles of Consolidation

This section recommends how to do a basic consolidation. It addresses intergovernmental transactions, unrealized gains and losses, and what to do when the financial statements are being consolidated have different year ends.

PS 2510 – Additional Areas of Consolidation

This section recommends how to account for those rare situations that can arise in a consolidation exercise. It addresses non-controlling interest, acquisitions, sale of all or part of a government unit, and what to do when a governmental unit becomes a business enterprise.

PS 2600 – Foreign Currency Translation

This section recommends how to account for foreign denominated monetary assets for initial and subsequent recognition and measurement. It addresses the presentation of the gains and losses associated with subsequent measurement. It provides recommendations on when the application of hedge accounting is appropriate.

PS 3030 – Temporary Investments

This section recommends how to account for and report all investments that are transitional or current in nature, such as short-term investments made to obtain a return on a temporary basis.

PS 3040 – Portfolio Investments

This section recommends how to account for and report long-term investments. It addresses initial subsequent recognition, losses in value, gains and losses on sale, and investments made with concessionary terms.

PS 3050 – Loans Receivable

This section recommends how to account for and report loans receivable. It addresses situations that can arise in the public sector such as loans to be repaid with future appropriations, forgivable loans, and loans with concessionary terms. It provides recommendations on write-offs and valuation.

PS 3060 – Government Partnerships

This section addresses those contractual partnership agreements where the organization is outside of the control of the reporting entity. It defines a partnership and recommends the appropriate accounting.

PS 3070 – Investments in Government Business Enterprises

This section describes how to apply the modified equity method of accounting. It addresses the components of the investment and income accounts, the same of all or part of a government business enterprise, financial statements at different dates and when an organization no longer meets the definition of a government business enterprise.

PS 3100 – Restricted Assets and Revenues

This section recommends how to account for and report restricted assets and revenues in the financial statements of governments. The recommendations do not apply to trusts under administration that are excluded from the government reporting entity.

PS 3230 – Long-Term Debt

This section deals with the presentation and disclosure of long-term debt in government financial statements.

PS 3250 – Retirement Benefits

This section defines retirement benefits and recommends how to account for defined contribution/benefit plans, multiple employer plans, and measurement of any related assets and liabilities.

PS 3255 – Post-Employment Benefits, Compensated Absences, and Termination Benefits

This section provides definitions of each type of benefits, and recommends recognition points and measurements of the related liability.

PS 3270 – Solid-Waste Landfill Closure and Post-Closure Liability

This section recommends how to account for and report the liability for closure and post-closure care of solid waste landfill site.

PS 3310 – Loan Guarantees

This section recommends how to account for and report government loan guarantees in government financial statements. Accrual is required when a default is likely.

PS 3410 – Government Transfers

This section defines various types of transfers and recommends when liabilities should be reported. It also addresses advance payments and accounting for contingent recoveries.

PSG-2 – Leased Tangible Capital Assets

This guideline defines a capital lease and recommends how to account for any gain or loss associated with the transaction.

PSG-3 – Sale and Leaseback Transactions

This guideline defines a sale and leaseback transaction and describes how to account for them when the leaseback involves either a capital lease or an operating lease.³

³ Service Nova Scotia and Municipal Relations. Municipal Financial Reporting Public Sector Standards PSAB 101. January 2004.

Appendix IV: The Province of Manitoba's Transition to Full GAAP PSAB Compliance

The Province of Manitoba made a commitment to fully comply with GAAP/PSAB for the 2008 fiscal year, which extended to the Province's budgeting and reporting process. The following is a model of how the Province of Manitoba met the various challenges it encountered when taking strides to becoming more GAAP/PSAB compliant. Municipalities may find this framework useful when adopting the GAAP/PSAB principles. Some of the descriptions of the activities have been modified to be more suitable to municipalities.

In their commitment to implementing GAAP/PSAB, the Province of Manitoba encountered the following challenges with financial planning and reporting processes:

- Summary Financial Statements
 - The Government committed to fully implement all provisions of GAAP, including the expansion of the GRE (Government Reporting Entity).
- Summary Budgeting
 - The annual budget tabled by the Government will be a summary budget prepared for the entire GRE and using the accounting principles inherent to GAAP/PSAB.
- Summary Interim Reporting
 - The Province provides quarterly reports at the end of its first, second, and third quarters. The commitment to summary reporting will ultimately require these interim financial statements to be prepared on a GAAP/PSAB basis and presented for the full GRE.
- Annual Report
 - Complete implementation of summary reporting will include the preparation of an annual report that will contain a comprehensive financial statement discussion and analysis.⁴

Although municipalities in Nova Scotia may encounter different challenges when adopting all of the GAAP/PSAB standards, the process of implementing the recent standards may be similar to the Manitoba case. In this particular situation, the Province of Manitoba was met with the challenge of the expansion of the GRE and the ongoing implementation of new GAAP/PSAB standards. In order to comply with these changes, the Province of Manitoba formed a Steering Committee to oversee the project. This Steering Committee decided to seek external expertise to properly execute the impending challenges. After completing a request for proposal process, Deloitte was selected to provide project management and consulting services to help adopt GAAP/PSAB requirements.⁵

⁴ Deloitte & Touche LLP and affiliated entities. Province of Manitoba Report on Summary Financial Reporting Project Executive Summary.
http://www.gov.mb.ca/finance/pdf/executive_summary.pdf.

⁵ Ibid.

Municipalities in Nova Scotia may choose to seek external help for expertise surrounding GAAP/PSAB requirements to aid their municipality in fully complying with the new accounting standards. If municipalities in Nova Scotia decide to implement the new accounting standards independently, they can consider the process that Deloitte took when implementing GAAP/PSAB to the Province of Manitoba.⁶

Deloitte undertook four types of activities before synthesizing the findings and formulating its recommendations. These activities included:

1. Meetings and Discussions with Stakeholders

Over the course of the project, Deloitte met regularly with a Steering Committee. Deloitte also met with the representatives of each of the Department of Finance, and representatives from the working groups (the use of the working groups is explained in more detail below).

2. Analysis

As part of their work, Deloitte undertook various analyses to analyze the GRE and to gain a better understanding of the Canadian public sector financial reporting landscape. The Department of Finance was also involved in some of the analyses.

3. Working Group Interaction

In order to manage the magnitude and complexity of the task inherent in consulting with the large number of entities within the GRE, a decision was made early in the project to divide the GRE entities into logical groupings. As a result, seven working groups were established. The groups were broken down into Recreation, Public Safety/Emergency Services, Public Works, and Environment.

Throughout the project, there were three meetings held with each working group. First, the Steering Committee held an orientation session to describe the commitment to Summary Reporting. Then, Deloitte facilitated the first working group session, where each working group discussed their views on the issues that they anticipated for their organizations. After consultation with the Steering Committee on the issues raised by the working groups, a second working group session was held to describe the other issues concerning the implementation of GAAP/PSAB. For municipalities in Nova Scotia, the meetings do not necessarily need to limit their working group meetings to two, depending on the depth and need for discussions.

⁶ Deloitte & Touche LLP and affiliated entities. Province of Manitoba Report on Summary Financial Reporting Project Executive Summary.
http://www.gov.mb.ca/finance/pdf/executive_summary.pdf.

4. *Review of Existing Processes*

The meetings with the Department of Finance gathered information about the current accounting processes. By collecting this information, Deloitte was able to determine where the changes needed to be made.⁷

After completing these preliminary steps, Deloitte compiled a detailed list of specific issues identified by each stakeholder and working group. This list was titled 'Challenges'. Based on this list of challenges, Deloitte then compiled an 'Implementation Plan', which was comprised of six components:

1. *The Guiding Principles*

After the Steering Committee and Deloitte had analysed the findings from the working groups and the challenges, the two groups agreed upon a set of guiding principles. These guiding principles addressed the issues identified by the stakeholders, and were subsequently addressed to all of the working groups to provide clarity.

2. *Impact of the Guiding Principles*

After establishing the guiding principles, the next step is to apply these principles against the identified issues. Some of the guiding principles might address arising issues and concerns, however, if there are issues and concerns that may still need to be addressed, the guiding principles should be applied.

3. *Communication*

The success of the implementation plan will depend largely on the effectiveness of the communication among stakeholders. Open lines of communication will help to ensure that any problems encountered would be addressed on a timely basis, particularly when the timing for completion directly impacts other stakeholders or subsequent steps in the plan.

Deloitte has suggested that the communication be coordinated through an implementation task force. The principle elements of the task force's responsibility would be to:

- Monitor progress against the implementation plan;
- Serve as a resource for all individual GRE entities and working group coordinators as they each develop their own organizational plans to complete their component of the Summary Reporting responsibilities; and
- Serve as a consulting resource for smaller GRE entities that lack the expertise and skill to tackle their new responsibilities independently.

⁷ Deloitte & Touche LLP and affiliated entities. Province of Manitoba Report on Summary Financial Reporting Project Executive Summary.
http://www.gov.mb.ca/finance/pdf/executive_summary.pdf.

A standing committee on financial reporting should be developed to facilitate ongoing communication. The purpose of the committee would be to:

- Ensure that all concerns from GRE entities are addressed in a timely and comprehensive manner;
- Assess the implications of upcoming GAAP/PSAB standards;
- Prepare the GRE wide response to implementation requirements for new GAAP/PSAB standards; and
- Develop the annual timetables for budgeting and financial reporting processes.

4. *Resourcing*

A municipality should clearly outline the duties responsible for financial reporting and those correspondingly accountable for carrying out the duties. Deloitte recommends that a municipality should limit the number of people involved in financial reporting and budgeting. The same individuals involved with financial reporting should be involved with budgeting. Other areas involved with complying with GAAP/PSAB will be needed, and additional resources should be added as required.

5. *Legislation*

Municipalities should ensure that their Summary Reporting is congruent with the municipality's and the Province's legislations.

6. *Specific Action Steps*

In order to implement this plan, municipalities may consider developing 'to do' lists for its working groups, Steering Committee, and a potential task force. This could help in easing the process as well as developing a strategic plan that can be utilized when the GAAP/PSAB changes in the future.⁸

After completing the Implementation Guide, Deloitte has recommended that the Province of Manitoba '*Look to the Future*', which could include a commitment to maintaining compliance with the changing GAAP/PSAB and encountering any challenges. This document could include two components:

1. *Potential Implementation Risks*

The following are some issues that may arise when implementing changes:

a. *Changing responsibility assignments*

A significant number of parties within the financial reporting structure must accept new responsibilities to successfully implement the new plan. This will require compliance from the staff and to actively work to equip themselves with personnel, systems, and processes to execute the new responsibilities.

⁸ Deloitte & Touche LLP and affiliated entities. Province of Manitoba Report on Summary Financial Reporting Project Executive Summary.
http://www.gov.mb.ca/finance/pdf/executive_summary.pdf.

- b. Degree of integration of activities and timeliness across the GRE
By having so many entities involved in the reporting process, risk may be involved with the execution of the implementation plan. The degree of integration should be reduced.

2. *Anticipating Future Issues*

By complying with GAAP/PSAB, a municipality needs to anticipate future evolution in its accounting procedures. GAAP/PSAB are continuously, and in order to remain compliant, municipalities need to remain flexible in updating their accounting standards. The impact of these changes will need to be assessed and plans will need to be implemented to meet the new requirements.⁹

⁹ Deloitte & Touche LLP and affiliated entities. Province of Manitoba Report on Summary Financial Reporting Project Executive Summary.
http://www.gov.mb.ca/finance/pdf/executive_summary.pdf.

Appendix V: The City of Mississauga – GAAP/PSAB Compliance

The City Mississauga is an example of a municipality that has successfully adopted PSAB and GAAP. The link below is the City of Mississauga's 2004 Financial Report. This document provides a detailed description of the municipality's financial report. This can act as an example for municipalities in Nova Scotia to consider when adopting the PSAB and GAAP accounting standards.

<http://www.mississauga.ca/portal/cityhall/budget>

References

City of Scottsdale, Arizona, Fiscal Year 2005/06 Budget. How to Use this Book.
<http://www.ci.scottsdale.az.us/finance/documents/Adopted/volume3c.pdf>.

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