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University of California GASB 35 Financial Statement Presentation

Issues Resolution Memo No. 127 *(Re-issued November 4, 2002)*

Recording Accrued Interest Expense Payable

Define Issues

Paragraph 16 of GASB Statement No. 34 requires the University to prepare financial statements using the economic resources measurement focus and the accrual basis of accounting. The University must convert the recording of interest expense from the cash basis of accounting to the accrual basis of accounting. The change in accounting policy is required for the fiscal year beginning July 1, 2001, with comparative information for the prior year necessary for restatement purposes.

Background

During 1999, the Government Accounting Standards Board (GASB) introduced GASB Statements 34 and 35. These Statements substantially revised the standards for external financial reporting by public institutions. The new reporting standards are required for the fiscal year beginning July 1, 2001, with comparative information for the prior year.

According to the new standards, the separately issued financial statements of public colleges and universities must include:

- Management's Discussion and Analysis (MD&A)
- Statement of Net Assets
- Statement of Revenues, Expenditures and Changes in Net Assets
- Statement of Cash Flows
- Notes to the Financial Statements

Financial statements must be prepared in accordance with GAAP (generally accepted accounting principles) and are subject to audit under GAAS (generally accepted auditing standards).

GAAP requires a change in accounting for interest expense.

Authoritative Guidance

GASB Statement No. 34 prescribes the measurement focus and basis of accounting required to be used in the University's financial statements. Paragraph 16 states the following:

Paragraph 16—The statement of net assets and the statement of activities should be prepared using the economic resources measurement focus and the accrual basis of accounting. Revenues, expenses, gains, losses, assets, and liabilities resulting from exchange and exchange-like transactions should be recognized when the exchange takes place¹¹. Revenues, expenses, gains, losses, assets, and liabilities resulting from nonexchange transactions should be recognized in accordance with the requirements of Statement 33...

Footnote 11—In this Statement, the terms transaction and transactions refer only to external events in which something of value (benefit) passes between two or more parties. The difference between exchange and exchange-like transactions is a matter of degree. In contrast to a “pure” exchange transaction, an exchange-like transaction is one in which the values exchanged, though related, may not be quite equal or in which the direct benefits may not be exclusively for the parties to the transaction. Nevertheless, the exchange characteristics of the transaction are strong enough to justify treating the transaction as an exchange for accounting recognition.

With respect to the economic resources measurement focus, Paragraph 18(2) of the National Council on Governmental Accounting Statement 1 (NCGAS 1), *Governmental Accounting and Financial Reporting Principles*, indicates:

Paragraph 18(2)—*Proprietary Fund* revenues and expenses should be recognized on the accrual basis. Revenues should be recognized in the accounting period in which they are earned and become measurable; expenses should be recognized in the period incurred, if measurable.

With respect to the accrual basis of accounting, NCGAS 1, Paragraphs 58 and 8(b) state the following:

Paragraph 58—“Basis of accounting” refers to when revenues, expenditures, expenses, and transfers—and the related assets and liabilities—are recognized in the accounts and reported in the financial statements. Specifically, it relates to the *timing* of the measurements made, regardless of the nature of the measurement, on either the cash or accrual method. For example, whether depreciation is recognized depends on whether expenses or expenditures are being measured rather than on whether the cash or accrual basis is used.

Paragraph 8(b)—Proprietary Fund revenues and expenses should be recognized on the accrual basis. Revenues should be recognized in the accounting period in which they are earned and become measurable; expenses should be recognized in the period incurred, if measurable.

Finally, NCGAS 1, Paragraph 60 states:

Paragraph 60—The accrual basis is the superior method for accounting for the economic resources of any organization. It results in accounting measurements based on the substance of transactions and events, rather than merely when cash is received or disbursed, and thus enhances their relevance, neutrality, timeliness, completeness, and comparability. Accordingly, the Council recommends use of the accrual basis to the fullest extent practicable in the government environment. The accrual basis is necessarily applied somewhat differently in the proprietary funds (accrual basis) than in the government funds (modified accrual basis), however. The cash basis of accounting is not appropriate.

Approach

For Fiscal Year Ending June 30, 2001

The University must convert from the cash basis method of accounting for interest expense to the accrual basis of accounting beginning in FY 2001-2002. Prior year information will need to be accumulated in order to support comparative financial statements.

Campuses will be required to calculate accrued interest expense on all external debt recorded on their ledgers as of June 30, 2001 (interest due on outstanding debt between the date of the most recent cash interest payment and June 30) and report those details to UCOP (see Exhibit 1 to this IRM). Interest expense on pooled debt will be calculated by UCOP. The University will not record the accrued interest in the General Ledger for the fiscal year ending June 30, 2001; during FY 2001-2002, UCOP will request that campuses make the following entry to record the accrued interest expense as a prior-year adjustment:

Debit Fund Balance (use Plant Fund transaction code 6100 or Loan Fund transaction code 8600—Prior Year Hand Posted Journal Entries)

Credit Fund Balance¹

1 Campuses must use the following transaction code(s), as appropriate:

Transcode (TC) Description	Auxiliary & Service Enterprises TC	Hospital TC	Other TC
<i>Plant Fund Transaction Codes</i>			
Payment of Interest on Bank Loans	2210	2240	2270
Payment of Interest on Tax-Exempt Commercial Paper			2273

Transcode (TC) Description	Auxiliary & Service Enterprises TC	Hospital TC	Other TC
Payment of Interest/Discount on Taxable Commercial Paper			2274
Payment of Interest on Bonds	2215	2245	2275
Payment of Interest on Capital Leases/Installment Purchases	2220	2250	2280
Payment of Interest on Other	2225	2255	2285
Repayment of Interest on State Capital Leases			2290
Repayment of Interest on State Energy Efficiency Bonds			2291
<i>Loan Fund Transaction Codes</i>			
Faculty Mortgage Program—Bond Interest			8133

For Fiscal Year Ending June 30, 2002 and Thereafter

Campuses and UCOP will be required to record the accrued interest expense payable on all external debt recorded in their ledgers as of June 30, 2002 (interest due on outstanding debt between the date of the most recent cash interest payment and June 30). Interest expense on pooled debt will be calculated and recorded by UCOP. The amount of accrued interest payable will be recorded in the June 30, 2002 General Ledger and reported on a closing schedule appendix (see Exhibit 2 of IRM No. 103). Campuses and UCOP will make the following entry at year-end on a reversing journal:

Debit Fund Balance²

Credit Current Liabilities-Other-Accounts Payable LTD-Interest Expense
(account should map to Account Group Code 114770)

2 Campuses and UCOP must use the transaction code(s) provided under Footnote 1, as appropriate

Note: Exhibit 2 of IRM No. 103, Current and Noncurrent Financing Activity—Distribution of Current and Noncurrent Financing Liabilities, includes a column (Interest Accrual at 6/30) to capture the interest accrual for outstanding debt obligations at the end of each fiscal year. This column is not required as part of the Exhibit 2 (June 30, 2001 closing schedule Appendix C) campus reporting package submission to UCOP for the year ended June 30, 2001, but will be required for June 30, 2002.

Next Steps—Required Actions

Responsibility (C, OP)	Required Completion Date	Action Item/Task
C/OP	31-Oct-01	Submit FY 2000-2001 Interest Expense Accrual Amounts— Submit the June 30, 2001 interest expense accrual amounts to UCOP, as information, in order to restate the June 30, 2001 financial statements in FY 2001-2002 (see Exhibit 1 of this IRM). <u>These amounts will not be recorded in campus General Ledgers at June 30, 2001.</u> The information will be used to prepare entries to be made during FY 2001-2002 as prior-period adjustments.
OP	31-Jan-02	Provide Information for Recording Prior-Year Adjustment— Provide campuses with information for recording prior-year adjustment to recognize accrued interest expense as of June 30, 2001.
C	28-Feb-02	Record Prior-Year Adjustment— Record prior-year adjustment to recognize accrued interest expense as of June 20, 2001.
C/OP	1-Apr-02	Modify FY 2001-2002 Local Annual Closing Process— Modify FY 2001-2002 local annual closing process to record in the General Ledger the interest expense payable at June 30, 2002 on all outstanding debt.
C/OP	3-Aug-02	Record FY 2001-2002 Interest Expense— Record FY 2001-2002 amount of interest expense accrued.
C/OP	15-Aug-02	Report the FY 2001-2002 Amount of Interest Expense— Report the FY 2001-2002 amount of the interest expense accrued on Exhibit 2 (of IRM 103) of the financial reporting package submitted to UCOP.

IRM 127—Exhibit 1

Accrued Interest Expense Payable Summary for the Fiscal Year Ended June 30, 2001

Campus: _____

As of 6/30/01					
Interest Expense Payable	Date Last Paid	Auxiliary & Service Enterprises	Hospital	Other	Total
Accrued Interest Expense Payable on Bank Loans (TC 2210, 2240, or 2270) List by account and title and sub-total		\$ -	\$ -	\$ -	\$ -
Accrued Interest Expense Payable on Tax-Exempt Commercial Paper (TC 2273) List by account and title and sub-total		n/a	n/a		
Accrued Interest Expense Payable on Taxable Commercial Paper (TC 2274) List by account and title and sub-total		n/a	n/a		
Accrued Interest Expense Payable on Bonds (TC 2215, 2245, 2275) List by account and title and sub-total					
Accrued Interest Expense Payable on Capital Leases/Installment Purchases (TC 2220, 2250, 2280) List by account and title and sub-total					
Accrued Interest Expense Payable on Other (TC 2225, 2255, 2285) List by account and title and sub-total					
Accrued Interest Expense Payable on State Capital Leases (TC 2290) List by account and title and sub-total		n/a	n/a		
Accrued Interest Expense Payable on State Energy Efficiency Bonds (TC 2291) List by account and title and sub-total		n/a	n/a		
Accrued Interest Expense Payable--Faculty Mortgage Program-Bond Interest (TC 8133) List by account and title and sub-total		n/a	n/a		
Total Accrued Interest Expense Payable		\$ -	\$ -	\$ -	\$ -

Note: Accrued interest will not be recorded in campus General Ledgers at June 30, 2001. It will be used to reclassify the June 30, 2001 financial statements in conjunction with the June 30, 2002 Annual Report. Only include interest on debt recorded locally.