Central Financial Reporting and Accounting System

White Paper

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Calculating Reversions to the State General Fund

This white paper is issued by the New Mexico Department of Finance and Administration's Financial Control Division. It is intended as a key for understanding finance and accounting related issues and does not supersede the rules and regulations of the Department of Finance and Administration or the policies and procedures in the *Central Financial Reporting and Accounting System Policies and Procedures Manual*.

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Introduction

The New Mexico State Legislature makes appropriations to the departments and agencies of the State of New Mexico. These appropriations are authorizations allowing the departments and agencies to make expenditures and, are funded by various sources including the State General Fund. The State General Fund is the repository for most of the State's revenues (taxes, fees, investment income, etc.).

Each month, usually at a rate approximately equal to one twelfth of the total appropriations to be funded by the State General Fund, the New Mexico Department of Finance and Administration transfers money from the State General Fund to the funds administered by the departments and agencies.

Most appropriations are in effect for a period of one fiscal year, beginning July 1 and ending June 30. However, many appropriations (called "multiple-year appropriations") are in effect for several fiscal years.

After a specific appropriation lapses, the difference between the dollar amount of the appropriation received and the related expenditures made by the agency usually must be paid back to the State General Fund. The State uses its own jargon to describe the type of money that must be paid back, the aggregate amount of money that must be paid back, and the type of fund that holds money that must be paid back.

The type of money that must be paid back is called "reverting money." The aggregate amount of money that must be paid back is called a "reversion." A fund that holds reverting money is called a "reverting fund." Conversely, if state law exempts certain money or a specific fund from having to revert, the fund and the money are referred to as "non-reverting."

Given the reverting versus non-reverting status of money and funds, calculating reversions to the State General Fund can be complicated. Complications include: a) the intricacies of, and sometimes conflicts between, generally accepted accounting principles (GAAP) and the budgetary basis of accounting used by the State; and b) the practice of agencies using State General Fund money for cash flow until revenues from other sources are collected.

The following discussion explains how to calculate reversions, taking into account all these complicating factors. A thorough understanding of generally accepted accounting principles, the budgetary basis of accounting used by the State, and state statutes and laws (legislation) is needed to calculate reversions accurately.

Understanding the Accounting

The following equation brings together generally accepted accounting principles and the budgetary basis of accounting used by the State to calculate an amount referred to as "unreserved, undesignated fund balance." By law unreserved, undesignated fund balances, at June 30, must revert to the State General Fund. The terms "unreserved," and "undesignated" are explained on page 5.

Fund balance, July 1

\+ Revenue
\- Expenditures
\+ Transfers-in and other financing sources
\- Transfers-out and other financing uses

= **Fund balance, June 30**

\- Reserved fund balance
\- Designated fund balance

= **Unreserved, undesignated fund balance, June 30**

The first part of this equation uses generally accepted accounting principles to calculate fund balances at June 30. The second part of the equation uses the budgetary basis of accounting to calculate unreserved, undesignated fund balances at June 30. Calculating unreserved, undesignated fund balances by first calculating fund balance helps ensure an accurate calculation by eliminating the confusion that can arise when applying, to one equation, both generally accepted accounting principles and the budgetary basis of accounting.

Fund Balance and Generally Accepted Accounting Principles

Generally accepted accounting principles require that transactions accounted for in governmental funds (general, special revenue, capital projects, and debt service funds) or in fiduciary funds of a similar nature (expendable trust funds) be recorded using the modified accrual basis of accounting. Transactions accounted for in proprietary funds (enterprise and internal service funds) or in fiduciary funds with the same measurement objective (nonexpendable trust and pension trust funds) should be recorded on the accrual basis.

Under the modified accrual basis of accounting, revenues are recognized and recorded in the accounting period in which they become susceptible to accrual – that is, when they become both measurable and available. Expenditures are recognized and recorded in the period the related liability is incurred. Transfers among funds are recognized in the period in which the interfund receivables and payables arise.

In other words, generally accepted accounting principles define what revenues, expenditures, and transfers are, and define in which period (fiscal year) they are recorded.

Unreserved, Undesignated Fund Balance and the Budgetary Basis of Accounting Used by the State

The budgetary basis of accounting used by the State is for the most part consistent with generally accepted accounting principles, except in two areas.

1. <u>Encumbrances.</u>

The State recognizes encumbrances (commitments related to unperformed contracts) as expenditures. The General Appropriation Act defines expenditures as:

> costs, expenses, **encumbrances** and other financing uses, other than refunds authorized by law, recognized in accordance with generally accepted accounting principles

> for the legally authorized budget amounts and budget period. [emphasis added]

This exception becomes a deduction from fund balance, a reservation of fund balance – non-reverting money. Like this deduction, all other reservations of fund balance must be specifically authorized by legislation. In applying its budgetary basis of accounting, the State distinguishes between reserved fund balances and designated fund balances.

A reserved fund balance is a fund balance earmarked for the purpose of providing resources to pay for future expenditures related to outstanding commitments – valid unperformed contracts. On a budgetary basis, these commitments are expenditures even though they are not expenditures under generally accepted accounting principles. This conflict between accounting methods requires an adjustment to fund balance to arrive at the budgetary basis fund balance: unreserved, undesignated fund balance.

A designated fund balance is a fund balance that has been designated by legislation for a specific purpose, the expenditure or encumbrance for which has not yet occurred but is anticipated some time in the future, if and when an appropriation is made. On a budgetary basis, a designated fund balance is considered a resource, albeit restricted to a specific purpose, and is nonreverting.

2. Disbursements for purchase of capital assets.

The second area in which the budgetary basis is not consistent with generally accepted accounting principles is in the recognition and recording of disbursements for the purchase of capital assets. Instead of recording capital assets and recognizing depreciation expense over the life of the assets, the budgetary basis of accounting (for proprietary funds and for nonexpendable and pension trust funds) expenses the cost of the assets in the year the asset is purchased.

Understanding the Legislation

Legislation must be followed when calculating the amount of a reversion. Therefore, a thorough understanding of relevant legislation is necessary to make the calculation accurately.

General Legislation

Two general state laws govern most reversions.

1. Section 6-5-10, NMSA, 1978, as amended.

This statute requires in part:

> All unreserved undesignated fund balances in reverting funds and accounts as reflected in the central financial reporting and accounting system as of June 30, as adjusted, shall revert to the general fund within ten days of release of the audit report for the fiscal year.

This statute relates to the entire reversion equation shown on page 3. It requires that the result obtained from the equation – unreserved, undesignated fund balance – be reverted. The state departments' and agencies' reports include each component of the equation, stated in accordance with generally accepted accounting principles, with expenditures on a budgetary basis (expenditures including encumbrances) disclosed separately. This statute also establishes a budgetary basis of accounting separate from generally accepted accounting principles. It also relates the date of reversion to the audit report.

2. The General Appropriation Act.

The following is an excerpt from the General Appropriation Act of 1998. It requires:

> Unencumbered balances in agency accounts remaining at the end of fiscal year 1998 shall revert to the general fund by October 1, 1998, unless otherwise indicated in the General Appropriation Act of 1998 or otherwise provided by law.

This provision of law relates to the second part of the equation. It allows an agency to keep the portion of fund balance representing valid encumbrances and the portion designated for subsequent year expenditure by the General Appropriation Act or other laws.

There are many appropriation acts besides the General Appropriation Act that use language similar to that above. However, some appropriation acts provide an all-encompassing exemption from making reversions. For example, this language is in the Laws of 1998 Chapter 3:

> Any unexpended or unencumbered balance remaining in the fund [public school capital improvements fund] at the end of fiscal year 1998 shall not revert to the general fund.

This language makes the entire fund non-reverting by designating fund balance for future expenditures.

Specific Legislation

Calculating reversions requires careful attention to legislation that is specific to individual funds (or money). For example, many of the laws and statutes that create departments and agencies (including boards, commissions, etc.) specifically address the reverting/non-reverting nature of those agencies' funds. The following is an example taken from Section 61-28A-22, NMSA, 1978:

> All amounts paid into the fund at the end of each fiscal year shall accumulate to the credit of the fund

This language designates the fund (including fund balance) and all money paid into the fund as non-reverting. This overrides the general legislation discussed above. In terms of the amounts paid into the fund, it also overrides another statute that plays a significant role is designating which funds recognize revenue collected by the State. This statute, Section 6-4-2.1, NMSA, 1978, states in part:

> There is created a fund to be known as the “general fund” to which the state treasurer shall credit all revenues not otherwise allocated by law.

In essence, this statute requires that all money collected by departments and agencies and constituting revenue to the State must be credited to the State General Fund unless it is specifically allocated by law to another fund. Application of this statute can have a significant effect on the calculation of fund balances, as the agency collecting the money may be doing so on behalf of the State General Fund. In such a case the agency collecting the money records a liability to the State General Fund, instead of revenue. Correctly classifying money collected, as either revenue or a liability, is necessary to calculate unreserved, undesignated fund balances accurately.

When researching, you may find apparent conflicts between generally accepted accounting principles and State law. If a conflict exists, the legislation must be followed. In most cases, however, you will discover that there is not a conflict.

For example, the following provision appears in the General Appropriation Act and appears to conflict with generally accepted accounting principles:

> “interagency transfers” means revenue, other than internal service funds, legally transferred from one agency to another.

Under generally accepted accounting principle, most interagency transfers are not revenue but cash operating transfers between funds. But it is important to understand that this provision does not conflict with generally accepted accounting principles when read in conjunction with anther provision that also appears in the Act:

> When approving operating budgets based on appropriations in the General Appropriation Act of 1998, the state budget division is specifically authorized to approve only those budgets that are in accordance **with generally accepted accounting principles** for the purpose of properly classifying other financing sources and uses, including interfund, intrafund and interagency transfers. [emphasis added]

Adjusting the Amount Reverted After the Annual Audit

Section 6-5-10 makes reference to “the central financial reporting and accounting system” (C-FRAS) and to “audit report.” C-FRAS and the agencies’ audit reports disclose the amount of fund balances at different points in time. Usually, the fund balance reflected in C-FRAS is the amount of fund balance **before** reversions are recorded. The fund balance reflected in the audit reports represents fund balance **after** reversions are recorded.

It is important to understand the effect that recording reversions has on fund balances. A reversion is an “other financing use”; and therefore, reduces fund balance. For example, if C-FRAS reflects an unreserved, undesignated fund balance of $10,000, recording the $10,000 due to the State General Fund increases “other financing uses” which, in this example, decreases the fund balance to zero. Because of the accounting relationship between reversions, other financing uses, and fund balance, an audit report should never reflect an unreserved, undesignated fund balance, as it has been eliminated by recording the amount due to the State General Fund.

It is also important to understand that any audit adjustments made to any of the factors in the equation – revenue, expenditures, etc. – will result in either an increase or decrease in the unreserved, undesignated fund balance. For this reason, Section 6-5-10 does not require the reversion to be made until after the audit is completed. However, the Department of Finance and Administration requires agencies to make reversions sooner: within sixty days after the end of the fiscal year. The Department, however, allows the amount reverted to be adjusted later based on the results of the annual audit.

Examples

Examples 1 through 7 pertain to the same agency, Agency X.

1. Basic calculation

Agency X’s operating fund (a governmental fund) received an appropriation and transfer of $1,000,000 from the State General Fund for fiscal year 1998. Agency X expended $900,000 of the appropriation – $800,000 in cash disbursements and $100,000 in encumbrances. There is not any specific legislation making the operating fund or money within the fund nonreverting.

The amount to revert (unreserved, undesignated fund balance) is calculated as follows:

Fund balance, July 1	$ 00
Revenue	00
Expenditures	(800,000)
Transfers-in and other financing sources	1,000,000
Transfers-out and other financing uses	(0)
Fund balance, June 30	200,000
Reserved fund balance	(100,000)
Designated fund balance	(0)
Unreserved, undesignated fund balance, June 30	$ 100,000

2. Factoring in other revenue (fees)

When reconciling its operating fund to the C-FRAS June 1998 reports, Agency X discovered that it failed to record a deposit for $70.00. The deposit consisted of fees for copies. Under Section 14-2-9, NMSA, 1978, Agency X is allowed to charge a reasonable fee for copying public records. Agency X adjusted its calculation as follows:

Beginning fund balance, July 1	$ 00
Revenue	**70**
Expenditures	(800,000)
Transfers-in and other financing sources	1,000,000
Transfers-out and other financing uses	(00)
Fund balance, June 30	**200,070**
Reserved fund balance	(100,000)
Designated fund balance	(00)
Unreserved, undesignated fund balance, June 30	**$ 100,070**

3. Factoring in other revenue (interest)

Agency X maintains a bank account. The account has been authorized by the State Treasurer's Office and the Department of Finance and Administration. Agency X uses the account to administer a large petty cash fund maintained by its remote field office. The account earned $25 of interest during the fiscal year just ended. Agency X has not recorded the interest earned.

Agency X is allowed to collect the interest under Section 6-4-2.1, NMSA, 1978. However, since it is collecting the interest on behalf of the State General Fund and not one of its own funds, the revenue and fund balance are not affected. Instead, the interest must be recorded as a liability to the State General Fund.

4. Factoring in encumbrances and accounts payable

In preparing for its annual audit, Agency X analyzed its encumbrances and determined that $25,000 of the encumbrances was actually accounts payable at the end of the fiscal year. Agency X made the following adjustments to its equation. Notice that the adjustments do not change the amount to revert.

Beginning Fund Balance, July 1	$ 00
Revenue	70
Expenditures	**(825,000)**
Transfers-in and other financing sources	1,000,000
Transfers-out and other financing uses	(00)
Fund Balance, June 30	**175,070**
Reserved Fund Balance	**(75,000)**
Designated Fund Balance	(00)
Unreserved, Undesignated fund balance, June 30	$ 100,070

5. Factoring in Grants

Agency X applied for a grant based on maintenance of effort achieved in a prior fiscal year. Agency X was awarded the grant on June 30, 1998. Under the terms of the grant, Agency X may collect the grant money beginning on July 1. Also under the terms of the grant, the grant money can only be expended on programs administered by Agency X. As of June 30, 1998, Agency X had not recorded the award of the grant nor made any expenditures that could be charged to the grant.

Under the modified accrual basis of accounting for governmental funds, revenues are recognized and recorded in the accounting period in which they become susceptible to accrual – that is, when they become both measurable and available. "Available" means the revenue is collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period.

Although the award was made on June 30, Agency X should not record the grant as fiscal year 1998 revenue, since the grant was not "available."

Concerning the recognition of revenue, the Department of Finance and Administration's policy is consistent with generally accepted accounting principles. As such the "susceptibility to accrual" criterion mentioned above requires judgement, consideration of the materiality of the item in question, and due regard for the practicality of accrual, as well as consistency in application.

6. Factoring in multiple-year appropriations

In January 1998, the Legislature appropriated $50,000 to Agency X from the State General Fund. The appropriation was a multiple-year appropriation valid for fiscal years 1998 and 1999. Since this is a special appropriation, to receive the related transfer Agency X is required to submit a request to the Department of Finance and Administration. As of June 30, 1998, Agency X had not requested the transfer.

Agency X should accrue the transfer since the transfer was receivable from the State General Fund in fiscal year 1998 and should adjust its calculation as follows. Notice that the adjustment does not change the amount to revert (unreserved, undesignated fund balance).

Beginning Fund Balance, July 1	$ 00
Revenue	70
Expenditures	(825,000)
Transfers-in and other financing sources	**1,050,000**
Transfers-out and other financing uses	(00)
Fund Balance, June 30	**225,070**
Reserved Fund Balance	(75,000)
Designated Fund Balance	**(50,000)**
Unreserved, undesignated fund balance, June 30	$ 100,070

Agency X **must** disclose, in its audited financial statements, the nature and authority for the $50,000 in designated fund balance.

7. Recording reversions

Agency X has reconciled to the C-FRAS reports, completed its search for unrecorded liabilities, identified valid encumbrances, identified accounts payable, recorded receivables, etc. Agency X is now ready to make and record the reversion to the general fund. Once it records the reversion, Agency X makes the following adjustment to its calculation of unreserved, undesignated fund balance. Notice that the reversion to the State General Fund is an "other financing use."

Fund balance, July 1	$ 00
Revenue	70
Expenditures	(825,000)
Transfers-in and other financing sources	1,050,000
Transfers-out and other financing uses	**(100,070)**
Fund Balance, June 30	**125,000**
Reserved fund balance	(75,000)
Designated fund balance	(50,000)
Unreserved, undesignated fund balance, June 30	**$ 00**

Agency X's operating fund is a reverting fund. As such, after all adjustments have been recorded including the reversion to the State General Fund, the unreserved, undesignated fund balance must equal zero.

8. Calculating reversions when reverting and non-reverting monies are commingled in one fund

Agency Y receives approximately half of its funding from the State General Fund and half from fees it collects. Following law, Agency Y credits the fees to its operating fund, which is by law nonreverting.

For fiscal year 1998, Agency Y received $500,000 from the State General Fund and $495,000 in fees. During the fiscal year, Agency Y had expenditures of $900,000. At June 30, 1998, Agency Y did not have any encumbrances outstanding. Unreserved, undesignated fund balance is calculated as follows:

Fund balance, July 1	$	00
Revenue		**495,000**
Expenditures		**(900,000)**
Transfers-in and other financing sources		**500,000**
Transfers-out and other financing uses		(00)
Fund balance, June 30		**95,000**
Reserved fund balance		(00)
Designated fund balance		(00)
Unreserved, undesignated fund balance, June 30	**$**	**95,000**

This example demonstrates that to the extent they are appropriated, and in the absence of any legislation to the contrary, revenues collected by an agency or department are considered to be expended before transfers from the State General Fund.

9. <u>Calculating reversions when an appropriation limits the amount of non-reverting monies that can be expended</u>

Agency Z also receives funding from both the State General Fund and the collection of fees. For fiscal year 1998 it received $400,000 in fees and $500,000 in transfers from the State General Fund. Of the $400,000 in fees, the General Appropriation Act authorized expenditure of $300,000. For fiscal year 1998, Agency Z's expenditures were $750,000. At June 30, 1998, Agency Z did not have any encumbrances outstanding. Unreserved, undesignated fund balance is calculated as follows.

Fund balance, July 1	$	00
Revenue		**400,000**
Expenditures		**(750,000)**
Transfers-in and other financing sources		**500,000**
Transfers-out and other financing uses		(0)
Fund balance, June 30		**150,000**
Reserved fund balance		(00)
Designated fund balance		**(100,000)**
Unreserved, undesignated fund balance, June 30	**$**	**50,000**

The $100,000 designated fund balance results from subtracting the amount appropriated from fee revenue ($400,000 - $300,000). In essence, the General Appropriation Act allowed only $300,000 of fees to be expended while allowing up to $500,000 to be expended from the State General Fund transfer. This resulted in Agency Z's $750,000 of expenditures being funded as follows: $300,000 came from fees and $450,000 ($750,000 - $300,000) came from the State General Fund. Subtract the $450,000 from the amount transferred from the General Fund and the result is the $50,000 of unreserved, undesignated fund balance.

10. Calculating reversions when beginning fund balance existed

Agency A's operating fund is nonreverting. Agency A began fiscal year 1998 with a designated fund balance of $100,000. Agency A receives all its funding from fees. During fiscal year 1998 it collected $800,000 in fees. Taking into account the beginning balance, the Legislature appropriated $850,000 of the fees. During fiscal year 1998, Agency A had expenditures of $825,000. At June 30, 1998 it did not have any encumbrances outstanding. Unreserved, undesignated fund balance is calculated as follows.

Fund balance, July 1	**$**	**100,000**
Revenue		**800,000**
Expenditures		**(825,000)**
Transfers-in and other financing sources		00
Transfers-out and other financing uses		(00)
Fund balance, June 30		**75,000**
Reserved fund balance		(00)
Designated fund balance		**(75,000)**
Unreserved, undesignated fund balance, June 30	**$**	**00**

Examples 11 and 12 pertain to the same agency, Agency B.

11. Calculating reversions when fund balance carries forward from one fiscal year to the next

Agency B started fiscal year 1998 with a fund balance of $100,000. The entire $100,000 consisted of a reserve for fiscal year 1997 encumbrances. During the fiscal year, $50,000 of the encumbrances resulted in expenditures and $20,000 of the encumbrances never materialized and were cancelled. At June 30, 1998, $30,000 of the encumbrances remained outstanding and valid.

For fiscal year 1998, Agency B received an appropriation and transfer from the State General Fund of $1,000,000 and had expenditures of $1,010,000. At June 30, 1998, in addition to the $30,000 of encumbrances attributable to 1997, it had $10,000 of encumbrances attributable to fiscal year 1998.

Fund balance, July 1	$ **100,000**
Revenue	00
Expenditures	**(1,010,000)**
Transfers-in and other financing sources	**1,000,000**
Transfers-out and other financing uses	(00)
Fund balance, June 30	**90,000**
Reserved fund balance	**(40,000)**
Designated fund balance	**(00)**
Unreserved, undesignated fund balance, June 30	$ **50,000**

Agency B must disclose in its audited financial statements the components of the $40,000 in reserved fund balance: $30,000 of encumbrances from 1997; and $10,000 of encumbrances from 1998.

The equation above calculates the amount of reversion without regard to the fiscal year that generated the reversion. However, the amount of reversion must be calculated by fiscal year and disclosed in the audited financial statements by fiscal year. The next example, demonstrates how to calculate the amount of reversion by fiscal year.

12. Disclosure of reversions in audited financial statements

The equation on page 3 should be used to calculate the amount to revert and to calculate the detailed reversion information needed for the audited financial statements. However, reversion in the audited financial statement must be disclosed by fiscal year, and in some cases, by appropriation. The equation above can be easily adapted to calculating reversions by fiscal year or by appropriation.

Notice that the expenditure activity ($1,010,000) for fiscal year 1998 is spread between two appropriations: the reserved balance remaining from the 1997 appropriation and the 1998 appropriation.

	1997	1998	Total
Fund Balance, July 1	$100,000	00	$100,000
Revenue		00	00
Expenditures	50,000	960,000	1,010,000
Transfers-in and other financing sources	00	1,000,000	1,000,000
Transfers-out and other financing uses	00	00	00
Fund Balance, June 30	50,000	40,000	90,000
Reserved fund balance	30,000	10,000	40,000
Designated fund balance	00	00	00
Unreserved, undesignated fund balance, June 30	$ 20,000	$ 30,000	$ 50,000

Also, notice that the $20,000 in 1997 encumbrances that failed to materialize and were cancelled is now part of unreserved, undesignated fund balance.

13. Re-appropriating fund balances

Agency C calculated an unreserved, undesignated fund balance at June 30 of $100,000. The $100,000 resulted from Agency C's failure to implement a program before June 30, 1998 when the $100,000 appropriation for the program lapsed. On November 1, 1998, to complete its financial statements for its annual audit, Agency C recorded the $100,000 reversion. However, Agency C never transferred the cash to the State General Fund in anticipation of requesting that the $100,000 be "re-appropriated" by the Legislature.

In January 1999, Agency C requested that the Legislature re-appropriate "the $100,000 balance in Agency C's operating fund." The legislature appropriated $100,000 from the cash balance in Agency C's operating fund.

Agency C does not have a cash balance in its fund. Under Section 6-5-10, NMSA, 1978, that cash balance became the State General Fund's on June 30 and was required to be transferred to the State General Fund ten days after the release of Agency C's audit report.

Agency C should have requested an appropriation from the State General Fund instead of requesting a re-appropriation of funds it does not have. Had Agency C made the request properly, it still would have to transfer the money it owes to the State General Fund, but it would also receive $100,000 from the State General Fund.