Accounting for Local Revenue Realignments Adopted in the 2004-05 State of California Budget (Including "Triple Flip")

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Derek Hanway, Financial Services Director, City of Burbank, Co-chair
Michael Moreland, Partner, Moreland & Associates, Inc., Co-chair
Ken Al-Imam, Partner, Conrad and Associates, L.L.P.
Clyde Brown, Partner, Clyde W. Brown & Associates
Susan Mayer, Finance Manager, City of Napa
Lisa Hildebrand, Finance Director, City of Carlsbad
Paul Sundeen, Finance Director, City of Riverside

I. Introduction

A. Purpose of Paper

The State of California's FY 2004-05 adopted budget has significantly impacted the valuation, distribution method, and timing of several key local government revenues.

The California State Association of County Auditors has issued ***"SB 1096 Guidelines (Uniform Guidelines for the Implementation of Senate Bill No. 1096 as Amended by AB 2115 Concerning Funding Provisions Relative to Counties, Cities, Special Districts, and Redevelopment Agencies in Connection with the State of California Budget for fiscal Year 2004-2005 and Beyond)."*** These guidelines focus on the **distribution** of these impacted revenues through discussion of the timing and calculation of cash disbursements. They also provide background information, state code references, and specific procedures to be commonly implemented by all Counties.

The purpose of this white paper is to provide **financial accounting** and **reporting** guidance for these impacted revenues, including:

- Interpretation and examples of revenue recognition polices and the accrual options available to local governments
- Recommend revenue classification for financial statement presentation

B. Impacted Revenues

The following is a listing of impacted local revenues, along the common reference names coined by stakeholders and participants in the state budget negotiation process:

Local Revenue	Impact Reference Name
2004-05 and Forward	
Sales Tax	"Triple Flip"
Motor Vehicle License Fee	"VLF Swap"
Property Tax	"ERAF III"
2003-04 and Prior	
Motor Vehicle License Fee	"VLF Loan"
State Mandates	"SB 90 Claims"

II. Sales Tax – "Triple Flip"

A. Background Information

- Prior to FY 2003-04, cities have generally received 1% of the Bradley-Burns state-wide sales tax.
- As of July 1, 2004, the State has reduced the local allocation by .25%, and used this .25% as security for the State's "Economic Recovery Bonds."
- The State has replaced this .25% reduction of sales tax with a dollar-for-dollar allocation of local property tax from County ERAF funds.
- The estimation, distribution, reconciliation, and true-up process for the .25% back-fill leaves Cities with year-end cash flow timing differences from the prior distribution method.

B. Cash Flow Prior to "Triple Flip"

- The State has distributed quarterly sales tax to local governments through a monthly advance and quarterly reconciliation process. The following is an example of quarterly cash flow:

April to June Retail Sales	Cash Distribution to Cities
1st Advance (30% of quarterly estimate)	June
2nd Advance (30% of quarterly estimate)	July
3rd Advance (40% of quarterly estimate)	August
Reconciliation between advances/actual	September

C. Accrual Policies Prior to "Triple Flip"

- GASB Statements #33 and 36 provide accounting guidelines for revenue recognition for non-exchange transactions such as sales tax. Sales tax revenue is considered "earned" at the point of sale.
- CCMA has issued a white paper providing guidance for GASB Statement #22, now superceded by GASB Statements #33 and #36, recommending that Cities accrue the State's 2nd quarter advances, received by Cities in July and August, into the year ending June 30, since these revenues had been earned at the point of sale prior to June 30.
- If a City has adopted a 90-day availability policy for sales tax revenue recognition, the city would also accrue the 2nd quarter reconciliation payment, received in September (if material).

D. New Cash Flow, Beginning July 1, 2004

- Most Cities will continue to receive .75% of sales tax revenues directly from the State in the same prior distribution method described in Section 8 above. Cities who had been receiving a Bradley Burns allocation of less than 1% before the Triple Flip will receive their usual amount, less .25%. A sample of the new state quarterly remittance advice is presented below. The remittance advice reports taxes at both the original and reduced tax levels.
- The State Department of Finance will estimate the .25% local share of sales tax each year by September 1st, based upon actual prior year results and a projected state-wide growth factor.
- Counties are scheduled to distribute cash to cities based upon this estimate in two equal installments in January and May.
- This County cash distribution may differ from the City's actual .25% of sales tax for the following reasons:
    - State Department of Finance annual estimate vs. actual revenue
    - Allocation of estimate by jurisdiction
    - The selection of calendar months included in annual State estimate (month of point of sale vs. month of cash advance)
- A reconciliation "true-up" between actual taxes earned and the estimated amounts distributed will be calculated by the state.
- For State budget purposes, the State Department of Finance has estimated the FY 2004-05 "true-up" in February 2005, before actual sales tax data is available. This estimate may be further refined during the State's May budget "Revise." The "true-up" for FY 2004-05, scheduled for distribution by counties in January 2006, may be followed by a subsequent "true-up" in January 2007.
- The State Department of Finance's implementation and reporting methodology should be used for cash planning purposes, but not necessarily for financial reporting purposes. Cities should carefully consider the revenue recognition guidance below to follow generally accepted accounting principles for non-exchange transactions.

Sample Quaterly Statement

State of California - Board of Equalization
Statement of Bradley-Burns Local Tax Distribution

(Jurisidiction #)	**Date: 12/14/2004**	**For the Periods Shown Below**
Payee: City Treasurer		
Total Due	08/13-11/12	1,000,000
State Tax		(250,000)
Local Tax		750,000
Prior Advances	08/13-11/12	(673,500)
Adjusted Cost of Admin		(10,200)
Balance	08/13-11/12	66,300
Current Advance	11/13-12/13	240,600
Total Payment per Section 7203.1		306,900

E. New Accrual Policies, Beginning July 1, 2004

- Ongoing .75%:
  Sales tax revenue accruals should follow existing GASB #33/36 guidance for the .75% of tax that will continue to be received directly from the state. For example, if a City has a 60-day availability policy, the second quarter advances received in July and August would be accrued into the prior year. A 90-day availability policy would increase the accrual to include the quarterly reconciliation payment received in September.

- Triple-flip .25% - Fund-level statements:
  Cities should consider the State Department of Finance sales tax estimation and "true-up" reporting as simply a stream of available cash flow information. Cities should rely upon the Board of Equalization quarterly statements for calculation of actual .75 and .25% sales tax allocations for the purpose of financial reporting.

  If Cities maintain a 60- or 90-day availability period as the basis for determining revenue availability for the modified-accrual fund-level statements, the receivable recorded for the January true-up would be offset by deferred revenue (if material). In this case, these Cities will experience a one-time drop in revenue from past practice.

  Alternatively, cities may adopt a seven months or longer availability period for these transactions, which would create the basis for accrual and revenue recognition of a portion of the County true-up distribution scheduled for the subsequent January. Longer availability policies are already in practice at some local governments to address normal delays in grant reimbursements. In this case, total sales tax revenues would be most consistent with revenues reported in years before the flip.

This practice allows cities to report revenues consistent with the Economic Recovery Act's objective of making local governments whole from its series of revenue reallocations.

- Triple-flip .25% - Full accrual statements:
  Government-wide statements on the full accrual basis of accounting should include accrual and revenue recognition for the subsequent year 'true up" adjustment payment.

F. Timing Difference: State Distribution Quarter vs. City Revenue Quarter

- The end-of-year sales tax receivable to be recorded as due from the County will differ from the annual reconciliation amount reported by the State each year in September.
- The State distribution methodology may undergo change as implementation mechanics are further developed. As of February 2005, it is understood that the State's sales tax estimate for FY 2004-05 is based upon 10.5 calendar months of cash distributions instead of 12, for a net loss in cash flow for the year of implementation of 1.5 months and a permanent reporting lag of 1.5 months from the Board of Equalization's point-of-sale based reporting. The 1.5 months will be made up during the last year of the Triple Flip.
- Since government accounting standards call for revenue recognition at the point-of-sale, cities with a 7+ month revenue availability period will need to recognize additional revenue from a portion of the January County advance for the under lying May and June point-of-sale taxes included by the State in the subsequent year's revenue estimate. The accrual should be sufficient to recognize the ERAF .25% of fiscal year point-of-sales tax revenue, as calculated on the first three lines in the above sample BOE quarterly statement. Cities with a 60- or 90-day availability period will also accrue the May and June portion of the January County advance, but will offset this accrual with deferred revenue.

Example of Timing Difference:
State Distribtuion Quarter vs. City Revenue Quarter

	April-June 2005	July-Sept 2005	Sept-Dec 2005	Jan-Mar 2006	April-June 2006	Total FY 2005-06
State's Annual .25% Estimate: Point of sale revenue, under state implementation procedure assumed for FY 2005-06	112,500 a	225,000	225,000	225,000	112,500	900,000
As distributed by Counties to Cities				450,000	450,000	900,000
City's point-of-sale revenue recognition, with 7+ month availability period		225,000	225,000	225,000	225,000	900,000
City's General Ledger Entries:						
Cash receipt				450,000	450,000	900,000
Reverse prior year accrual				a (112,500)		(112,500)
Record new year accrual					112,500	112,500
	-	-	-	337,500	562,500	900,000

G. Revenue Classification for Financial Statement Presentation

- Classification:
  - .75%: Continue to report as "Sales Tax"
  - .25%: Report as "In-lieu Sales Tax", within "Tax" Category
  - Suggested statistical section reporting in CAFR: Combined reporting as "Sales Tax"

- Rationale:
  "In-lieu Sales Tax" classification is preferable to an "Intergovernmental Revenue/shared state revenue" alternative since the economic basis of the transaction/valuation is still sales tax, even though the source of funds is now a temporary allocation of the state-controlled County ERAF fund.

H. Examples

- Two examples are presented below.
- The first example is for cities that have selected a revenue recognition policy with a 7 month + availability period. It is also for use by all cities in the government-wide statements.
- The second example is for fund-level reporting for cities with a 90-day availability period. A 90-day example has been presented to show the cash flow for the full April to June point-of-sale quarter. Cities with a 60-day availability period should refer to the footnote on the face of the example that references the September cash flow to be excluded from fund level revenue.

TRIPLE FLIP EXAMPLES
Fund Level Statements (With Seven Month + Availability Period) and Accrual-basis Government-wide Statements

Assumptions

	July-Sept	Oct-Dec	Jan-Mar	Apr-Jun	Total
Sales Tax:					
1.00% Bradley Burns allocation*	1,000,000	1,000,000	1,000,000	1,000,000	4,000,000
0.75% New local allocation*	750,000	750,000	750,000	750,000	3,000,000 (a)
0.25% New State allocation	250,000	250,000	250,000	250,000	1,000,000 (b)

* Most common tax rates; some cities differ

Cash Flow

Board of Equalization Payments: Point of Sale	City Receipt		July-Sept	Oct-Dec	Jan-Mar	Apr-Jun	After June 30	Total
July	Sep	30%	210,000					210,000
Aug	Oct	30%		210,000				210,000
	Nov	40%		280,000				280,000
Reconciliation	Dec			50,000				50,000
Oct	Dec	30%		210,000				210,000
Nov	Jan	30%			210,000			210,000
Dec	Feb	40%			280,000			280,000
Reconciliation	Mar				50,000			50,000
Jan	Mar	30%			210,000			210,000
Feb	Apr	30%				210,000		210,000
Mar	May	40%				280,000		280,000
Reconciliation	June					50,000		50,000
Apr	Jun	30%				210,000		210,000
May	July	30%					210,000	210,000
Jun	Aug	40%					280,000	280,000
Reconciliation	Sept						50,000	50,000
Gross cash flow from State			210,000	750,000	750,000	750,000	540,000	(a) 3,000,000
BOE admin fees				(10,000)	(10,000)	(10,000)	(10,000)	(40,000)
Net cash flow from State			210,000	740,000	740,000	740,000	530,000 (3)	2,960,000 (1)
County Payments (FY 2004-05)								
State Dept of Finance estimate		100%	450,000	900,000	900,000	900,000	450,000	3,600,000
		25%	112,500	225,000	225,000	225,000	112,500	900,000
Adjustment from 12 to 10.5 months								(112,500)
County ERAF distribution		25%			393,750	393,750		787,500
Annual reconciliation, per State : Under-estimated revenue							100,000	100,000
Annual cash flow, per State			-	-	393,750	393,750	100,000	887,500
May/June revenue distributed in subsequent year advance							112,500 (c)	(b) 112,500
Net cash flow from County			-	-	393,750	393,750	212,500 (4)	1,000,000 (2)
County Payments (Future years)								
State Dept of Finance estimate		100%	450,000	900,000	900,000	900,000	450,000	3,600,000
		25%	112,500	225,000	225,000	225,000	112,500	900,000
County ERAF distribution		25%			450,000	450,000		900,000
Annual reconciliation, per State							100,000	100,000
Cash flow accrued into prior year					(c) (112,500)			(112,500)
May/June revenue distributed in subsequent year advance							112,500	(b) 112,500
Net cash flow from County			-	-	337,500	450,000	212,500 (5)	1,000,000 (2)

Footnotes

(a) (b) (c) See intra-page references

(1) (2) (3) (4) (5) See references to journal entries on subsequent page

TRIPLE FLIP EXAMPLES
Fund Level Statements (With Seven Month + Availability Period) and Accrual-basis Government-wide Statements

Continued

Financial Statement Presentation

$ 3,960,000	
Taxes:	
Sales tax	1 2,960,000
In-lieu sales tax	2 1,000,000

Year-end Journal Entries

	Debit	Credit
Due from other governments	742,500	
Sales tax revenue		3 530,000
In-lieu sales tax revenue		4 5 212,500

TRIPLE FLIP EXAMPLES
Fund Level Statements (With 90-day Availability Period)

Assumptions

Sales Tax:	July-Sept	Oct-Dec	Jan-Mar	Apr-Jun	Total
1.00% Bradley Burns allocation*	1,000,000	1,000,000	1,000,000	1,000,000	4,000,000
0.75% New local allocation*	750,000	750,000	750,000	750,000	3,000,000 (a)
0.25% New State allocation	250,000	250,000	250,000	250,000	1,000,000 (b)

* Most common tax rates; some cities differ

Board of Equalization Payments: Point of Sale	City Receipt		Cash Flow July-Sept	Oct-Dec	Jan-Mar	Apr-Jun	After June 30	Total
July	Sep	30%	210,000					210,000
Aug	Oct	30%		210,000				210,000
Sep	Nov	40%		280,000				280,000
	Dec			50,000				50,000
Oct	Dec	30%		210,000				210,000
Nov	Jan	30%			210,000			210,000
Dec	Feb	40%			280,000			280,000
Reconciliation	Mar				50,000			50,000
Jan	Mar	30%			210,000			210,000
Feb	Apr	30%				210,000		210,000
Mar	May	40%				280,000		280,000
Reconciliation	June					50,000		50,000
Apr	Jun	30%				210,000		210,000
May	July	30%					210,000	210,000
Jun	Aug	40%					280,000	280,000
(A) Reconciliation	Sept						50,000	50,000
Gross cash flow from State			210,000	750,000	750,000	750,000	540,000	(a) 3,000,000
BOE admin fees				(10,000)	(10,000)	(10,000)	(10,000)	(40,000)
Net cash flow from State			210,000	740,000	740,000	740,000	530,000 (4)	2,960,000 (1)

County Payments (FY 2004-05)		July-Sept	Oct-Dec	Jan-Mar	Apr-Jun	After June 30	Total
State Dept of Finance estimate	100%	450,000	900,000	900,000	900,000	450,000	3,600,000
	25%	112,500	225,000	225,000	225,000	112,500	900,000
Adjustment from 12 to 10.5 months					-		(112,500)
County ERAF distribution	25%			393,750	393,750		787,500
Annual reconciliation, per State : Under-estimated revenue						100,000	100,000
Annual cash flow, per State		-	-	393,750	393,750	100,000	887,500 (2)
May/June revenue distributed in subsequent year advance						112,500 (c)	112,500
Net cash flow from County		-	-	393,750	393,750	212,500 (5)	(b) 1,000,000

County Payments (Future years)		July-Sept	Oct-Dec	Jan-Mar	Apr-Jun	After June 30	Total
State Dept of Finance estimate	100%	450,000	900,000	900,000	900,000	450,000	3,600,000
	25%	112,500	225,000	225,000	225,000	112,500	900,000
County ERAF distribution	25%			450,000	450,000		900,000
Annual reconciliation, per State						100,000	100,000
Prior year cash flow				(c) (112,500)			(112,500)
May/June revenue distributed in subsequent year advance						112,500	112,500
Net cash flow from County		-	-	337,500	450,000	212,500 (6)	(b) 1,000,000 (3)

Footnotes

(A) Cities with 60-day availability periods: Exclude September cash flow from revenue and receivable

(a) (b) (c) See intra-page references

(1) (2) (3) (4) (5) (6) See references to journal entries on subsequent page

TRIPLE FLIP EXAMPLES
Fund Level Statements (With 90-day Availability Period)

Continued

Financial Statement Presentation

FY 04-05 Year of Implementation

$ 3,847,500		
Sales tax	1	2,960,000
In-lieu sales tax	2	887,500

Future Years

$ 3,960,000		
Sales tax	1	2,960,000
In-lieu sales tax	3	1,000,000

Year-end Journal Entries

	Debit		Credit
Due from other governments	742,500		
Sales tax revenue		4	530,000
Deferred revenue		5 6	212,500

Note
The entry listed above is for fund-level reporting. The following additional entry is required for government-wide reporting to bring revenue up to the full accrual basis:

	Debit		Credit
Deferred revenue	212,500		
In-lieu sales tax		5 6	212,500

II. Motor Vehicle License Fee - "VLF Swap"

A. Background Information

- The State has previously assessed a 2% of value Motor Vehicle License Fee (VLF) on car registrants on behalf of local governments.
- During FY 03-04, the State dropped this fee from 2% to .67%. Except for the first three months of year (see "VLF Loan Section Below"), the State back-filled this fee reduction with other State funds, keeping local government revenue "whole."
- Beginning in FY 04-05, the local government share of Motor Vehicle License fees has further narrowed. Cities will continue to receive the .67% portion of the fee directly from the State, but this amount will now be net of County realignment and administrative fee reductions. Cities should continue to record this portion of VLF revenue in the same manor as before the Swap.
- The State has now backfilled the 2% to .67% fee reduction VLF revenue loss with an additional allocation of local property tax from County ERAF funds.

B. New Cash Flow - "VLF Swap"

- For a transition year of FY 04-05, the State has estimated each local government's share of VLF. Counties are scheduled to distribute this estimate to Cities in two installments, in

January and May. Also for this transition year, a true-up reconciliation between actual VLF and the State estimate is scheduled by the State by September 1, 2005. County distribution of this true-up is scheduled for January of the following year.

- For FY 05-06 and beyond, the VLF Swap will be valued at the original FY 04-05 amount, plus annual growth at the rate of the jurisdiction's growth in assessed valuation.

C. New Accrual Policies – "VLF Swap"

- For the FY 04-05 transition year, the true-up distribution scheduled for January 2006 is subject to accrual at June 30, 2005 if the City has defined a availability period of 7 months or greater. This may be an immaterial amount.
- For FY 05-06 and beyond, no accruals are necessary in the fund or government-wide statements, since County distributions to Cities are scheduled for January and May.

D. Revenue Classification/Financial Statement Presentation - "VLF Swap"

- FY 04-05 (transition year):
    - Classification: "Intergovernmental/In-lieu VLF"
    - Rationale: Valuation still based upon original VLF

- FY 05-06 and beyond:
    - Classification: "Taxes/Property Tax"
    - Rationale: Measurement and growth is now based upon assessed valuation

III. Property Tax - "ERAF III"

A. Background Information

- FY 04-05 and FY 05-06: Local governments have agreed to a two-year property tax revenue reduction and shift to the State in exchange for support of Measure A, a voter-approved ballot measure that now offers protection to local governments from future state revenue losses.
- The revenue shift will be implemented through a temporary reduction in the City's local property tax allocation and a corresponding contribution to the County ERAF fund. As discussed above, the County ERAF Fund now provides distributions back to Cities for the Triple Flip and VLF Swap revenue reallocations.
- This revenue shift is the third ERAF shift of property taxes from local governments. The first two, implemented during FY 92-93 and FY 93-94, continue to cause ongoing reductions of property tax revenue.

B. Cash Flow

- Property tax is distributed to Cities periodically throughout year as received by the Counties. The most significant payments occur in December and April as tax bills become due from property owners.
- The annual ERAF contributions are a fixed annual amount, calculated by the State.
- The ERAF contribution reduces the City's property tax distribution from the County.

C. Accrual Policies

- ERAF III does not require any change to normal year-end property tax accruals of subsequent County receipts.

D. Revenue Classification/Financial Statement Presentation

- No new revenue classifications are required. Property tax revenue for the two impacted fiscal years will simply be a lower amount than in prior years. Cities may choose to asterisk its trend information in statistical section of its financial statements to explain the two-year shortfall.

IV. Motor Vehicle License Fee - "VLF Loan"

A. Background

- As discussed above, during FY 2003-04, The State withheld three months of VLF backfill revenues from its normal distributions to Cities. During this period, consumer fee had been restored from .67% to 2%, but the increase was subsequently rescinded and refunded to consumers. The State backfill was restored beginning with the fourth month of the year.
- Lost revenues have been quantified and are available, by jurisdiction, on the State Controller's web site.
- The FY 2004-05 State budget calls for repayment of this "VLF Loan" in FY 06-07.

B. Accrual Policies for Loan

- The State's loan commitment is measurable and should be considered for accrual.
- Since loan repayment is not scheduled until FY 06-07, the availability test is not met. Accordingly, the loan receivable should be offset with deferred revenue on the Fund level modified-accrual financial statements. This keeps the value of the loan receivable out of Fund Balance.
- The deferral should be reversed for accrual-based reporting on the government-wide financial statements. This includes the loan value in net assets.
- The purpose of this white paper is to provide accounting guidance and not to provide judgment about the collectability of this receivable, which is a management estimate. If a jurisdiction conservatively concludes that realization is not probable, an allowance for doubtful accounts account could be set up, for a net receivable of zero. If the agency makes this determination, the allowance should be consistent on both the fund level and entity wide statements.

C. Revenue Classification/Financial Statement Presentation

- If revenue is recognized on accrual-basis entity wide statements, the revenue retains its intergovernmental classification.

D. Securitization

- Financing programs have become available for cities to "sell" their VLF loan receivable to a third party for accelerated cash flow.
- The sale of a receivable does not change the nature or classification of the underlying revenue. In the year in which the receivable becomes available for fund-level reporting, the revenue would continue to be classified as Intergovernmental/VLF.
- Government-wide statements would recognize Intergovernmental/VLF revenue in the year in which the loan was first recorded.

V. State Mandates - "SB 90 Claims"

- In some cases, the State has reimbursed local governments for the cost of implementing State mandates. These reimbursements have been inconsistently funded by the State.
- Measure 1-A, the same ballot measure discussed with "ERAF III" above, provides some additional commitment by the state to resume repayments.
- However, due to the uncertainty prompted by the volatility of these transactions in the past, a case can be made for recording these reimbursements when and if received, or when the probability of collection increases.
- If a receivable is recorded, it could be offset with an allowance for doubtful accounts to reflect the uncertain probability of collection.
- At a minimum, deferred revenue should offset any receivable on the fund level modified-accrual statements to reflect the deferred availability of these reimbursements.