

GASB STATEMENT 42 IMPLEMENTATION ISSUES

Accounts Receivable Recognition

Issue

To determine criteria for recognition of accounts receivables pertaining to Office of Risk Management claims and Federal disaster grant payments due to physical damage of assets.

Background

During fiscal year 2006, the State suffered devastating losses from two major hurricanes. As a result, State entities insured by the Office of Risk Management (ORM) will be eligible for payment on claims for repair/replacement of buildings and contents, and business interruption. (Normally payment of claims would be subject to a \$1,000 deductible per loss, but this requirement has been waived for the hurricanes). The maximum payout by ORM will be \$500 million per occurrence. Typically, the maximum payout of insurance is made before the State would be in a position to receive supplemental Federal disaster grant assistance for the repair, replacement, or restoration of disaster-damaged publicly owned facilities from the Federal Emergency Management Agency (FEMA). However, the State has an agreement with FEMA that will allow for the immediate reimbursement prior to complete payout of insurance proceeds. Of the \$500 million in insurance proceeds, \$25 million is self-insurance. Per the agreement with FEMA, the remaining \$475 million will be distributed at 85% (\$403 million) for buildings and contents, and 15% (\$72 million) for business interruption. A negative project worksheet (PW) for the approximately \$403 million for buildings and contents will be completed and insurance proceeds will be remitted to FEMA sometime in the future. The normal Federal share per FEMA is not less than 75% of the eligible costs for emergency measures and permanent restoration. However, because of the severity of the damage from Hurricane Katrina, the Federal share is 90% in this case.

ORM Claim Payments

The State of Louisiana through ORM provides insurance coverage for damage to state-owned property which includes damage to buildings and improvements, contents, inventories, mobile equipment, heating and air conditioning systems, boats, aircraft, and licensed and non-licensed vehicles. This coverage includes, but is not limited to, payment for expenses to secure damaged property, temporary relocation costs, cleanup and debris removal, and repair/replacement for insured property. Buildings and improvements are insured up to the replacement cost at the time of the loss. Normally, all movable property (building contents) is insured up to the actual cash value at the time of the loss; however, in the case of Hurricane Katrina, the State has an agreement with FEMA that will allow all building contents to be insured up to the replacement

value. Insurance coverage is not available for damage to infrastructure from natural disasters.

Due to the magnitude of the damage from the hurricanes during fiscal year 2006, Facility Planning and Control will assess the needs of the State and make a determination of priorities for payment in accordance with life and public safety priorities set by the Division of Administration, Office of the Commissioner. It is unlikely that all insurance recoveries from ORM will be disbursed to state entities prior to the end of 2006. Accordingly, a determination needs to be made as to whether an accounts receivable for these funds should be established at June 30, 2006. GASB 42 addresses recognition of insurance recoveries. According to GASB 42, paragraph 21, insurance recoveries should be recognized only when realized or realizable. If an insurer has admitted or acknowledged coverage, an insurance recovery would be realizable. If the insurer has denied coverage, the insurance recovery generally would not be realizable.

For some initial property damage claims, Facility Planning and Control will forward vendor invoices to the ORM claims department for payment on projects that they administer. Property damage claims for permanent repairs generally less than \$100,000 will be paid by Facility Planning and Control using insurance proceeds forwarded to FP&C by ORM. Payment will not be made directly to the affected entities. Facility Planning and Control will prioritize projects, and this will affect the timing of when payments will be made.

For business interruption claims, payments will be made by ORM directly to entities. ORM has engaged a consultant to determine the business interruption losses for state agencies. Accordingly, when the consultant completes the assessment affects when payments will be made. In some cases, business interruption coverage will be used to help get the entities back in business by providing coverage for physical damage that is not covered by FEMA or ORM.

FEMA Grant Funds

The FEMA Public Assistance Program provides supplemental Federal disaster grant assistance for the repair, replacement, or restoration of disaster-damaged, publicly owned facilities. The Public Assistance Program is based on the Robert T. Stafford Disaster Relief and Emergency Assistance Act (Stafford Act). This statute is implemented and interpreted by regulations published in Title 44 of the Code of Federal Regulations (44 CFR) Part 206. These documents govern the eligibility criteria through which FEMA provides funds for public assistance. The eligibility criteria include four components:

- a. **Applicant** – (or subgrantee) - a state government agency, a local government, a Private Nonprofit organization that owns or operates facilities open to the general public and performs services otherwise performed by a government agency, or a Federally recognized Indian tribe.

- b. Facility** – a building, system, or equipment that is built or manufactured, or an improved and maintained natural feature, that is owned by an eligible applicant.
- c. Work** – to be eligible, must be required as a direct result of a declared event, must be within the designated disaster area, and must be the legal responsibility of an eligible applicant at the time of the disaster. Eligible work includes Emergency Work and Permanent Work.
- d. Cost** – to be eligible, must be reasonable and necessary to accomplish the eligible work, must comply with Federal, State, and local requirements for procurement, and does not include (or is reduced by) insurance proceeds, salvage values, and other credits.

The applicant must follow the application process as described by FEMA. A project worksheet (PW) will be developed by FEMA if a large project, (\$55,500 or above) or may be developed by the applicant if a small project (under \$55,500). The PW will include the scope of eligible work for the project, the estimated or actual costs necessary to complete the work, and special considerations, such as insurance and hazard mitigation. Once the PW is approved by FEMA, the funds will be made available in the State's account (through the Governor's Office of Homeland Security and Emergency Preparedness). The State will then disburse the funds to the applicants.

Normally, FEMA would reduce otherwise eligible costs by the actual or anticipated insurance recoveries the applicant receives, even if the applicant has not completed negotiations with the insurer. However, this requirement has been waived, based on the agreement the State has with FEMA. The State must notify FEMA of any entitlement to insurance settlement or recoveries for a facility and its contents.

FEMA Supplemental Disaster Grant Assistance meets the requirements of a voluntary nonexchange transaction according to GASB 33, *Accounting and Financial Reporting for Nonexchange Transactions*. A voluntary non-exchange transaction occurs when two parties enter into an agreement willingly in which a government gives (or receives) value without directly receiving (or giving) equal value in return, and results from legislative or contractual agreements. Typically, eligibility requirements are imposed on the recipient, including one or more of the following:

- a. Characteristics of recipients** – has the required characteristics specified by the provider, such as the applicant described above.
- b. Time requirements** – the period of time when the resources are required to be used (for FEMA grants, is typically 6 months for emergency work, and 18 months for permanent work, but can be extended based on extenuating circumstances or unusual project requirements).
- c. Reimbursements** – resources are offered on a reimbursement or expenditure-driven basis and the recipient has **incurred** allowable costs under the program. (Small project {projects < \$55,500} funding for FEMA is based on estimated costs, if actual costs are not yet available. Large project funding is based on documented actual costs, and is normally paid on a reimbursement basis).

- d. Contingencies** – the provider’s offer of resources is contingent upon a specified action of the recipient and that action has occurred, such as a requirement to contribute its own resources for a specified purpose (the State’s share of eligible costs – this requirement is met by the State in using CDBG funds as matching funds).

Per GASB 33, paragraph 19, “Eligibility requirements are conditions established by enabling legislation or the provider that are required to be met before a transaction (other than the provision of cash or other assets in advance) can occur. That is, until those requirements are met, the provider does not have a liability, the recipient does not have a receivable, and the recognition of expenses or revenues for resources transmitted in advance should be deferred.” Before the recipient has met all the eligibility requirements, the offer by the provider “has the characteristics of an executory contract, and no liability or receivable should be recognized” (GASB 33, paragraph 81).

Recommendation

ORM Business Interruption and Property Claims:

Governmental, Proprietary, and Fiduciary Funds:

According to GASB 42, footnote 8, insurance recoveries received from the General Fund (ORM) should be accounted for as interfund reimbursements to the extent of the impairment loss, if any, and be reported as transfers from General Fund in the fund financial statements for amounts in excess of the impairment loss. Reimbursements are interfund activity – activity within and among the three fund categories (governmental, proprietary, and fiduciary). Per GASB 34, paragraph 112(b.)(2), interfund reimbursements are repayments from the funds responsible for particular expenditures or expenses to the funds that initially paid for them; reimbursements should not be displayed in the financial statements. Instead, interfund reimbursements are treated as an adjustment to expenses or expenditures; that is, an increase in expenditures or expenses in the reimbursing fund (General Fund - ORM) and a corresponding decrease in expenditures or expenses in the reimbursed fund (other governmental fund, proprietary fund, or fiduciary fund).

We recommend that ORM **physical damage claim payments** be recognized as described above when the amount of the claim payment to be received by a governmental, proprietary, or fiduciary fund is known. For governmental or proprietary funds, if a transfer is recognized in the 45-day close period, a corresponding due from would also be recognized. For fiduciary funds, which do not recognize transfers, other income would be increased for any payment for physical damage claim payments from General Fund in excess of impairment loss.

If received for other than property damage not covered by FEMA or ORM, we recommend that ORM **business interruption claim payments** be recognized as a transfer from General Fund or an extraordinary item, as appropriate, by governmental and proprietary funds, or as other income or an extraordinary item, as appropriate, by

fiduciary funds, when the amount of the claim payment to be received is known. At this point, the recovery would be realizable, as ORM has admitted or acknowledged coverage. If a transfer is recognized in the 45-day close period, a corresponding due from would also be recognized. Impairment losses calculated for physical damage should not be a factor for business interruption claims, so no part would be considered a reimbursement.

Discrete Component Units:

We recommend that ORM **business interruption claims** be recognized as an accounts receivable by discrete component units using the accrual basis of accounting when the amount of the claim payment to be received is known. At this point, the recovery would be realizable, as ORM has admitted or acknowledged coverage.

For **property claims**, we recommend that an accounts receivable be recognized by discrete component units when the vendor invoice amounts are approved for payment by ORM/FP&C. At this point, the recovery would be realizable, as ORM has admitted or acknowledged coverage. These amounts will be paid to facility planning for projects that they administer.

Federal Funds:

Governmental Funds and State Agencies under the General Fund:

Governmental funds using the modified accrual basis of accounting should recognize revenues when they become both measurable and available (NCGA Statement 1, *Governmental Accounting and Financial Reporting Principles*, paragraph 63). GASB 33, paragraph 30(d) requires that revenue for voluntary nonexchange transactions should be recognized under the modified accrual basis “in the period when all applicable eligibility requirements have been met *and* the resources are available”. However, receivables are not subject to the “available” criterion that revenues are subject to. Receivables for governmental funds should be recognized as soon as all eligibility requirements have been met. If the revenue is not available, the receivable should be offset by a liability for deferred revenue (*Governmental Accounting, Auditing, and Financial Reporting*, 2005, pg. 86). Per GASB 33, paragraph 20 (c), the reimbursement eligibility requirement is met when a recipient has incurred allowable costs under the applicable program. For governmental funds and State agencies under the General Fund, eligibility requirements will be considered to be met when allowable costs have been incurred, assuming all other eligibility requirements have been met. At this point, a receivable should be recognized.

If the entity has incurred allowable costs by June 30th for which all eligibility requirements have been met, a receivable should be established at June 30th. If the entity receives revenue subsequent to June 30th, for costs incurred by June 30th, for which all eligibility requirements have been met, a receivable should be established at June 30th. However, a revenue should only be recognized for entities using the

modified accrual basis of accounting when allowable costs have been incurred **and** the funds are available at the Governors' Office of Homeland Security and Emergency Preparedness.

If the entity determines that part of the receivable recognized may not actually be collected, then an allowance for doubtful accounts should be established for the amount of the receivable that is not expected to be collected. This amount should be based on the individual entity's experience with collecting receivables from a particular federal source, or on professional judgment if the entity has no prior experience in collecting receivables from a particular source. Any amount established as an allowance should be supported by documentation demonstrating how the allowance was developed.

Proprietary Funds, Fiduciary Funds, and Discrete Component Units:

Proprietary and Fiduciary Funds and Discrete Component Units using the accrual basis of accounting should recognize revenues and receivables when all eligibility requirements have been met. Per GASB 33, paragraph 20 (c), the reimbursement eligibility requirement is met when a recipient has **incurred** allowable costs under the applicable program. Therefore, receivables should be recognized when allowable costs have been incurred, assuming all other eligibility requirements have been met. If the entity has incurred allowable costs by June 30th for which all eligibility requirements have been met, a receivable should be established at June 30th. If the entity receives revenue subsequent to June 30th, for costs incurred by June 30th, for which all eligibility requirements have been met, a receivable should be established at June 30th.

If the entity determines that part of the receivable recognized may not actually be collected, then an allowance for doubtful accounts should be established for the amount of the receivable that is not expected to be collected. This amount should be based on the individual entity's experience with collecting receivables from a particular federal source, or on professional judgment if the entity has no prior experience in collecting receivables from a particular source. Any amount established as an allowance should be supported by documentation demonstrating how the allowance was developed.