



*Proprietary & Confidential*

FINAL REPORT

**Incline Village General Improvement District**  
EVALUATION OF CERTAIN ACCOUNTING AND REPORTING MATTERS

November 30, 2020

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# I. EXECUTIVE SUMMARY

## A. SCOPE AND METHODOLOGY

Moss Adams LLP was contracted by Incline Village General Improvement District (District) to analyze and provide guidance on; whether certain of the District’s activities should be reported in enterprise funds vs. governmental funds; the allocation of central service costs; punch card accounting; and whether the District’s current capitalization policies and actual practices are in agreement with applicable accounting standards.

This engagement was performed in accordance with Standards for Consulting Services established by the American Institute of Certified Public Accountants. Accordingly, we provide no opinion, attestation, or other form of assurance with respect to our work or the information upon which our work is based. This report was developed based on information gained from our interviews, reading policies, budgets, financial statements and other documents, comparisons of the District’s practices against Generally Accepted Accounting Standards as provided by the Governmental Accounting Standards Board and other recognized best practices. The procedures we performed do not constitute an examination in accordance with generally accepted auditing standards or attestation standards.

## B. SUMMARY OF FINDINGS AND RECOMMENDATIONS

Based on our analysis, we identified the following observations as opportunities for the District to improve its accounting and reporting practices.

OBSERVATIONS AND RECOMMENDATIONS	
1	<p><b>Observation</b></p> <p>The District’s Community Services and Beach recreational activities are capital asset intensive, primarily financed by user charges, and currently reported within governmental fund-types using the modified accrual basis of accounting. This reporting was found to meet Generally Accepted Accounting Principles (GAAP) criteria for governmental fund reporting based on the lack of external restrictions on rates charged, debt that is not secured solely by user charges, and the lack of financial policies that are sufficiently written and followed that require user charges to be set at rates sufficient to cover all costs including capital assets and debt service.</p> <p><b>Recommendation</b></p> <p>While governmental fund reporting can be supported with the District’s current circumstances, the District should report these activities through the use of Enterprise Funds to achieve the benefits of the full accrual basis of accounting. These activities generally meet the GAAP definition of ‘business-type’ activities and are better suited for reporting within enterprise funds that use the full accrual basis of accounting to provide stakeholders with a better understanding of the sufficiency of the rates charged to users in covering all costs incurred including the use of capital assets and debt service.</p>
2	<p><b>Observation</b></p> <p>The District allocates certain costs reported in the General Fund to the other funds with the departments and activities that benefit from those costs through an inter-fund charge reported as a negative expense in the General Fund financial statements titled Central Services Cost Allocation Income. The District’s allocation of costs is in compliance with GAAP and meets State</p>



OBSERVATIONS AND RECOMMENDATIONS	
	<p>budgetary requirements, but the current presentation in the financial statements is not in compliance with GAAP.</p>
<b>Recommendation</b>	<p>If the current method of reporting expenditures initially within the General Fund is maintained, the expenditures and reporting of the related income as a negative expenditure should be removed from the General Fund and only reported as expenses or expenditures in the reimbursing funds.</p>
<b>3</b>	<p><b>Observation</b></p> <p>The District currently tracks the utilization of punch cards and records a portion of the related Recreation Fee revenues commensurate with the value of the punch card within the fund and activity for which the punch card was presented for use through a contra-revenue accounting procedure. The contra-revenue accounting methodology is confusing to stakeholders, complicates the budgeting process, and requires more time and effort than the perceived benefit it provides.</p>
<b>Recommendation</b>	<p>Discontinue the use of contra-revenue accounting for the utilization of punch cards. Report Recreation Fee revenues within the different funds and activities according to an allocation approved by the Board during the annual budget approval process.</p>
<b>4</b>	<p><b>Observation</b></p> <p>The District has been capitalizing expenditures incurred in the development of master plans as well as costs incurred that do not relate to specific capital projects or that increase the service capacity of an existing capital asset which is not in compliance with established accounting practices. In addition, the capitalization policies and practices are not sufficiently detailed to provide guidance on what types of costs should be considered for capitalization.</p>
<b>Recommendation</b>	<p>The District is in need of developing more robust capitalization policies that provide for the different stages of a capital project, how to handle costs incurred in each phase, clarification on the nature of expenditures that increase the service capacity and therefore appropriate to capitalize, and the nature of expenditures that are repairs and maintenance and therefore expensed as incurred.</p>

Moss Adams would like to thank the Board members, Audit Committee members, and District staff for their cooperation and assistance during our engagement.



## II. BACKGROUND, SCOPE, AND METHODOLOGY

### A. BACKGROUND

The District has been granted authority by Washoe County to provide water, sewer and solid waste services, as well as recreational facilities and programs for the benefit of individuals owning property or residing within its geographical boundaries as well as the general public. The activities of the District are accounted for in a series of individual funds intended to assist in meeting its requirement for demonstrating legal compliance, transparency, prudent financial management, and compliance with applicable governmental accounting and reporting standards.

For the past several years, questions have been raised regarding the appropriate basis of accounting and related fund-type to be used for the District's recreational activities, the methodology used to allocate certain costs that benefit multiple activities, the accounting treatment utilized when punch cards are presented to gain access and other benefits at various recreational venues, and the accounting practices utilized that have resulted in the capitalization of certain types of costs instead of immediate expensing.

### B. SCOPE AND METHODOLOGY

The scope of this engagement was to evaluate the District's accounting and reporting in the following areas compared to generally accepted accounting principles as applied to governmental entities and or accepted governmental best practices:

1. Determine whether the District's recreational activities currently accounted for within Community Services and Beach through the use of governmental funds is in compliance with Generally Accepted Accounting Principles (GAAP), and specifically whether they should be reported in enterprise funds instead of special revenue, capital projects, and debt service funds.
2. Evaluate whether the District's central service cost allocation practice complies with applicable accounting standards and recognized best practices.
3. Evaluate whether the District's current punch card accounting is in compliance with applicable accounting standards.
4. Determine whether the District's capital asset capitalization practices are in compliance with GAAP and accepted best practices.

This evaluation was conducted in four phases:

1. Startup/management: Conduct planning procedures and hold engagement kickoff meeting with Audit Committee members and District management.
2. Fact Finding: Perform interviews and inquiries with key stakeholders, obtain and review relevant documents.
3. Analysis: Compare existing practices against applicable generally accepted accounting standards as applied to governments and accepted best practices.
4. Reporting: Present findings and observations to the District's Audit Committee and District management to validate facts and confirm the practicality of recommendations.

The primary techniques used to conduct this evaluation included:



- **Review Documents:** We gathered relevant documentation for review. Examples of relevant documentation included the comprehensive annual financial reports (CAFR), Board financial policies in general, facility fee ordinance, capitalization policies and practices, cost allocation policies, budgets, bond agreements, Nevada Revised Statutes, and certain other information provided to us summarizing the issues.
- **Conduct Interviews:** We conducted interviews and inquiries with stakeholders to obtain an understanding of the current accounting and reporting practices and related issues.

Our interviews and inquiries including the following departments and positions:

- Audit Committee
  - Three different current audit committee members
- Management
  - General Manager
  - Director of Finance
  - Controller
- Members at large
  - Two community members
- State of Nevada
  - Department of Taxation
- Governmental Accounting Standards Board
  - Senior Research Manager
- **Evaluation of District practices against applicable accounting standards:** We compared the District's accounting practices against accounting standards issued by the Governmental Accounting Standards Board (GASB); guidance in the American Institute of CPA's State and Local Government Accounting and Auditing Guide; editorial material included in the Governmental Accounting, Auditing, And Financial Reporting (GAAFR or Blue Book), the Nevada Revised Statutes (NRS) applicable to General Improvement Districts; and Best Practice Advisories, issued by the Government Finance Officers Association (GFOA) representing accepted Best Practices.



### III. OBSERVATIONS AND RECOMMENDATIONS

## Enterprise fund reporting for recreational activities

Based on input gathered from interviews, documents reviewed, and our evaluation of existing practices compared to applicable accounting standards and best practices, we have the following observations and recommendations.

1	<b>Observation</b>	The District’s recreational activities reported in Community Services and Beach are currently reported within Governmental Funds and follow the related modified accrual basis of accounting. These activities are generally referred to as business-type activities as they rely mostly on charges to residents and the public for use of the various recreational venues and activities. Governmental funds and modified accrual basis of accounting is not designed to report whether the revenues generated from charges for services is sufficient to cover all costs incurred including capital assets and debt service.
	<b>Recommendation</b>	The District should use the full accrual basis of accounting through the use of enterprise funds for the recreational activities reported within Community Services and Beach. The full accrual basis of accounting will allow the District to determine what portion of its operating costs, including the use of capital assets and interest incurred on debt, are recovered from the rates it charges for these activities.
2	<b>Observation</b>	The District has established that Resolutions are the method used by the Board to document commitments placed on resources as defined in GAAP. Further, we found that there is an intent of the Board and management to commit the resources generated from the Recreation Facility Fee as allocated by the Board to provide additional resources for the related operations, capital projects, and debt service, of the various activities within the Community Services and Beach funds. However, It appears the District is relying on the resolution adopted annually by the Board that authorizes the assessment and collection of this fee by the County Assessor as the resolution that also establishes the commitment as defined in GAAP.
	<b>Recommendation</b>	Should the District decide to continue the use of governmental funds for the reporting its recreational activities within Community Services and Beach, the District should consider adopting a separate resolution with wording that clearly establishes its intent to commit the Recreation Facility Fee to the activities within Community Services and Beach as provided by the applicable accounting standards to support its use of special revenue funds.



3	<b>Observation</b>	One of the reasons provided to us for the switch from Enterprise to Special Revenue funds for Community Services and Beach activities was to improve the ability to track and monitor resources dedicated to acquisition of capital assets and repayment of debt supporting the recreational activities within these funds.
	<b>Recommendation</b>	Should the decision be made to report Community Services and Beach as enterprise funds, the District could consider the use of separate budgetary funds for purposes of tracking and monitoring resources designated for specific purposes like acquisition of capital assets or repayment of debt that are combined with the enterprise funds for external financial reporting purposes, or otherwise tracking resources within the enterprise funds with constraints separately through the chart of accounts and related separate line items in the budgetary forms used for State budget compliance purposes.

**Observation of current reporting.**

From review of prior year CAFR’s, summaries of the issues provided to us from various stakeholders, and results of interviews conducted, we learned that the District used enterprise funds to account for its recreational activities within Community Services and Beach prior to 2016. We learned that a change was made to report these activities within governmental funds at the direction of former management staff to address personal preferences as well as feedback from certain District stakeholders that it would be easier to track the spendable resources within a series of governmental funds using the modified accrual basis of accounting. Since 2016, the District has used separate special revenue funds to report the activities of Community Services and Beach, along with separate capital projects funds to account for resources used to finance capital expenditures for Community Services and Beach, and separate debt service funds to account for resources used for the repayment of debt the proceeds from which were used to fund capital assets acquired to provide the services reported within Community Services and Beach.

**External financial reporting guidance – Enterprise Funds.**

Full accrual basis of accounting through the use of enterprise funds is recognized as appropriate to account for activities that are primarily financed by user fees and charges for services. Enterprise funds *may* be used when fees are charged to external users for goods and services and when management determines that a measurement of the extent to which fees and charges are sufficient to cover the full cost of providing goods or services including capital costs (depreciation, replacements, and debt service) is prudent. Enterprise funds are *required* when outstanding debt is backed solely by user fees and charges; laws or regulations require the establishment of fees and charges at rates sufficient to recover costs including capital costs; and when there is a pricing policy that fees and charges are to be set to recover costs, including capital costs. (GASB Cod 1300.109 a-c, GASB 34 par 67 a-c, AICPA SLG A&A par 2.30)

Enterprise funds are most commonly used for public utilities including water, sewer, solid waste, and power where charges to consumers of these services are the primary revenue source. Often there





are laws and regulations governing these activities and rates charged to consumers, along with requirements user fees and charges be set at levels necessary to cover all costs including capital costs. Enterprise funds are often voluntarily used for activities primarily financed with fees and charges, or when management determines that it is prudent to measure the results of operations on the economic resources measurement focus that can only be accomplished through the full accrual basis of accounting. Examples include golf courses, parking facilities, pools, raceways or motor sports, health and mental health services, among others.

There is diversity in practice as to whether an entity's pricing policies, in and of themselves, can create a requirement to use enterprise fund accounting for external reporting purposes. Financial statement preparers and auditors have viewed this guidance in the accounting standards as permissive guidance as opposed to a requirement to use of enterprise funds.

### **External financial reporting guidance – Governmental Funds.**

Modified accrual basis of accounting through the use of governmental funds is recognized as appropriate for most general governmental activities that are financed primarily with taxes, grants and entitlements, and other similar non-exchange revenue sources. The nature of these revenues lacks a direct connection between the value of the goods and services provided and the revenues received that finance them. (GASB Cod 1300.102)

The modified accrual basis through the use of governmental fund types allows for the tracking of spendable available resources. The use of special revenue, capital projects, and debt service is beneficial when there are constraints on certain spendable resources that have limits on the nature or type of activity or expenditure for which those resources are to be applied. The modified accrual basis of accounting with its focus on available spendable resources allows for the tracking of resources either externally restricted or internally committed to specific and limited activities and expenditures. (GASB Cod 1300.102a)

There are five governmental fund types that are used for an entity's general government activities, the General Fund, Special Revenue Funds, Capital Projects Funds, Debt Service Funds, and Permanent Funds. The District has been using special revenue funds for reporting Community Service and Beach resources and expenditures supporting the recreational venue operating costs incurred, separate capital projects funds for resources assigned to capital expenditures related to these recreational activities, and separate debt service funds for resources assigned to the repayment of debt the proceeds of which financed capital projects related to these recreational activities.

GAAP provides for the use of Special Revenue funds only when a *substantial portion* of the proceeds from *specific revenue sources* are *restricted or committed* to expenditure for specific purposes. Restrictions can only be created by laws or regulations and agreements with third parties through grant, contract, and other agreements. Commitments are created through actions taken by the Governing Board through their highest decision-making level of authority usually through ordinances or resolutions. The District has determined that Board approved resolutions are necessary to create a commitment. (GASB 54, par 30 & 31, 2019 CAFR footnote 1.P)

GAAP provides for the use of Capital Projects funds when financial resources are restricted, committed, or assigned to expenditure for capital outlays including the acquisition or construction of capital facilities and capital assets. The use of Capital Projects funds can be required to meet a legal



or contractual requirement, or based on a decision of management on the prudence of accounting for resources separately designated for capital outlays. (GASB Cod Sec 1300.106)

GAAP provides for the use of Debt Service funds for financial resources that are restricted, committed, or assigned to the expenditure for principal and interest on outstanding debt. The use of Debt Service funds can be required to meet a legal or contractual requirement, or based on a decision of management on the prudence of accounting for resources separately designated for debt service. (GASB Cod Sec 1300.107)

Governing Boards may create and use separate funds to achieve sound and expeditious financial administration, or to assist with compliance with grant or contractual provisions. When separate funds are used for management or budgetary purposes that don't meet the requirements to be reported as either Special Revenue, Capital Projects, or Debt Service funds, these funds are combined with the General Fund for external financial reporting purposes.

### **Evaluation of Enterprise Fund reporting guidance applicable to the District.**

In our review of the Nevada Revised Statutes, bond agreements, and other relevant documents, we did not find any laws, regulations, or revenue pledges solely backed by user fees and charges that would result in a requirement under GAAP to use enterprise funds for the District's Community Service and Beach activities.

A question has been raised by certain District stakeholders as to whether a third criteria provided in GAAP would require enterprise fund accounting in and of itself. The third criteria provides for the use of enterprise funds when pricing policies of the activity establish fees and charges designed to recover its costs, including capital costs. (GASB Cod 1300.109c)

Board Policy 6.1.0.2.2 appeared to be the primary codification of fees and charges policies for the District. The wording of this section was found to be generic and lacked sufficient linkages to the actual methodology to be used to determine the rates for fees and charges, and is insufficient to establish a Board intent for such fees and charges to be set at rates sufficient to recover all costs including capital or debt costs.

Furthermore, we found that the District's budgets have included subsidies of its recreational activities from the General Fund totaling \$1,211,000 over the last five years with actual cash transfers totaling \$650,000. This level of subsidy demonstrates the District's policies over the rates charged for its various activities are not established to cover all costs incurred within Community Services and Beach. When an activity is subsidized with resources other than user fees and charges, Enterprise Funds *may* be used for reporting the activity, but *would not be required*. (GASB Comprehensive Implementation Guide Q&A 705-13, AICPA SLG A&A 2.30)

In practice, enterprise funds have been used even in instances fees and charges are set at rates that are insufficient to recover all costs of providing particular services. An example is transit agencies where user fees and charges often provide less than 20% of the cost of operating the transit system and subsidies from taxpayers, states, and the federal government provide a majority of the revenue necessary to cover operating costs. Another is government operated medical clinics for low income individuals where fees and charges are set at amounts the users of those services can afford as opposed to the actual cost of providing the service, and, the government determines it prudent to be able to measure the subsidy level required to fund the activity from the entity's other revenue sources.



Therefore, the District has the option to report the recreational activities of Community Services and Beach within either governmental funds or enterprise funds.

### **Evaluation of Special Revenue Fund reporting guidance applicable to the District.**

In our review of state law, bond agreements, and other documents provided to us, we did not find any externally imposed restrictions on the revenue sources reported within Community Services and Beach. We did find there is an intent to acknowledge and honor constraints on the Facility Fees assessed by the Board that support the recreational activities within Community Services and Beach based on, and as documented within, the resolution adopted annually authorizing the County Assessor to assess and collect the fee on behalf of the District. As practice has developed, the Facility Fee is deemed to meet the substantial criteria in GAAP to justify the use of special revenue funds.

### **Recommendations.**

We recommend the District report its recreational activities for Community Services and Beach in respective enterprise funds. While the decision on the use of governmental or enterprise funds is optional given the District's specific circumstances, the determination of whether the financial condition of capital intensive activities funded primarily with fees and user charges is significantly enhanced through the use of the full accrual basis of accounting and the related use of Enterprise Funds. The full accrual basis of accounting through the use of Enterprise funds is necessary when it is important to know the extent to which fees and user charges are sufficient to cover all the costs incurred for a particular activity including capital costs. In addition, the determination of whether the financial condition of such activities is improving or declining over time requires a measurement of the wear and tear from the use of capital assets through the recording of depreciation among the operating expenses that is accomplished through the bases of accounting used by Enterprise Funds. Capital assets, long-term debt, and depreciation are not financial elements reported within Governmental fund financial statements that use the modified accrual basis of accounting.

Should the District want to improve the transparency of tracking and reporting resources designated for specific purposes like capital asset acquisition or construction or debt service separately from resources used in operations, we recommend the use of separate sub funds within Community Service and Beach that roll up into the Community Services and Beach Enterprise funds for external financial reporting purposes, but enable separate reporting for Board and management oversight purposes. In essence, the sub-fund financial statements can be used to demonstrate compliance with either external restrictions or Board created designations on resources and their uses, and the external Enterprise Fund financial statements can be used to determine whether the financial policies and actual practices of the District result in improvements or declines in the financial condition of these activities over time.

If the District decides to continue reporting its recreational activities within governmental funds, and if the District intends to continue to place constraints on the Facility Fee, we suggest that the District adopt a separate resolution addressed specifically to documenting the constraint it intends to place on the Fee by fund and purpose. This will improve the transparency about the Board's intent to constrain the Facility Fee, better meet GAAP requirements in establishing commitments, and allow separation in the purposes of this resolution and the resolution adopted authorizing the County Assessor to assess and collect the fee on behalf of the District.



## Central Services Cost Allocations

Based on input gathered from interviews, documents reviewed, and our evaluation of existing practices compared to applicable accounting standards and best practices, we have the following observations and recommendations.

1	Observation	The District accounts for certain central service costs in the General Fund that benefit or are otherwise necessary to support the activities and services reported in its other funds. These costs are combined with and reported among the expenditures by function in the General Fund, as expenditures by function or activity by the reimbursing fund, and as a 'negative expenditure' reported separately in the General Fund in the amount of the total reimbursements made during the year.
	Recommendation	Costs initially incurred and paid by the General Fund that ultimately benefit activities reported within, and reimbursed by, the other District funds, should not be reported in the General Fund's financial statements. They should be reported as transactions within the fund benefitting from the services provided.
2	Observation	The District's current practice is to initially record allocated costs within the General Fund.
	Recommendation	While the allocation of costs incurred by the General Fund and charged to other funds is in conformance with GAAP, it is more common to report costs that benefit multiple funds within Internal Service Funds similar to how the District accounts for and reports for its fleet, engineering, and building maintenance services.
3	Observation	The District's central service cost allocations lack full transparency in the budget document. A schedule is included in the document that provides support for the allocation percentages to the District's various activities but lacks the detail of which specific budgeted expenditure line items makes up the central service cost total that gets allocated.
	Recommendation	The District could improve the transparency of its central service cost allocations by providing the detail of line items included in the budget that make up the total central service costs that ultimately are allocated to the District's various activities.



4	<b>Observation</b>	The calculation of each activity's share of central service costs is based on averaging each activity's share of estimated full time equivalents, and budgeted wages, employee benefits, and services and supplies. This method is simplistic and does not allow for different bases for the unique nature of the different kinds of central service costs incurred. Related Board Policies and Practices identify the nature of central service costs eligible for allocation, but do not provide for the methodology to be used to allocate them.
	<b>Recommendation</b>	The District should consider revising Policies and Practices to include the methodology to be used to allocate central service costs. The methodology should allow for different bases for different types of costs incurred to better match amounts allocated with the drivers of those costs to the activities responsible for paying for them.
5	<b>Observation</b>	Central service costs allocated to the various activities of the District are based on budgeted amounts.
	<b>Recommendation</b>	The District should consider adjusting amounts charged to the various activities at year-end to match actual costs incurred, or alternatively, revise ensuing year allocations by prior year over or under charges compared to actual costs incurred so that reimbursements over time approximate the actual costs incurred.

#### **Observations of current Central Services Cost Allocation.**

The District incurs costs that benefit multiple activities reported within the various funds. Management uses two methodologies to account for, and allocate, those costs to the benefitting activities – the use of an Internal Service Fund (ISF), and the initial accounting and reporting of certain 'central service costs' as expenditures within the General Fund. Activities accounted for in the ISF are charged to the activities benefiting from the services provided through an interfund charge. Central services costs are allocated to the various activities/funds that benefit and reported separately by a negative expenditure in total in the General Fund financial statements along with expenditures/expense in the benefitting activity/fund for amounts allocated in their fund financial statements.

The District has Policy 18.1.0 and Practice 18.2.0 that provide for the allocation of central service costs that benefit or otherwise support the various activities of the District.

The District's Director of Finance performs an annual calculation, as part of the budget process, of central service costs to be allocated, along with the percentages to apply to the District's various activities, based on budgeted amounts for the ensuing year. The calculation of each activity's share of central service costs is based on averaging each activity's share of estimated full time equivalents, and budgeted wages, employee benefits, and services and supplies. It was not clear how the total



central service costs to be allocated is calculated as no detail was provided connecting the total to specific expenditure line items in the budget document.

As noted above, the central services costs allocation is part of the annual budget process, is included as a separate and distinct schedule in the budget document, and is available to the public for comment through the public process for budget adoption required by the State of Nevada.

### **GAAP and NRS Reporting Guidance for Cost Allocations**

Governments often provide services internally under shared service arrangements to promote the efficiency and effectiveness of the shared service. In addition, it is common for governments to incur costs that benefit or support activities reported within the various funds of the government. GAAP provides guidance to account for interfund activity within and among the three fund categories of governmental, proprietary, and fiduciary in two classifications – reciprocal and non-reciprocal.

Reciprocal interfund activity is used to describe situations involving the exchange of equal or almost equal value between funds. This is the equivalent of exchange or exchange-like transactions. Common types of transactions within this classification include loans between funds, and interfund services provided and used. The District's motor pool, engineering, and building maintenance are examples currently reported as interfund services provided and used. (GASB Cod Sec 1800.102a)

Non-reciprocal interfund activity is used to describe situations that do not involve the exchange of equal or almost equal value between funds, or the equivalent of non-exchange transactions. Common types of transactions within this classification include transfers of resources between funds, and reimbursement of costs from a fund responsible for the particular expenditures to the fund that initially paid for them. The District's interfund transfers and central service costs are examples of these classification of transactions. (GASB Cod Sec 1800.102b)

GAAP provides for different alternatives for the accounting of costs that benefit multiple activities. The most common methodology is to accumulate costs within an Internal Service Fund (ISF). ISF's are used to report any activity that provides goods or services to other funds, departments, or agencies of the entity on a cost-reimbursement basis. Rates are determined and charged to the benefitting activities at a level, that over time, approximate the costs incurred to allow the ISF to operate on a 'break-even' basis. (GASB Cod Sec 1300.110)

Another alternative is for the activity benefitting from an expenditure and ultimately responsible for covering the cost to reimburse the fund initially paying for the cost. Entries are made removing the cost from the fund that initially paid for it, and recording that cost in the fund benefitting from the expenditure. An example of this sort of transaction is the allocation of overhead. Allocations of overhead costs are to be reported as expenditures/expense of the benefitting activity/fund, and a reimbursement to the fund that initially paid for the cost. The result is the reimbursed cost is not reported in the financial statements as a transaction of the fund initially paying for the cost, but rather as a reduction of net position/fund balance and an expenditure/expense of the fund that ultimately is responsible for the cost. (GASB Cod Sec 1800.102 b (2), GAAFR 4-17)

Further, Nevada state law and budget preparation guidance provides, in general, for budgets based on GAAP, and specifically for interfund activity including quasi-external transactions, operating transfers, residual equity transfers, and the use of Internal Service Funds. (Nevada Form 4404LGF, NRS 354.543)





## **Evaluation of the District's Central Services Costs Allocations**

We find that the District Board has provided authority for the allocation of costs that benefit its various activities through adoption of Policies and Practices, and management is meeting state requirements through the budget process. We also find that the District is reporting in compliance with GAAP, with the exception of the issue noted in the following paragraph for its central service costs and activities currently reported within the General Fund.

The external financial statements could be improved by revising how the allocated costs are reported in the General Fund financial statements. As noted above, GAAP provides for costs initially paid for by one fund and reimbursed by another are to be excluded from the financial statements of the fund initially paying for the cost and as a reduction in net position/fund balance and an expenditure/expense in the financial statements of the funds ultimately benefitting from the service.

Improvements could be made in the allocation methodology. Best practices include evaluating six factors including the goals to be achieved, development of the allocation strategy, defining the level of cost detail, determining the actual cost of service, deciding on the bases of allocation, and considering potential drawbacks. The determination of the bases of allocation should take into consideration cause and effect relationships, the value of the benefits received, fairness, and a connection between an activity's desire to utilize the service and the cost to be incurred by that activity as a result. As examples, allocation based on cause and effect could include number of employee full-time equivalents, budgeted labor hours, building space occupied, number of PO's processed, number of checks issued, number of invoices processed, number of computers used and connected to the network, etc. Different bases could be used for separate types of costs. (GFOA Best Practices for Pricing Internal Services)

Another consideration that could simplify the ability of the District to determine the total and actual costs incurred as well as the sufficiency of the rates charged to the benefitting activities, would be to account for central service costs in an Internal Service Fund.

### **Recommendations.**

Should the District stick with its current practice of initially accounting for central service costs that benefit its various activities within the General Fund, the costs accumulated and allocated to other activities/funds should not be reported within the General Fund's external financial statements. They should be reported as costs within the activities/funds that receive the allocations.

The District should consider accounting for central services within an Internal Services Fund instead of through reimbursements to the General Fund. ISF's provide a mechanism to accumulate costs that benefit multiple activities/funds, allow for the capturing of all costs on a full accrual basis, and ISFs are specifically provided for in GAAP and the NRS. The use of ISF's require the setting of rates for interfund charges, over time, on a cost-reimbursement basis. Therefore, actual charges to benefitting activities will, over time, equal the actual costs incurred. The current practice of allocations based on initial budgets could result in over or under charging for the services provided.

To improve the transparency of the internal service costs allocated, we recommend a detailed schedule of the individual expenditure line items in the budget that make up the total to be allocated be included in the budget document along with the support for the allocation bases.



To better match the costs of services used by each activity, we recommend identifying the different types of costs to be allocated and using a basis for allocation for each type that better aligns with the drivers of that cost to the benefitting activities. The current allocation of cost is based on an averaging of four different elements that is heavily weighted toward the direct budgeted costs of each activity which may not be the best reflection of the level of central services needed by a particular activity.

Whether the District sticks to its existing practice of initially accumulating joint costs in the General Fund, or switches to the use of an Internal Services Fund, we recommend that interfund charges eventually become based on actual costs incurred. This can be done through a 'true-up' process and related accounting entries at year-end after all costs have been determined, or by adjusting rates to be charged in the ensuing year by the amount of cumulative over or under charges from prior periods. The correct use of an internal services fund will require reimbursement of actual costs incurred. Initial allocations based on budgeted expenditures/expenses is a common and efficient practice during the year.

12/7/20 DRAFT





# Punch Card Accounting

Based on input gathered from interviews, documents reviewed, and our evaluation of existing practices compared to applicable accounting standards and best practices, we have the following observations and recommendations.

1	<b>Observation</b>	The District's current punch card accounting methodology attempts to recognize portions of the Recreation Fee revenues within the activities by fund where the punch cards are presented for use. Further, we found that the District estimates the usage of punch cards and the budgeted Recreation Fee revenue by fund is consistent with that estimate.
	<b>Recommendation</b>	While we find the current accounting treatment for revenue realized from the Recreation Fee to be consistent with GAAP and the budget requirements of the State, we recommend ceasing the use of the current accounting methodology. This methodology complicates revenue estimates to use for budget purposes, is confusing to stakeholders, and requires a significant amount of staff time during the year to administer. The time, cost, and complexity involved appears to outweigh the benefits perceived to be achieved.
2	<b>Observation</b>	The Board has the authority to determine the allocation of the Recreation Fee proceeds to fund operations, capital asset acquisitions, and/or debt service of both Community Services and Beach. The allocation in any particular year can address the immediate needs of the District as determined by the Board and informed by actual usage of each venue and activity in prior years as well as estimated use in the ensuing year.
	<b>Recommendation</b>	The District should record revenues from the Recreation Fee proceeds within the different activities and funds according to the allocation determined by the Board at the time of the budget adoption.
3	<b>Observation</b>	Management has been classifying the Recreation Fee as a non-program related general revenue and therefore resulting from a non-exchange transaction since 2015 but has not specifically disclosed its policy on its revenue classification in the notes to the financial statements.
	<b>Recommendation</b>	Whether the District continues to report its recreational activities within governmental funds or switches to enterprise funds, its policy on the classification of the revenue should be disclosed in the notes to the financial statements. We recommend the District stick to the non-



exchange classification of the recreation fee, and if the decision is to switch to enterprise fund reporting, to report the fee within the non-operating section in the statement of revenues and expenses and the non-capital related financing activities section in the statement of cash flows.

### **Observation of current punch card accounting.**

Board Policy 2.1.0.2.4 provides for the reporting of the annual recreation and beach fee and the allocation of the fee to the District's various recreational activities, capital projects, and debt service. The policy provides that the Board will authorize the allocation through the budget process.

Policy 16.1.1 provides the authority for charging the recreation fee and the basis for which it will be assessed, the method and manner of the assessment and collection of the fee, and the benefits the fee provides residents through certain uses and rates at the District's various recreational facilities. The Board approved Ordinance 7 provides for the establishment of the uses and rates, rules and regulations for recreation passes and punch cards which are presented by residents at the recreational facilities to obtain the benefits and privileges provided to them in exchange for payment of the fee.

For the past several years, the Recreation Fee has been set at \$830 per land parcel. Through the budget adoption process, the Board determines the allocation of the proceeds from this fee among the different recreational activities reported in Community Services and Beach funds, as well as amounts designated for capital asset acquisitions and debt service benefitting the activities within these two funds.

To take advantage of the privileges provided by Ordinance 7, members have the option of receiving a picture pass or punch cards to present when utilizing the various recreational activities and facilities that, among other benefits, allow for reduced pricing compared to rates charged the general public. Management has attempted to recognize a portion of the Recreation Fee as revenue to the activity for which the punch cards were presented for use.

We found that the District has been utilizing a contra-revenue accounting methodology that attempts to recognize a portion of the Recreation Fee as revenue to the activity/facility to which the punch cards are presented for use somewhat commensurate with the value of the reduced rates the punch card use provides. We also learned that during the budget preparation and adoption process, the District has revised budgeted recreation fee revenues by activity from the initial allocation in an effort to estimate where punch cards will be presented for use. The budgeted revenues by activity as revised are made available to the public and are part of the public process and ultimately approved by the Board as part of the state required budget adoption process.

In our interviews with various stakeholders, we heard that the initial purpose of the contra-revenue accounting methodology was developed in an effort to better align a portion of the Recreation Fee revenues with the activity for which the punch cards were presented for use. However, we heard from many stakeholders the current revenue recognition practice is complicated, confusing, requires significant staff time, and seems inconsistent with the authority of the Board to allocate the recreation



fee to fund the various recreational activities and related capital acquisitions and debt service pursuant to their discretion.

We understand that some District stakeholders have raised the question as to whether the contra-revenue accounting methodology ends up with a reallocation of recreation fee revenues paid by certain residents that don't have beach privileges away from the Community Services Fund and records them as revenues within the Beach Fund. From inquiries of management and the observations of documents provided to us, we did not find that resources from the fees paid by members without beach privileges were reallocated and transferred out of the Community Services Fund. Nor did we find actual revenues reported for a year to be inconsistent with the intent of the adopted budget.

From review of past comprehensive annual financial reports, we find that management has been inconsistent in the classification of the Recreation Fee revenue within the financial statements, and not currently following GAAP. Prior to 2016 when the District was reporting its recreational activities within enterprise funds, the fee was classified as 'operating revenue' consistent with exchange or exchange-like accounting guidance. After 2016 the District classified the fee as 'general revenues' which is consistent with the non-exchange transaction accounting guidance, and only appropriate when the fee is unrelated to funding specific programs or activities of the District.

#### **Applicable revenue recognition guidance applicable to the Recreation Fee.**

A governmental accounting system must make it possible to present fairly and with full disclosure the funds and activities of the governmental unit in conformity with GAAP, and to determine and demonstrate compliance with finance related legal and contractual provisions. Governing bodies, by definition, exercise the "power of the purse" by their responsibility to authorize the entity to raise and spend public money. This authorization in Nevada comes through the adoption of the annual budget. (GASB Cod Sec 1100.101, GAAFR 4-2, NRS 354.596-598)

The use of funds is the established mechanism to meet the objective noted above. A fund reports financial resources which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with regulations, restrictions, or limitations. The particular use of a fund can be dictated by laws, regulations, or often as determined at the discretion of the governing board. (GAAFR 4-1&2)

GAAP provides for revenue recognition based on the classification of the underlying transactions which generally falls into two classifications of exchange or exchange-like, and non-exchange. Exchange transactions generally result from fees charged to users for goods or services where the fee is commensurate with the value received by the user. Greens fees at a golf course or the day-use fee at a gym are examples. Non-exchange transactions result when the provider of the resources does not necessarily receive something of equal value in return. Examples include the payment of taxes to fund general government services like community planning and public safety. The classification of the underlying revenue has significant implications on the timing of recognition of a resource (an asset or reduction of a liability) and revenue. It also has implications on the fund-type to be used for the underlying activity. (GAAFR 8-1&2)

There are instances the parties to the services may be willing to receive or pay amounts that are similar, but may not be same, as the value of the underlying goods and services. These transactions are classified as exchange-like transactions. 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 are strong enough to justify treating the transaction as exchange for accounting purposes. (GASB Cod Sec N50.503)

Exchange and exchange-like transactions are to be recognized as, or over the period when, the underlying service is provided. Non-exchange transaction accounting guidance is provided by GASB Statement No. 33 which generally provides for asset recognition when a resources are received or at the time a legal right to resources exist, and revenues recognized when all eligibility criteria are met securing the entity’s right to the resources.

There is diversity in practice in the application of existing guidance with transactions that are not pure exchange or non-exchange. As a result, GAAP requires management to set a policy to be consistently applied as to the nature of transactions considered program revenues for its governmental activities, and operating revenues for its business-type activities and to disclose the policy in the footnotes to the financial statements. From review of past CAFR’s, we did not find a disclosure specific to the revenue classification of the District’s Recreation Fee. (GASB Cod Sec 2300.106)

In the government-wide statement of activities, revenues are to be classified as either program or general. Program revenues are defined as those directly associated with the function or program and would disappear if the function or program were eliminated. Examples include fees and charges paid by those who purchase, use, or otherwise directly benefit from the service, program-specific grants and contributions restricted to financing the underlying function or activity, and interest earnings on investments restricted to use by a specific function or activity. General revenues are defined as those not directly related to financing a specific function or activity. Examples are taxes, grants and contributions that are not restricted to a specific function or activity, and interest on invested resources not restricted to specific functions or activities. (GASB Cod Sec 2200.136-140)

### **Evaluation of the District’s current Punch Card accounting methodology**

We find that the District’s Board has the authority to assess the Recreation Fee as provided in the Board Policies and Ordinances. Further, the Board has the authority to determine the allocation of the fee among the District’s various recreational funds, activities, and related capital and debt service reserves which is memorialized in the District’s adopted budget. As noted above, the budgeted allocation of the Recreation Fee has included revisions for the District’s estimated usage of punch cards among the various recreational activities prior to adoption by the District’s Board.

In addition, we find that the District’s current contra-revenue accounting methodology results in Recreation Fee revenues recognized by the various activities and funds in accordance with the intent of the approved budget, as well as the accounting literature for reporting revenue within the various funds of an entity at the discretion of the governing board.

Further, based on existing guidance available today and on the diversity in practice in the application of revenue classification criteria for certain transactions, we can understand why management has not been able to come to a definitive conclusion on the classification of the District’s Recreation Fee



presumably resulting in the switch in classification after 2015. While the fee is not 'pure' in the same sense as the payment of greens fees for a round of golf, the fee does provide specific rights and privileges to residents to the District's recreational activities along with the District's policy of using the fee, in addition to user charges, to directly finance recreational activity operations, capital needs, and debt service.

One factor that would seem to support management's current classification as 'non-exchange' is the fact that the assessment and payment of the fee lacks the mutual assent of the parties. Residents do not have a choice on the payment of the fee unlike the decision to play golf and incur greens fees. GASB's new revenue and expense recognition project currently under deliberation provides for four criteria to be met for a transaction to be considered exchange or exchange-like including the concept of 'mutual assent' of the parties. This concept is not included in current accounting standards and is being discussed, in part, to provide clearer guidance on what constitutes an exchange transaction. (GASB Revenue and Expense Recognition Preliminary Views Ch 3, par 3)

We find that the classification of the recreation fee in the government-wide statement of activities since 2015 as a general revenue is inconsistent with GAAP in that the fee is assessed specifically to finance the District's recreational activities. As such, it meets the criteria to be reported as a program revenue in the statement of activities. Further, the fee meets the criteria to be included in the charges for services column in the statement. (GASB Cod Sec 2200.137)

### **Recommendations.**

We recommend ceasing the use of contra-revenue accounting currently applied to the portion of the recreation fee revenues associated with the value attributed to the use of punch cards. We question the benefits derived compared to cost incurred by the District to administer this approach especially given the Board's authority to allocate the resources they deem appropriate to best meet the needs for the ensuing year through the adopted budget. In addition, setting the allocation through the adopted budget eliminates the variability that results when punch cards are utilized differently from preliminary estimates included in the budget thereby providing management more certainty as to actual resources available to finance each activity during the year, and should significantly reduce staff time and effort required to perform the daily and monthly accounting.

We recommend the recreation fee proceeds be reported within the activities and funds consistent with the allocation initially set by the Board during the budget adoption process irrespective of where punch cards are utilized by the District's patrons during the year.

We recommend the District include its policy on the classification of the recreation fee as either program or general revenue, or, either operating or non-operating, in the footnotes to the financial statements. If the District continues to report its recreational activities within governmental funds, we recommend the fee be classified as program revenues and reported in the charges for services column and on the appropriate lines for the portions related to Community Services and Beach activities. If the District reports the recreational activities in enterprise funds, we recommend the fee be reported as non-operating revenue.



# Capital Asset Accounting

Based on input gathered from interviews, documents reviewed, and our evaluation of existing practices compared to applicable accounting standards and best practices, we have the following observations and recommendations.

1	<b>Observation</b>	The District's current accounting practice includes posting certain costs incurred to its construction-in-progress account based on the nature of an expenditure, or services provided to the District by certain employees, without requiring a clear connection of the cost incurred to the increased service capacity of a specific capital asset. The costs posted to construction-in-progress are later transferred and included in the capitalized cost of existing and new capital assets. Further, we found that costs are capitalized without an evaluation of what stage a particular project is in whether a preliminary or feasibility stage, actual construction stage, or post-construction stage. As a result, expenditures incurred in preliminary stages in past projects have been capitalized by the District that don't meet current accounting guidance for capitalization.
	<b>Recommendation</b>	The District's practices and policies should be revised to acknowledge different stages to a project, definition of costs incurred in each stage, and how to account for the expenditures incurred in each stage, consistent with established and accepted governmental accounting practices.
2	<b>Observation</b>	The District's past history of capitalizing feasibility studies and master plans is not consistent with with current recognized governmental accounting practice.
	<b>Recommendation</b>	The District should expense expenditures for feasibility studies and master plans.
3	<b>Observation</b>	The District has historically capitalized repair projects without a complete evaluation of whether the repair truly increased the capacity of the asset to provide service. Board policies currently do not provide sufficient guidance on what constitutes an increase in service capacity for its various types of capital assets.
	<b>Recommendation</b>	Board policies and practices should be revised to provide for capitalization of expenditures that truly increase service capacity, and





further, that provide the criteria to be followed in making the increased service capacity decision on expenditures by nature or function of the different asset types versus expenditures that should be expensed.

### **Observation of current capitalization practices.**

From our interviews of various stakeholders, we learned that the District has routinely treated a number of different types of expenditures initially as capital outlays and included in the capital asset account titled 'construction-in-progress'. These costs are allocated to and included with the costs incurred to actually construct a project and reclassified to other capital asset classifications once projects are completed.

Costs initially included in construction in progress include master plans, feasibility studies, and payroll costs for certain District employees like engineers involved in the District's capital asset planning processes. Decisions on whether to include a cost in construction in progress appear to be more from established practice based on the nature of a type of expenditure like engineering staff payroll costs, instead of based on an evaluation of whether the costs were incurred to actually construct a specific asset and without consideration of what stage a project is in.

Board policy 8.1.0 and 9.1.0 establish some of the elements of a framework with which to establish whether an expenditure should be capitalized including the useful life for a particular capital asset. 9.1.0.1.0 provides that an asset must provide utility for two years or more to be eligible for capitalization. 9.1.0.3.0 provides that only expenditures in excess of \$5,000 will be eligible for capitalization.

Board practice 2.9.0.1.2.1 provides that an asset must have a useful life of at least three years to be eligible for capitalization which is inconsistent with the guidance in policy 9.1.0.

Board practice 2.9.0.1.2.4 provides guidance for when repair project expenditures would be eligible for capitalization including the concept of increases to 'productivity' that are necessary in addition to the concept of increasing the useful life.

### **Applicable capital expenditure and best practice accounting guidance.**

There is relatively little material in the accounting standards to provide specific guidance on when it is appropriate to treat an expenditure as a capital. Rather, most of the guidance is based on GASB Concepts Statement No. 4 which provides general concepts only, anecdotal guidance from other standards like the accounting for intangible assets, asset impairments, elimination of the capitalization of interest costs, among others, and what has evolved in practice. Existing guidance defines capital assets as land, improvement to land, easements, buildings, building improvements, vehicles, machinery, equipment, works of art and historical treasures, infrastructure, and all other tangible and intangible assets that are used in operations and that have initial useful lives extending beyond a single reporting period. Infrastructure assets are long-lived capital assets that normally are stationary in nature and normally can be preserved for a significantly greater number of years than most capital assets including roads, bridges, tunnels, drainage water and sewer systems. (GASB Cod Sec 1400.103)



Accepted practice includes recognition of the different stages of a project including preliminary, construction, and post-construction. Preliminary stage activities include conceptual formulation and evaluation of alternatives, determination of future needs, feasibility studies, and development of financing alternatives. Construction stage includes the engineering and design work on the chosen alternative, actual construction costs, direct payroll of employees working on the project along with certain overhead, and ancillary charges necessary to get the asset in working condition. Post construction stage includes, among other costs, training of employees on use of a particular asset. (GASB Cod Sec 1400.143-149)

Costs incurred in the preliminary and post-construction stages are expensed as costs in these stages are not directly connected with creating service capacity of a particular asset. A project is not considered to enter the construction stage until an actual project alternative has been selected, it is determined the selected alternative will meet the intended needs and objectives, financing for the project has been identified, and the entity establishes in some meaningful way it is committed to proceed with the project such as, for example, including the financing sources and necessary expenditures in the budget. (GAAFR 23-7 to 9)

Governments often expend resources on existing capital assets. Most often, these expenditures simply preserve the asset's utility and are expensed as routine repairs and maintenance. Any outlay that does no more than return a capital asset to its original condition, regardless of the amount expended, should be classified as maintenance and repairs. Since maintenance and repairs provide no additional value, their cost should be recognized as expense when incurred. (GAAFR 23-10)

Best practices to consider for inclusion in policies and practices include:

- The different stages of a project and the types of costs incurred in the different stages.
- The accounting treatment of costs incurred in the different stages.
- What elements or criteria need to be met for expenditures associated with a repair project to be eligible for capitalization based on the concept of service capacity in addition to the extension of useful life of an asset.
- Provide for a different dollar threshold for the different classifications of capital assets.
  - (GFOA best practices)

#### **Evaluation of the District's current capitalization practices.**

We find that the District's practice of capitalizing expenditures incurred in what would meet the definition of the preliminary stage of a project as noted above is inconsistent with the accepted practice. Examples include payments to external consultants and internal staff payroll costs to develop master plans, feasibility studies, and related engineering and overall system planning.

In addition, we find that the District has capitalized expenditures incurred for repair projects without a careful consideration of portions of the costs incurred that bring the asset back to its previous service capacity and therefore should be expensed, versus the portion of costs that actually increased the service capacity and or significantly increased the asset's useful life. When a particular project has elements of both repairs and improvements, an appropriate portion of the cost should be allocated to repairs and therefore expensed, and a portion to the improvement and capitalized. (GAAFR 27-10)





Further, we found the District's Board policies and practices lacked a framework for recognition and nature of costs incurred in the various stages of a project along with the accounting treatment to be applied with each stage.

### **Recommendations.**

The District's policies and practices should be expanded to provide additional guidance. One area to consider is revisions to recognize, provide descriptions of the types and nature of expenditures incurred in, and provide guidance on how to account for, the various stages of a capital project. The stages should include, at a minimum, preliminary, development or construction, and post-development or construction. Only costs incurred in the development and construction stage should be identified as eligible for capitalization. Another area to consider is a revision of the dollar thresholds to apply to the different classes of capital assets.

Costs incurred for master plans, feasibility studies, exploration of various project financing alternatives; and all internal payroll costs for engineering, planning, and administrative efforts incurred in what would fall into the preliminary project stage should be expensed when incurred. These costs do not directly provide service capacity to any particular capital asset, and therefore, do not meet current recognized practice for costs eligible for capitalization.

Each project related to an existing capital asset should be carefully evaluated with respect to the objective of the project. For example, was the project anticipated as part of the ongoing and necessary maintenance to keep the asset in good working order without increasing service capacity and therefore not eligible for capitalization, a repair that was not anticipated but necessary to keep the asset in good working order without increasing the service capacity and not eligible for capitalization, or was the project previously identified as part of an overall plan to increase the service capacity or the overall remaining useful life of the asset and therefore eligible for capitalization. The policy could provide the criteria to be applied unique to the different classes of capital assets necessary to make the determination on whether a significant increase in service capacity or useful life will result. As an example, policies for road resurfacing might include that laying more than a certain number of inches of new asphalt on an existing road is required to support the service capacity has been increased and the resurfacing project costs are eligible for capitalization. Application of sealants or laying new asphalt of less than a certain depth is considered repairs and maintenance and expensed when incurred.

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