

City of Alexandria, Virginia

MEMORANDUM

DATE: APRIL 22, 2005

TO: THE HONORABLE MAYOR AND MEMBERS OF CITY COUNCIL

FROM: JAMES K. HARTMANN, CITY MANAGER 

SUBJECT: BUDGET MEMO # 91: COMPENSATED ABSENCES

In response to Mayor Euille’s question on compensated absence funding policy, the following information is provided.

During the 1980s and the early 1990s, the Governmental Accounting Standards Board (GASB) was planning on instituting new rules which would have made state and local governments accrue for compensated absences. This meant the City and City Schools would have had to budget and expense for sick, comp time and annual leave liability which had been earned by its employees. This was a \$5.7 million liability in 1990 (which has increased to \$21.4 million by the end of FY 2005). In anticipation of this new GASB rule, and in order to cushion the first year fiscal shock of this accounting rule change, the City designated \$5.7 million in fund balance for Compensated Absences in FY 1990. This equaled 100% of the liability at that time. The current \$7.2 million designation equals 34% of the current liability.

In the late 1990s, GASB changed course (in large part because of local and state government advocacy against the compensated absence accounting change) and issued GASB 34 which, while recognizing the compensated absences as a liability, it was not one which needed to be expensed and budgeted for. However, it is included in the calculation of City “Net Assets.”

As a result of the shift in GASB position, the amount designated from Fund Balance for compensated absences, which had grown to \$10.8 million by FY 1996, was reduced downward and is now at \$7.2 million. It has remained frozen at \$7.2 million since FY 2000. Departmental budgets are charged when leave is paid out upon employee retirement or separation.

While the original driving GASB accounting rule reason for the compensated absence designation has largely been eliminated, the \$7.2 million designated has been and continues to serve as an important element to make sure that Council’s adopted Debt Related Financial Policies (see page 10-51 of the proposed budget) are adhered to. While the compensated absence funds are designated, they are not reserved and therefore remain part of the unreserved General Fund Fund Balance. Those Debt Related Financial Policies have established lower limits of how much Unreserved General Fund Fund Balance there should be at no less than 10% of General Fund

Revenues. For FY 2006 (see page 4-63 of the proposed budget) the Unreserved General Fund Fund Balance is estimated at 11.9%. This measure has been dropping towards the floor level of 10% over the last few years as the budget has grown and the Unreserved General Fund Fund Balance has stayed roughly at the same level. If the \$7.2 million in compensated absence was budgeted and expended for other purposes, then the Unreserved General Fund Fund Balance would drop below the City's 10% lower level limit and the Debt Related Financial Policies would be violated.

The attached budget memo from April 2001 provides more details on the history of the compensated absence issue.

As the bond rating agencies consider the City's Debt Related Financial Policies exemplary policies, and since the bond rating agencies review City compliance with these policies each time the City sells bonds, it is recommended that the City maintain consistency with these policies when the FY 2006 budget is adopted and that the compensated absences designation not be reduced.

Attachment

*City of Alexandria, Virginia*

**MEMORANDUM**

DATE: APRIL 24, 2001

TO: THE HONORABLE MAYOR AND MEMBERS OF CITY COUNCIL

FROM: PHILIP SUNDERLAND, CITY MANAGER

SUBJECT: BUDGET MEMO # 30: COMPENSATED ABSENCES

The following memorandum is in response to Councilman Euille's request for an analysis and history of \$7.2 million designation of General Fund balance for compensated absences as found on page 4-61 of the FY 2002 Proposed Operating Budget.

Compensated absences are absences for which employees will eventually be paid, such as vacation and sick leave. Under Governmental Accounting and Financial Reporting Standards issued by the Governmental Accounting and Standards Board (GASB), the City is required to accrue on its accounting records and financial statements a liability as employees earn the right to receive benefits for compensated absences that are attributable to services already rendered and that are not contingent on a specific event that is outside the control of the employer and employee. Upon retirement or termination of service, all City employees are paid for any unused annual leave. City employees who have completed twenty or more years of service and who voluntarily separate from City service are paid for 25 percent of their unused sick leave. The School Board has similar programs. Thus, the City is required to accrue a compensated absence liability for the unused annual leave of employees, and for 25 percent of the unused sick leave of employees with 20 years of service.

Each year as the accounting records are finalized, the City and School Board calculate and record the dollar value of these compensated absences. During the 1980s, City staff were aware that GASB was planning on changing governmental accounting standards and that, with the new standards and reporting model, all assets and liabilities (short- and long-term) would be combined into one statement. Given that the City needs to follow GASB requirements, and given that the City's financial statements are reviewed and are considered a key piece of financial information by the bond rating agencies, the City decided to address the compensated absence liability, and planned GASB reporting standard (that would highlight this liability), by designating part of unreserved fund balance for compensated absences.

As a result, the City designated \$5.7 million in FY 1990 as its estimate of the cost of 100% of the City and Schools compensated absence liability. That amount grew as the compensated absence liability grew until it reached \$10.8 million in FY 1996. Since then, the percentage of designation

has been decreased as part of the fiscal policies recommended in budgets by the City Manager to 67% (FY 1997) and to 50% (FY 1998). Currently there is some \$7.2 million designated, which represents 50% of the estimated City and School compensated absence liability as of June 30, 2000.

After more than a decade of debate, GASB adopted Statement #34 and issued it in June 1999. The financial reporting method that GASB used in Statement #34 to structure governmental financial reporting on long-term liabilities and assets made the liability for compensated absences less important than the prior GASB draft Statements that dealt with this issue. However, the change in GASB reporting methods still requires the City to report compensated absence liabilities. By changing the structure of the asset reporting, GASB did reduce the significance of the compensated absence liability; in effect, this liability was diluted by the way assets were reported. While GASB requires the City to record and report this liability, there is no GASB or legal requirement that a locality fund this liability.

However, the importance of the funds designated for compensated absences has not diminished for City financial policy reasons. This is because the City's deb-related financial policies require that the City maintain no less than a 10% unreserved General Fund balance as a percentage of General Fund Revenues (the policy is detailed on page 10-49 of the FY 2002 Proposed Budget).

For example, as of June 30, 2001, it is estimated (Budget memo #14, page 185) that the City will have an unreserved balance of \$53.1 million or 15.8 percent of FY 2001 General Fund revenues. Approximately \$16.7 million of this balance is proposed to be used in future years for the City's proposed Capital Improvement Program and \$3.5 is proposed to be used to balance the FY 2002 budget. If one deducted these two planned designated uses and then deducted the \$7.2 million designation for compensated absences, the unreserved fund balance would fall to 7.7% of General Fund revenues, and therefore be below the minimum target that the City has formally established as its fiscal policy.

The following is a chronology of the City's designations for compensated absences:

- 1. **August 1982** National Council of Governmental Accounting (NCGA) issued NCGA Statement 4 *Accounting and Financial Reporting Principles for Claims and Judgements and Compensated Absences*.
- 2. **June 30, 1984** City implemented NCGA Statement 4 *Accounting and Financial Reporting Principles for Claims and Judgements and Compensated Absences* by recording \$4.4 million in the General Long-Term Debt Account Group.
- 3. **May 1990** Governmental Accounting Standards Board (GASB) issued GASB Statement No. 11 *Measurement Focus and Basis of Accounting - Governmental Fund Operating Statements*.

4. **June 30, 1990** City designated \$5.7 million of fund balance for Compensated Absences and Others in anticipation of the effect of GASB Statement No. 11. Designation includes compensated absences less one month's sales tax. Basis for designation does not change until June 1993.
5. **November 1992** GASB issued GASB Statement No. 16 *Accounting for Compensated Absences*.
6. **June 1993** GASB issued GASB Statement No. 17 *Measurement Focus and Basis of Accounting-Governmental Fund Operations Statement*. Amendment to the effective dates of GASB Statement No. 11 and related statements which delayed implementation of GASB statement No. 11 for two years.
7. **December 1993** GASB issued GASB Statement No.22 *Accounting for Taxpayer-Assessed Tax Revenues in Governmental Funds*. Statement is effective for fiscal years beginning after June 15, 1994.
8. **June 30, 1995** City implemented GASB Statement No. 22. Increases Reservation of Fund Balance for Compensated Absences by eliminating the one month's sales tax. City includes a discussion of its position on GASB Statement No. 11 in the Comprehensive Annual Financial Report (CAFR) Transmittal Letter.
9. **March 18, 1997** City Manager released Proposed FY 1998 Budget which contains a line changing the compensated absence designation from 100% to 75% of the total liability.
10. **March 19, 1997** City Manager issued a memorandum to City Council explaining the rationale for the Compensated Absence designation and giving the history of the designation.
11. **October 14, 1997** BFAAC adopts report on Debt-Related Financial Policies, which contains an appendix on the City's General Fund/Net Asset Balance. In the report, BFAAC recommends that the policy on undesignated General Fund balance be changed to include a policy on Net Asset balance in preparation for the new financial reporting model. The Appendix of the report includes a discussion of the entity-wide financial statements and mentions that infrastructure assets will be included in the entity-wide financial statements.

- 12. **December 9, 1997** City Council adopted revisions to Debt-Related Financial Policies which includes revisions for future implementation of the new reporting model.
- 13. **March 17, 1998** City Manager released FY 1999 Proposed Budget which contains a line changing the compensated absence designation from 75% to 50% of the total liability.
- 14. **March 16, 1999** City released FY 2000 Proposed Budget issue which shows no change in compensated absences since GASB Statement 34 preliminary implementation information appears to allow assets to offset the liability. Staff consciously made no change so we could assess the impact of Statement 34.
- 15. **November 11, 1999** City released 1999 CAFR, which contains a draft of the new reporting model.
- 16. **November 6, 2000** City released FY 2000 CAFR, which makes the City the first major city to fully implement the requirements of GASB Statement #34.

Attachment: I. Compensated Absence Funding (FY 1990-FY 2000)

Staff: Mark Jinks, Assistant City Manager  
 Dan Neckel, Director of Finance  
 Laura Triggs, Deputy Director of Finance/Comptroller

Compensated Absences  
City of Alexandria, Virginia  
April 23, 2001

Fiscal Year	Long Term Liability			General Fund Designation Amount	Designation Description
	City and Library	Schools	Total		
2000	\$10,754,880	\$3,460,923	\$14,215,803	\$7,208,635	50% of City & Schools
1999	10,229,064	3,408,626	13,637,690	6,818,845	50% of City & Schools
1998	10,059,396	3,162,402	13,221,798	6,610,899	50% of City & Schools
1997	8,976,757	3,101,536	12,078,293	8,093,599	67% of City & Schools
1996	8,403,289	2,388,177	10,791,466	10,791,466	100% of City & Schools .
1995	7,569,257	2,084,208	9,653,465	9,653,465	100% of City & Schools
1994	7,229,069	1,870,724	9,099,793	7,710,801	**
1993	9,108,998 *		9,108,998	7,901,811	**
1992	8,368,529 *		8,368,529	7,148,116	**
1991	7,751,832 *		7,751,832	6,692,423	**
1990	6,730,072		6,730,072	5,730,072	**

\* Includes City, Library and Schools.

\*\* 100% of City and Schools, less one month of accrued sales tax.

*City of Alexandria, Virginia*

MEMORANDUM

DATE: NOVEMBER 12, 1999

TO: MARK JINKS, DIRECTOR, FINANCIAL & INFORMATION  
TECHNOLOGY SERVICES

FROM: DAN NECKEL, DIRECTOR OF FINANCE *Dan*

SUBJECT: COMPENSATED ABSENCES

Per your e-mail of November 10, listed below are the chronology of designations for compensated absences and implementation of changes to the Financial Reporting Model.

1. **August 1982** NCGA issued NCGA Statement 4 *Accounting and Financial Reporting Principles for Claims and Judgements and Compensated Absences*.
2. **June 30, 1984** City implemented NCGA Statement 4 *Accounting and Financial Reporting Principles for Claims and Judgements and Compensated Absences* by recording \$4.4 million in the General Long-Term Debt Account Group.
3. **May 1990** GASB issued GASB Statement No. 11 *Measurement Focus and Basis of Accounting - Governmental Fund Operating Statements*.
4. **June 30, 1990** City designated \$5.7 million of fund balance for Compensated Absences and Others in anticipation of the effect of GASB Statement No. 11. Designation includes compensated absences less one month's sales tax. Basis for designation does not change until June 1993 (attachment # 4).
5. **November 1992** GASB issued GASB Statement No. 16 *Accounting for Compensated Absences*.
6. **June 1993** GASB issued GASB Statement No. 17 *Measurement Focus and Basis of Accounting-Governmental Fund Operations Statement*. Amendment to the effective dates of GASB Statement No. 11 and related statements which delayed implementation of GASB statement No. 11 for two years.
7. **December 1993** GASB issued GASB Statement No. 22 *Accounting for Taxpayer-Assessed Tax Revenues in Governmental Funds*. Statement is effective for fiscal years beginning after June 15, 1994.

- 8. June 30, 1995** City implemented GASB Statement No. 22. Increases Reservation of Fund Balance for Compensated Absences by eliminating the one month's sales tax. City includes a discussion of its position on GASB Statement 11 in the CAFR Transmittal Letter (attachment # 8).
- 9. March 18, 1997** City Manager released Proposed FY 1998 Budget which contains a line changing the compensated absence designation from 100% to 75% of the total liability (attachment # 9).
- 10. March 19, 1997** City Manager issued a memo to City Council explaining the rationale for the Compensated Absence designation and giving the history of the designation (attachment # 10).
- 11. October 20, 1997** Arthur Gitajn issued e-mail confirming that the Designation for Compensated Absences in the 1997 CAFR should be 75% of the liability (attachment # 11).
- 12. October 14, 1997** BFAAC adopts report on Debt-Related Financial Policies, which contains an appendix on the City's General Fund/Net Asset Balance. In the report, BFAAC recommends that the policy on undesignated General Fund balance be changed to include a policy on Net Asset balance in preparation for the new financial reporting model. The Appendix of the report includes a discussion of the entity-wide financial statements and mentions that infrastructure assets will be included in the entity-wide financial statements (detail part of attachment # 13).
- 13. December 9, 1997** City Council adopts revisions to Debt-Related Financial Policies which includes revisions for future implementation of the new reporting model (attachment # 13).
- 14. March 17, 1998** City Manager released Proposed FY 1999 Budget which contains a line changing the compensated absence designation from 75% to 50% of the total liability (attachment # 14).
- 15. October 20, 1998** Arthur Gitajn issued e-mail to City Manager describing words in CAFR footnote for General Fund designations. No specific mention of the Designation for Compensated Absences other than designations will be the same as in the Approved Budget (attachment # 15).
- 16. March 16, 1999** City released FY 2000 budget issue which shows no change in compensated absences since GASB Statement 34 preliminary implementation information appears to allow assets to offset the liability. Staff consciously made no change so we could assess the impact of Statement 34 (attachment # 16).
- 17. November 11, 1999** City released 1999 CAFR, which contains a draft of the new reporting model.