



Agency Policies and Procedures

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## Refund of Excess Retained Earnings

### Policy Objectives:

Agency policy and procedures for refund of excess retained earnings are designed to:

- Provide guidance to the internal service funds for the handling of excess retained earnings and
- Ensure consistent accounting of customer refunds of excess retained earnings.

### Background Information:

Theoretically, an internal service fund should have revenues equal to expenses and no retained earnings. However, internal service funds are dependent upon a reasonable level of working capital reserve in retained earnings to operate. A working capital reserve up to 60 days is considered reasonable; however, a working capital reserve exceeding the 60 days may be approved by the cognizant Federal agency in exceptional cases. When retained earnings are higher than the working capital reserve considered reasonable, there is a concern that the surplus may lead to the assessment of a federal refund of excess retained earnings. With this in mind, the internal service funds should consider refunding the retained earnings in excess of the allowable working capital reserve. The refund should be in the form of cash refunds or applied as a credit to the billable agency's account.

Unfortunately, for governmental entities, no specific authoritative guidance exists addressing refunds of excess retained earnings. We can only use the information we know from the accounting principles for the private-sector, and apply them to the internal service funds. Refunds of retained earnings must not be used to reduce current revenue so that revenues are reported accurately. The Department of Minnesota Management and Budget (MMB) recommends that the refund be made in the year following the excess.

### Authority:

- **Financial Accounting Standards Board (FASB) Statement 71 & FASB Statement of Financial Accounting Standards (FAS) 71** provides accounting for the effects of certain types of regulation.
- **Governmental Accounting Standards Boards (GASB) Statement Number 34** provides the new financial reporting requirements for state and local governments.
- **[Federal Office of Management and Budget \(OMB\) Circular A-87 Cost Principles for State, Local and Indian Tribal Governments](#)** - Federal guideline that establishes the principles of determining the allowable costs incurred by state and local governments.
- **2000 Miller Generally Accepted Accounting Principles (GAAP) Guide** provides generally accepted accounting principles and specialized industry accounting principles.
- **[MAPS Operations Manual Policy and Procedure 0108-01](http://www.mmb.state.mn.us/chapter-1/212-212)** specifies the process for internal service fund rate approval. (<http://www.mmb.state.mn.us/chapter-1/212-212>)

**Business Risks:**

- Revenue would be understated if refunds were applied to current sales, thus creating an understatement of current earnings.
- A miscalculation of projected earnings would occur if statistical information were not correct.

**Policies and Procedure:**

1. Division's Responsibilities

- A. It is the division's responsibility to work as a team with the Financial Management and Reporting (FMR) Division accountant and MMB to determine if a refund is permissible and warranted.
- B. The division staff should work with the FMR Division accountant and MMB staff to review excess retained earnings taking the following into consideration:
  1. What is the amount of excess retained earnings from the Reconciliation of Retained Earnings worksheet (Refer to Exhibit A) prepared by the MMB,
  2. What are the amount of current and projected revenues,
  3. Does the internal service fund continually reduce rates to compensate for the increase in use of their services,
  4. Does the internal service fund use statistical analysis to aid in the measurement of future services versus the anticipated use of current and future services,
  5. Is the retained earnings account monitored on a quarterly basis to determine if excess retained earnings are anticipated, and
  6. Will the rate package be utilized as a way to help reduce the retained earnings of the entity? If this is not possible (due to the increase in use of services one entity gives to another), a refund of service overcharges should be made available to applicable agencies.
- C. Based upon the above analysis, MMB may require the internal service fund to adjust future rates for the excess amount. If MMB determines that a customer refund should be issued, the division must work with the FMR Division accountant to determine how to handle the refund.

2. FMR Responsibilities

- A. It is the FMR Division accountant's responsibility to assist the division to properly classify the refund. The refund *must not* be reported as a reduction to current revenue.
- B. The FMR Division accountants are responsible for reviewing the rate package to ensure that the retained earnings balance is adequately adjusted downward if the retained earnings exceed the allowable working capital reserve. This should be done to insure that no federal penalties are imposed.

**See Also:**

FMR Auditor's Technical Memo #00-10

Refer to the [Glossary](#) for definitions of the key terms listed below:

cognizant federal agency  
working capital reserve

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Exhibit A

## RECONCILIATION OF RETAINED EARNINGS

### RE-BALANCE TO OMB A-87

FOR YEARS ENDING JUNE 30, 2000

(All Figures in 000's)

R/E Balance July 1, 1999 (End Balance per Prior Year A-87 Rec)			<u>\$XXX</u>
RETAINED EARNINGS INCREASE(DECREASE) PER CAFR			
A-87 Revenues (Actual and Imputed)			
From Attached Financial Statements		\$XXX	
Actual Interest Income Per CAFR			
Or			
Imputed Interest Income on Average Cash Balance	\$XXX		
Other Revenues		XXX	
Total Revenues			<u>XXX</u>
Expenditures (Direct Costs per CAFR)			
Cost of Goods Sold		XXX	
Operating Expense		XXX	
Non-Operating Expenses:			
Master Lease Interest Expense		XXX	
Master Lease Refund of Interest & Financing Costs		XXX	
(Gain) or Loss on disposal of fixed assets		XXX	
Less A-87 Unallowable costs:			
Capital Outlay		XXX	
Projected Cost Increases/Replacement Reserve		XXX	
Interest & Financing Costs (Net Master Lease Costs)		XXX	
Amortization of Deferred Financing Costs		XXX	
Other		XXX	
Add: A-87 Allowable costs			
Indirect Costs From SWCAP (if not allocated in SWCAP)		XXX	
Depreciation or Use Allowance (if not in actual costs above)		XXX	
Other		<u>XXX</u>	
Total OMB A-87 Allowable Expenditures			<u>XXX</u>
Net Increase (Decrease) to Retained Earnings			XXX
TRANSFERS Per CAFR (per Accounting Records)			
Transfers In		XXX	
Transfers Out		XXX	
Net Transfers			(A) <u>XXX</u>
Retained Earnings Balance			(B) <u>XXX</u>
OMB A-87 60 Day Allowable Balance Total			
Amount in Excess(Deficit) Balance (A-B)			<u>XXX</u>