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Understanding and implementing GASB's new financial reporting model : a question and answer guide for preparers and auditors of state and local government financial statements;

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AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

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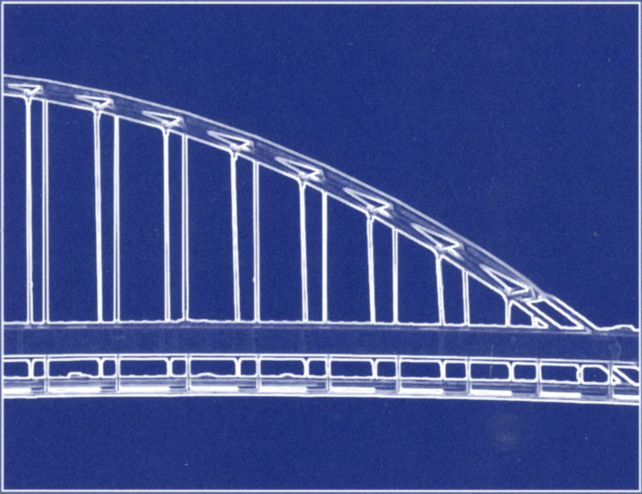

A Question and Answer Guide for Preparers and Auditors of State and Local Governmental Financial Statements

AICPA

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AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Understanding and Implementing GASB's New Financial Reporting Model

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Preface

Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, is the result of an almost decade-long effort by the GASB to reexamine the financial reporting model for state and local governments. The GASB undertook exhaustive due process during this project—an Invitation to Comment document, two Preliminary Views documents, an Exposure Draft, focus group sessions, public hearings, and task force and other meetings with constituent groups. Even before the project formally began, the GASB conducted studies on project-related issues. GASB Statement No. 34 makes significant changes in the way state and local governmental entities report their financial statements, the most notable change being the presentation of a set of highly aggregated, "full accrual" financial statements. At the same time, however, the Statement retains many familiar features of current governmental financial reporting, in particular fund-based financial statements.

State and local governmental financial statement preparers and auditors will need to comprehend and implement a vast number of changes in accounting and financial reporting. They will have to explain those changes to persons who are unfamiliar with the particulars of accounting, much less the unique area of state and local governmental accounting. Comprehension, implementation, and explanation will be ongoing processes as preparers and auditors analyze, interpret, and implement the new standards in their own environments. The GASB, the AICPA, and many other organizations will be developing and providing materials to assist in that process.

This Question and Answer (Q&A) Guide is one of the first efforts in that regard. It has been issued by the Accounting and Auditing Publications group of the AICPA to provide nonauthoritative practical guidance. It is designed to help preparers and auditors begin the process of understanding, and it identifies issues that they should consider early in the implementation process. The AICPA plans to develop additional materials to assist in analyzing, interpreting, and implementing GASB Statement No. 34 and in auditing the resulting financial statements. Among those materials are a revision of the Audit and Accounting Guide *Audits of State and Local Governmental Units*, a Practice Aid on preparing and auditing governmental financial statements, and continuing professional education courses.

I wish to acknowledge those who reviewed drafts of this Q&A Guide and gave many helpful suggestions for improving it: David Bean, Karen Coutinho, Frank Crawford, Mary Foelster, Susan Frohlich, D. Scot Loyd, and Ken Schermann.

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Understanding and Implementing GASB's New Financial Reporting Model

A Question and Answer Guide for Preparers and Auditors of State and Local Governmental Financial Statements

Introduction

The following questions and answers (Q&As) digest the contents of Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments.*[1] The answers have parenthetical references to the relevant paragraphs in the standards section of the Statement. Commentary that analyzes the standards and presents planning and implementation issues follow the digests and are labeled "Observation." This Q&A Guide includes four appendixes. Appendix A shows a few of the numerous illustrative financial statements included in appendix C of Statement No. 34. Appendix B presents the basic features of Statement No. 34's government-wide financial statements, and appendix C presents the basic features of the Statement's fund financial statements. The appendixes are cross-referenced to the Q&As for additional detail. Appendix D presents brief definitions of selected terms used in the new financial reporting model. This Q&A Guide is a nonauthoritative practice aid; users should refer to Statement No. 34 for authoritative guidance and for additional details.

Overview

1. What is the purpose of the GASB's new financial reporting model?

The purpose of the new financial reporting model is to provide more understandable and useful financial reports to a wider range of users than did the previous model. This purpose is achieved by providing information that will meet or partially meet the accountability and other objectives in GASB Concepts Statement No. 1, *Objectives of*

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[1] Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments,* is copyrighted by the Governmental Accounting Standards Board, 401 Merritt 7, P.O. Box 5116, Norwalk, CT 06856-5116, USA. Portions are reprinted with permission. Complete copies of this document are available from GASB. (Request product code GC34 from the GASB's Order Department at 800-748-0659).

Financial Reporting. Part I of GASB Statement No. 34's appendix B, *Basis for Conclusions*, provides an extensive discussion of the concepts underlying the new financial reporting model. (¶1–2)

2. *To what entities does GASB Statement No. 34 apply?*

The Statement applies to the general-purpose external financial reports of all state and local governmental entities (hereafter governments or governmental entities) except public colleges and universities. The GASB is considering the applicability of GASB Statement No. 34 to those institutions and issued an Exposure Draft (ED) of a proposed Statement, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities*, on June 30, 1999. If finalized, that Statement would require those institutions to prepare their financial statements using the provisions of Statement No. 34. (¶3)

OBSERVATION

Governmental entities are defined in a few AICPA Audit and Accounting Guides, including *Audits of State and Local Governmental Units* with Conforming Changes as of May 1, 1999, paragraph 1.12. Governmental entities include public corporations and bodies corporate and politic. They also include other organizations with one or more of the following characteristics: (1) popular election of officers or appointment (or approval) of a controlling majority of the members of the organization's governing body by officials of one or more state or local governments, (2) the potential for unilateral dissolution by a government with the net assets reverting to a government, or (3) the power to enact and enforce a tax levy.

GASB Statement No. 34 does not currently apply to public colleges and universities, even if those institutions are included in another government's financial statements, for example, as part of a primary government's legal entity or as a component unit. Therefore, there could be significant uncertainties about how to incorporate an institution's financial information into another government's financial report. However, if the GASB issues a final Statement on the basic financial statements of public colleges and universities substantially as proposed, provisions already existing in Statement No. 34 adequately address how to incorporate that financial information.

3. *What are the basic requirements of the new financial reporting model?*

The new financial reporting model requires governments to present certain basic financial statements as well as a management's discussion and analysis (MD&A) and certain other required supplementary information (RSI).

The basic financial statements include (1) government-wide financial statements, (2) fund financial statements, and (3) notes to the financial statements.

- The government-wide financial statements report information for the reporting government as a whole, except for its fiduciary activities. These financial statements use the economic resources/accrual measurement focus and basis of accounting (MFBA) and include transactions and balances relating to all assets, including infrastructure capital assets.
- Following the government-wide financial statements are fund financial statements for the primary government's governmental, proprietary, and fiduciary funds (including fiduciary component units).[2] These financial statements use different MFBAs depending on the fund category: Governmental funds use the current financial resources/modified accrual MFBA; proprietary funds use the economic resources/accrual MFBA; and fiduciary funds generally use the economic resources/accrual MFBA.
- The notes to the financial statements disclose information essential for the fair presentation of the basic financial statements that is not displayed in the financial statements. The notes are an integral part of the basic financial statements.

See the further discussion of the basic financial statements and the notes in Q&As 8–56.

MD&A is RSI that precedes and introduces the basic financial statements. Other RSI required by the new financial reporting model, which are budgetary comparison schedules for certain governmental funds and information about infrastructure assets using the modified approach, is presented immediately following the notes to the financial statements and is introduced in Q&A 57. (¶4, 6, 8, 12, 79, 92, 107, and 113)

OBSERVATION

GASB Statement No. 34's basic financial statements replace the general-purpose financial statements (GPFS) previously required for governments. Previously, governmental financial statements only presented a government's funds by fund type and its account groups, for example, the general fund, the special revenue fund type, the enterprise fund type, and the general fixed assets account group. The new

[2] The primary government includes blended component units as defined in GASB Statement No. 14, *The Financial Reporting Entity*.

financial reporting model continues to include fund-based financial statements, but with significant changes, as discussed later in this Q&A Guide. The new financial reporting model also adds a highly aggregated set of government-wide financial statements. The government-wide financial statements are designed to provide information about cost of services, operating results, and financial position of the government as an economic entity. Because the focus is on the government as an economic entity, the government-wide financial statements do not include activities accounted for in the fiduciary funds or fiduciary component units. The resources of fiduciary activities, which are not available to support the government's programs and other services, are reported only in the fund financial statements.

The government-wide financial statements are presented using a "full accrual" MFBA because these financial statements focus on economic activity and the effects on operations of consuming or using goods or services, rather than the effects of acquiring them. The MFBAs for fund financial statements do not fundamentally change because of the new financial reporting model.

The new financial reporting model requires MD&A and other RSI to ensure that (1) the information is presented and (2) the auditor is associated with it. However, RSI has a lower level of auditor involvement than do the basic financial statements. See the discussion of auditor involvement with RSI at Q&A 59. Statement No. 34 is silent about where MD&A is located in relation to the auditor's report on the basic financial statements. MD&A can precede the auditor's report if there is concern that placing it after that report will imply that it is covered by the opinion on the financial statements.

4. *What is the effect of GASB Statement No. 34 on the presentation of the comprehensive annual financial report?*

OBSERVATION

GASB Statement No. 34 does not alter the requirement[3] that governments prepare and publish a comprehensive annual financial report (CAFR). Statement No. 34 changes governmental financial reporting standards only as needed to implement the basic financial statements. Its scope does not include the CAFR as a whole, or even the full financial section of a CAFR. The GASB will consider the remaining components of the CAFR (for example, how to format the combining and individual fund financial statements and what to present in the statistical section) in a later phase of its financial reporting project. For the time being, previous standards[4] continue to apply to the remaining components of the CAFR, except

3 National Council on Governmental Accounting (NCGA) Statement No. 1, *Governmental Accounting and Financial Reporting Principles,* paragraphs 128 and 138.

4 GASB *Codification of Governmental Accounting and Financial Reporting Standards* (as of June 30, 1998), section 2200, *Comprehensive Annual Financial Report.*

that Statement No. 34's requirement to report major governmental and enterprise funds in the basic financial statements leaves only nonmajor governmental and enterprise funds to present in the CAFR's combining financial statements. See the discussion on exhibit H-1 in appendix C of Statement No. 34.

5. *When are governments required to implement GASB Statement No. 34?*

GASB Statement No. 34 is effective in three phases for the following dates based on the total annual revenues of the primary government's governmental and proprietary funds, although earlier application is encouraged.

Phase	*Total Annual Revenues in the First Fiscal Year Ending After June 15, 1999*	*Implementation Required for Periods Beginning After June 15*
1	\$100 million	2001
2	\$10 million < \$100 million	2002
3	\$10 million	2003

For this purpose, *revenues* include all revenues except for extraordinary items as defined in Q&A 25. *Revenues* also do not include other financing sources.

A component unit is required to implement Statement No. 34 no later than the same year as its primary government, regardless of the amount of its total revenues and even if its primary government implements the Statement early. (¶142–143)

Statement No. 34's transition requirements are discussed in Q&A 64. Special effective date and transition rules apply for reporting general infrastructure assets. See Q&A 15. Effective date requirements coordinating the implementation of GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, and Statement No. 34 are discussed in Q&A 49.

OBSERVATION

Although the implementation of GASB Statement No. 34 is not required until financial statements for fiscal years 2002 or later, preparers and auditors need to keep in mind that implementation affects the first date of that fiscal year. For example, as of July 1, 2001, preparers of phase 1 governments with June 30 fiscal year ends have to capture beginning balances using the new standards; their auditors have to audit those beginning balances. Preparers could calculate beginning balances by adjusting ending balances by the activity reported for the year of implementation. Preparers also need to decide whether to implement early.

Primary governments and component units need to coordinate the implementation of Statement No. 34. This is especially important if the preparer of a primary government's financial statements is considering early implementation.

The three implementation phases apply separately to component units by reference to the annual revenues of the units' own governmental and proprietary funds. Component units also are encouraged to implement Statement No. 34 earlier than their required phase. Therefore, some component units may implement the Statement before their primary governments do. However, this should not cause significant problems with incorporating a component unit's financial information into the reporting entity's financial report as provided for in GASB Statement No. 14, *The Financial Reporting Entity*.

There are several "big picture" implementation issues that preparers and auditors should consider immediately, even though implementation for individual governments may be a few years off. Preparers and auditors could obtain training on the Statement's requirements; the AICPA, state CPA societies, the GASB, and other organizations are planning training efforts. Preparers and auditors also could discuss the Statement's requirements and implications with the government's administration and legislative body. Part of that discussion could involve the funding needs for implementation. Depending on its size and complexity, a government may need to obtain additional personnel, consulting services, or new computer software programs to implement the Statement.

The financial statement preparer should consider developing an implementation plan that includes input from and consultation with the auditor, individual agencies and departments, and component units and their auditors as well as a detailed timetable for implementation. (Various issues on which preparers may need to consult with others are discussed throughout this Q&A Guide.) Auditors should consider the need to make changes to their audit contracts to cover the effects of the implementation, including the potential need to adjust the compensation level for the additional effort that may be required. Finally, preparers and auditors should consider monitoring the GASB's issuance of implementation guidance and "companion" standards. The GASB staff is planning to issue one or more Implementation Guides relating to Statement No. 34 in 2000. The GASB also has two "companion" standards in Exposure Draft as of June 30, 1999: one on the applicability of Statement No. 34 to public colleges and universities (see Q&A 2) and the other on the modified accrual recognition of expenditures for certain liabilities (see Q&A 36).

Some have questioned how Statement No. 34's changes to the basic financial statements might change the manner in which auditors approach the audits of governmental financial statements, including whether audit planning and reporting materiality will be raised to a government-wide level. The AICPA is considering those issues and plans to address them before the first required implementation date of Statement No. 34.

DETAILED DISCUSSION

Management's Discussion and Analysis

6. What information is presented in MD&A?

MD&A gives an objective and easily readable analysis of a government's financial activities based on currently known facts, decisions, or conditions. It presents short- and long-term analyses of the government's activities, compares current-year results with those of the prior year, and discusses the positive and negative aspects of that comparison. Some of the minimum requirements for MD&A are—

- A brief discussion of the basic financial statements, including how they relate to each other and the significant differences in the information they provide.
- Condensed current- and prior-year financial information from the government-wide financial statements with a comparative analysis that discusses reasons for significant interperiod changes and economic factors that significantly affected current-year operations.
- An analysis of individual fund financial information, including the reasons for significant changes in fund balances (or net assets) and whether limitations significantly affect the future use of fund resources.
- An analysis of significant variations between original and final budget amounts and between final budget amounts and actual budget results for the general fund. (¶8–11)

OBSERVATION

The previous listing highlights only some of GASB Statement No. 34's MD&A requirements. Preparers and auditors should consult the Statement for additional minimum requirements and details.

MD&A does not require the government's management to predict the future. It is based on information that management is aware of as of the date of the auditor's report. Any discussion of future effects is limited to events that already have happened (for example, enacted—not anticipated—budget or tax rate changes).

MD&A will require significant new information as well as a new presentation format for existing information. Preparers could develop in advance the necessary reporting "templates" for MD&A, including templates for the charts, graphs, and tables that Statement No. 34 encourages preparers to use. Preparers also could plan to develop MD&A information as they develop the basic financial statements.

The potential for duplication between a letter of transmittal and MD&A exists. If a letter of transmittal is presented, Statement No. 34 encourages governments not to duplicate in it information contained in MD&A. To help prevent redundancy, the GASB intends to work with organizations that administer certification programs and to develop implementation guidance that highlights areas of potential duplication. Preparers could plan to compare their MD&A with their transmittal letter to eliminate redundancy.

7. *What are the transition provisions for MD&A?*

Governments need not restate prior periods to provide the required comparative data for MD&A in the year of implementation. If they do not restate, however, they include a comment in MD&A that they will present a comparative analysis of government-wide data when prior-year information is available. Further, they are encouraged to provide comparative analyses of key elements of total governmental funds and total enterprise funds in MD&A for that period. (¶145)

Government-wide Financial Statements

Overview

8. *What are the required government-wide financial statements and what are the basic features of those statements?*

The government-wide financial statements are (1) a statement of net assets and (2) a statement of activities. The statement of net assets presents the government's financial position at a point in time (like a balance sheet does); the statement of activities presents its activities during a period (like an operating statement does). The government-wide financial statements—

- Present highly aggregated information for the overall government; they do not display individual funds or fund types.
- Do not include the activities reported in fiduciary funds or fiduciary component units (such as certain public employee retirement systems). Those activities are reported only in the fund financial statements.

- Present financial information in separate rows and columns for the (1) primary government's aggregate governmental activities, (2) primary government's aggregate business-type activities, (3) total primary government, and (4) discreetly presented component units.

Governmental activities generally are financed through taxes, intergovernmental revenues, and other nonexchange revenues and usually are reported in governmental and internal service funds. Business-type activities are financed wholly or partially by fees charged to external parties for goods or services and usually are reported in enterprise funds. Governments need not segregate activities in the government-wide financial statements as between governmental and business-type beyond what is already done by their segregation into governmental and proprietary funds.

Component unit data generally is aggregated into a single column, although certain component units may be presented in separate columns. See the further discussion of component unit reporting at Q&A 56. The component unit column(s) is placed to the right of the total primary government column, which totals the financial information for the governmental and business-type activities. The government-wide financial statements may present either a total column for the entity as a whole or prior-year data, or both, but they are not required. (¶12–15)

See Q&As 18 and 20 for a detailed discussion of the formatting of the government-wide financial statements. See the illustrative government-wide financial statements in exhibits A-1 and A-2 in appendix A of this Q&A Guide.

OBSERVATION

Unlike a business's financial statements, the government-wide financial statements do not present all of a government's activities and balances as a single entity. However, financial information as it relates to separate funds is not presented in those financial statements.

GASB Statement No. 34 describes governmental and business-type activities in terms of their sources of financing. However, it also indicates that fund classification is used to classify activities in the government-wide financial statements. Governments need not analyze the activities reported in each fund by source of financing to classify activities as governmental or business-type, although they are permitted to.

Although Statement No. 34 does not change the organizations that are component units, it does change the manner in which component units are presented by treating fiduciary component units differently than nonfiduciary component units. See Q&A 46 for a discussion of the presentation of fiduciary component units in the fiduciary fund financial statements.

Statement No. 34 requires a total column for the primary government but not for the reporting entity. This is consistent with the notion in GASB Statement No. 14 that the primary government is the focal point of financial reporting. Also, the total columns are not marked "memorandum only" as was done in the previous financial reporting model. The total columns in the previous model combined financial statements with different measurement focuses and bases of accounting. That differential does not now exist in governmental financial statements.

9. What is the MFBA of the government-wide financial statements?

The government-wide financial statements report all financial and capital assets (including infrastructure assets), short- and long-term liabilities, revenues, expenses, gains, and losses using the economic resources/accrual MFBA. Activity and balances resulting from exchange and exchange-like transactions are recognized when the exchange takes place; those resulting from nonexchange transactions are recognized based on the provisions of GASB Statement No. 33. See the further discussions of the accounting for capital assets in Q&As 11 though 17 and accounting for nonexchange transactions in Q&A 49. (¶12e and 16)

10. What is the applicability in the government-wide financial statements of previous GASB pronouncements and previous and future private-sector pronouncements?

Governmental and business-type activities use all applicable GASB pronouncements. Both also use all Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins (ARBs) of the Committee on Accounting Procedure (private-sector pronouncements) issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. Business-type activities also may apply all post-November 30, 1989, FASB pronouncements unless they conflict with or contradict GASB pronouncements. (¶17)

Not all previous GASB and private-sector pronouncements have to be applied retroactively to governmental activities. See the discussion at Q&A 64.

OBSERVATION

GASB Statement No. 34's requirements for applying previous GASB pronouncements and previous and future private-sector pronouncements to business-type activities is the same as previously required for proprietary funds and entities by GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*. Therefore, governments already have policies in place and experience in applying those pronouncements to transactions that are reported as business-type activities in the government-wide financial statements.

There will, however, be implementation issues relating to applying previous GASB and private-sector pronouncements to transactions that are reported as governmental activities. Although some governmental funds previously may have applied certain private-sector pronouncements, doing so was not required in many cases. Also, certain GASB and private-sector pronouncements that are not and have not been applicable to transactions reported in the governmental funds apply to those transactions when they are reported as governmental activities in the government-wide financial statements. This is because of the different MFBAs used in the different financial statements. Statement No. 34 does not specifically require previous private-sector pronouncements to be applied in governmental funds. However, when those pronouncements are applied to governmental activities, preparers may find it efficient also to apply them to those activities when they are reported in governmental funds, if appropriate.

Statement No. 34 does not extend the option to apply post-November 30, 1989, FASB pronouncements to governmental activities, even though they will be reported in the government-wide financial statements using the same MFBA as business-type activities. The option permits the financial reporting of business-type activities to be similar to that of similar private-sector activities. Governmental activities do not have that need.

The Statement No. 34 requirements for applying GASB and private-sector pronouncements to governmental and business-type activities also apply to component units reported in the government-wide financial statements through application to those units' separate government-wide financial statements.

The GASB staff currently plans to include in an Implementation Guide guidance on applying these provisions of the Statement. For example, the Implementation Guide will consider when GASB pronouncements issued before Statement No. 34 provide guidance on the use of accrual accounting and therefore should be applied to governmental activities. Further, footnotes 12 and 13 of the Statement discuss when to apply FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation*, and how to apply APB Opinion 20, *Accounting Changes*, respectively.

On its Web page at http://www.gasb.org, under the heading "Technical Projects," the GASB maintains a nonauthoritative list that discusses the applicability of post-November 30, 1989, FASB pronouncements and whether they conflict with or contradict GASB pronouncements. That list, which also is periodically published in the GASB's monthly newsletter, *Action Report*, can be a useful resource for preparers and auditors as new FASB pronouncements are issued.

Capital Assets

11. What are capital assets and how are they reported in the government-wide financial statements?

Capital assets are tangible and intangible assets that are used in operations and that have initial useful lives that extend beyond a single reporting period. They include land and improvements, easements, buildings and improvements, equipment, and works of art and historical treasures. Capital assets also include infrastructure assets—normally stationary capital assets that can be preserved for a significantly greater number of years than most capital assets. Infrastructure assets include roads, bridges, and tunnels; water, sewer, and drainage systems; dams; lighting systems; and buildings that are an ancillary part of a network of infrastructure assets. A government with the primary responsibility for managing an infrastructure asset reports that asset, even if a third party maintains it under contract.

Capital assets are reported in the statement of net assets at historical cost (or estimated fair value, if donated). The amount capitalized includes capitalized interest and ancillary charges to place the assets into service. A detailed discussion about estimating the historical costs of general infrastructure assets is in Q&A 16.

Capital assets are depreciated in the statement of activities over their estimated useful lives unless they are (1) infrastructure assets accounted for using the modified approach as discussed in Q&A 13; (2) noncapitalized collections of works of art, historical treasures, and similar assets as discussed in Q&A 17; or (3) inexhaustible (such as land and land improvements). Depreciation expense is reported in the statement of activities as discussed in Q&A 22. See the discussion of the calculation of depreciation at Q&A 12.

Depreciable capital assets are reported net of accumulated depreciation in the statement of net assets. Accumulated depreciation is reported in the statement (for example, parenthetically or as a separate line item that reduces the capital assets line item) or disclosed in the notes. Significant amounts of nondepreciable capital assets are reported as separate line items. Major classes of capital assets (infrastructure, land and improvements, buildings and improvements, and equipment) may be reported in the statement. Capital asset disclosures are discussed in Q&A 53. (¶18–22 and 154)

OBSERVATION

Although capital assets are assets with useful lives that extend beyond a single reporting period, in practice they usually are only those with useful lives of more than one year. For example, although an asset that has a useful life of six months and that is acquired in the final month of a fiscal year meets the definition of a capital asset if it is used in operations, preparers generally do not report it as a capital asset because of materiality considerations.

In considering the requirements of GASB Statement No. 34, preparers and auditors need to remain alert to certain terminology. When the Statement explains provisions using the terms *capital assets* and *infrastructure assets*, those provisions relate to all such assets belonging to the government, regardless of the fund or activity with which the assets are associated. However, when the Statement explains provisions using the terms *general capital assets* and *general infrastructure assets*, those provisions relate only to the assets associated with governmental activities.

Statement No. 34's requirements relating to the reporting of general capital assets, especially those relating to depreciation (including accumulated depreciation) and general infrastructure assets, will likely involve significant implementation efforts by preparers and auditors. Preparers should consider consulting with the government's departments and agencies, component units, auditors, and others involved with the financial reporting process as they plan the policies and procedures needed to implement those requirements. Also, preparers should consider the extent to which they need consultants and new accounting systems to implement those requirements.

Even though the GASB recognizes that substantial implementation efforts will be required, it believes that capitalizing and depreciating general capital assets is essential to accomplish the long-term, economic focus of the government-wide financial statements. Statement No. 34 establishes various provisions, including special transition provisions, as discussed in Q&As 12 through 17 to minimize the efforts and costs of capitalizing and depreciating capital assets.

Many governments previously have reported capital assets in their financial statements, except perhaps for general infrastructure assets. However, they previously may not have included the interest and ancillary charges that Statement No. 34 requires to be capitalized. An analysis of those costs likely may show them to be immaterial for purposes of retroactive capitalization. (Also, as discussed in Q&A 64, interest capitalization may be applied prospectively for general capital assets.) The implementation of Statement No. 34 may be an appropriate time for preparers to review their policies and procedures for capitalizing capital assets. Those policies and procedures might address the capitalization level for capital assets and identify the types of costs that are capitalized as improvements and the types of costs that are expensed as maintenance.

Statement No. 34 does not define intangible capital assets, and the GASB staff may provide additional guidance in an Implementation Guide. Intangible capital assets include capital leases and may include natural resource (water, oil, natural gas, and lumber) rights. Preparers need to consider intangible capital assets during the implementation process.

12. How are depreciation expense and accumulated depreciation calculated?

To measure depreciation expense, the historical cost (or other capitalized amount) of depreciable assets, less their estimated salvage values, is allocated over the estimated useful lives of the assets using a systematic and rational method. Governments may use any established depreciation method.

Depreciation need not be calculated for individual assets. It could be calculated for (1) classes of assets, (2) networks of assets, and (3) subsystems of networks. Footnote 14 of GASB Statement No. 34 defines a network of assets as "all assets that provide a particular type of service," stating that "a network of infrastructure assets may be only one infrastructure *asset* that is composed of many *components*. For example, a network of infrastructure assets may be a dam composed of a concrete dam, a concrete spillway, and a series of locks." Footnote 15 of the Statement defines a subsystem of a network of assets as "all assets that make up a similar portion or segment of a network of assets." It gives the example that "all the roads of a government could be considered a network of infrastructure assets. Interstate highways, state highways, and rural roads could each be considered a subsystem of that network."

To estimate the useful lives of its capital assets, a government could use internal information (such as historical records and replacement schedules) or general guidelines obtained from professional or industry organizations. Another alternative could be information for comparable assets of other governments. In estimating useful life, a government considers an asset's present condition and how long it can meet service demands (for example, because of anticipated capacity or technology issues).

Governments may use composite methods to calculate depreciation expense. These are methods of depreciating a group of similar assets or dissimilar assets of the same class using the same depreciation rate.

Methods of calculating a composite depreciation rate are discussed in Statement No. 34. Composite depreciation rates need to be adjusted if the assets in the composite or their estimated useful lives change significantly, which may happen as assets are capitalized or taken out of service. (¶22, 161, and 163–166)

OBSERVATION

GASB Statement No. 34 does not include specific standards for calculating accumulated depreciation at implementation, but it provides an example for general infrastructure assets in paragraphs 159 and 162. Accumulated depreciation at implementation is based on the retroactive application of the Statement's depreciation standards. That is, accumulated depreciation is based on the amount of depreciation that would have been charged through that date using the depreciation methods and useful life and salvage value estimates adopted at implementation. In subsequent periods, accumulated depreciation is increased for depreciation expense and reduced for the accumulated depreciation on capital asset disposals.

Governmental accounting systems may need to be adjusted to record the information needed to depreciate general capital assets, in particular, estimated salvage value and useful lives.

Statement No. 34 permits governments to use any established depreciation method. Such methods are discussed in various accounting textbooks.

13. Are there circumstances in which infrastructure assets need not be depreciated?

GASB Statement No. 34 includes a "modified approach" under which infrastructure assets that are part of a network or subsystem of a network need not be depreciated if two requirements are met.

The first requirement is for the government to have an asset-management system with certain features. The system has to have an up-to-date inventory of the infrastructure assets, and it has to estimate the annual costs to maintain and preserve those assets at the condition level the government has established and disclosed through administrative or executive policy or legislative action. The system also has to assess the condition of the assets periodically, summarizing the results using a measurement scale (for example, by using a condition index or by stating the percentage of the assets that are in good or poor condition). Condition assessments may be performed based on statistical samples of the assets or on a cyclical basis (for example, one-third of all the assets in the network or subsystem every three years.) The condition assessments also have to be documented in such a manner that they can be replicated. Footnote 18 of Statement No. 34 defines *replicable condition assessments* as "those that are based on sufficiently understandable and complete measurement methods such that different measurers using the same methods would reach substantially similar results."

The second requirement is that the government document that the assets are being preserved approximately at or above the condition level the government has established and disclosed. Adequate documentary evidence is a matter of professional judgment because governments' asset-management systems and condition assessment methods vary (both among governments and within governments for different assets). However, a government that uses the modified approach has to document that it has performed a complete condition assessment of the assets at least every three years. If the government uses a cyclical basis to perform condition assessments, a complete condition assessment is one that, over no more than three years, evaluates all the assets in the network or subsystem in a consistent manner. The government also has to document that the results of the three most recent complete condition assessments provide reasonable assurance that the assets are being preserved approximately at or above the intended condition level.

Under the modified approach, expenditures for additions and improvements to the infrastructure assets (which increase the original capacity or efficiency of assets rather than preserve their useful lives) are capitalized. All other expenditures are expensed in the period incurred.

If a government that has been using the modified approach no longer meets the two requirements discussed above, it must begin to depreciate the assets. That change is reported as a change in accounting estimate, meaning that depreciation is applied only prospectively, not retroactively.

For transition to the requirements of Statement No. 34, a government may begin to use the modified approach as long as at least one complete condition assessment is available and it documents that the assets are being preserved approximately at or above the intended condition level. (¶23–26 and 152)

RSI requirements when using the modified approach are discussed in Q&A 14. Disclosures for governments that use or will use the modified approach are discussed in Q&As 15, 52, and 53.

OBSERVATION

During due process on GASB Statement No. 34, some suggested that the GASB develop a "preservation method" (based on the fact that governments generally maintain their infrastructure) and require a "usage" charge for infrastructure only if the condition of those assets were to fall below an "acceptable" level. The GASB reviewed possible approaches for that concept but found that systems for managing infrastructure assets are not sufficiently consistent to use for financial statement recognition. The GASB intends to continue to research the possibility of an acceptable "preservation method" for financial statement recognition. In the meantime, it has adopted the modified approach to allow governments to begin to report infrastructure assets using a method other than historical-cost depreciation. The modified approach is based in part on the notion that inexhaustible assets need not be depreciated. However, because Statement No. 34 does not require particular condition assessment methods or a particular or consistent condition level, those assets may experience some measure of "using up." However, the RSI information for those assets will provide certain information in that regard.

Using the modified approach is an option to depreciating infrastructure assets; preparers need not use it if they do not wish to. The modified approach is not only for general infrastructure assets; it also may be applied to infrastructure assets reported in enterprise funds. If a government chooses to use the modified approach for infrastructure assets reported in enterprise funds, that approach is applied retroactively. That is, the government removes from accumulated depreciation and net assets the past effects of depreciating the assets.

The modified approach is not available only when Statement No. 34 is implemented; it also can be adopted later. However, Statement No. 34 does not specifically address whether that later adoption would be accounted for as a change in accounting principle (and thus applied retroactively) or a change in accounting estimate (and thus applied prospectively). However, under the provisions of APB Opinion 20 (which GASB Statement No. 34 applies to government-wide and proprietary fund financial statements), a later change to the modified approach would be accounted for as a change in accounting principle.

Governments may use various methods to measure the condition of their infrastructure assets. To use the modified approach, any method is acceptable if it is documented so it can be replicated.

In considering whether to use the modified approach, preparers should consider consulting with those responsible for managing infrastructure assets about the feasibility of doing so. Those managers need to understand the management and documentation requirements of the standard. Preparers also should consider consulting with their auditors about using the modified approach. Auditors can expect an extensive discussion of the auditing issues relating to the modified approach in a future revision of the Audit and Accounting Guide *Audits of State and Local Governmental Units*.

14. What RSI is required for infrastructure assets reported using the modified approach?

A government presents two RSI schedules:

1. For at least the three most recent complete condition assessments, the assessed condition of the assets, showing the dates of the assessments (As discussed in Q&A 13, these assessments have to be performed at least every three years.)
2. For the past five fiscal years, the annual estimate at the beginning of each year of maintenance and preservation costs for the assets, compared with the amounts actually expensed

If the government does not have this multiperiod information available when it implements GASB Statement No. 34, it presents the information for as many periods as it is available.

The government discloses in notes to the RSI the basis for the condition measurement, the measurement scale used to assess and report the condition,[5] and the intended condition level for preserving the assets. It also discloses factors that significantly affect trends in the reported information, such as changes in the measurement basis and scale and the intended condition level. If there is a change in intended condition level, the government also discloses an estimate of the effect of that change on the current-year estimate of maintenance and preservation costs.

Statement No. 34 encourages governments that do not use the modified approach but that have the above information to provide it as supplementary information. (¶132—133 and 153)

OBSERVATION

The RSI relating to the modified approach will help users assess the degree to which infrastructure assets are being maintained and preserved. Preparers that use the modified approach will have to obtain multiple years of information for RSI. However, if retroactive information is not available, GASB Statement No. 34 permits that information to be presented prospectively. An illustration of this RSI and the note disclosures is in Statement No. 34.

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[5] GASB Statement No. 34, paragraph 133, states, "For example, a basis for *condition measurement* could be distresses found in pavement surfaces. A *scale* used to assess and report condition could range from zero for a failed pavement to 100 for a pavement in perfect condition."

15. What are the effective date and transition provisions for applying GASB Statement No. 34's requirements to general infrastructure assets?

GASB Statement No. 34 applies prospectively to all general infrastructure assets beginning at the effective dates of the Statement (or earlier, if the Statement is implemented earlier). Governments also are encouraged to apply the Statement retroactively to all existing *major general infrastructure assets* (defined in the following paragraph) at that time. However, phase 1 governments need not retroactively report those assets until for fiscal years beginning after June 15, 2005—four years after their required implementation of Statement No. 34. Phase 2 governments have until fiscal years beginning after June 15, 2006. Phase 3 governments are encouraged but not required to report major general infrastructure assets retroactively. Reporting networks of nonmajor general infrastructure assets is encouraged, but not required.

Major general infrastructure assets are networks or subsystems of infrastructure assets (as defined in Q&As 11 and 12) associated with and generally arising from governmental activities and that are "major," as follows:

1. *A 10 percent rule for networks of assets.* The actual or estimated cost of the network is expected to be at least 10 percent of the total cost of all general capital assets reported in the first fiscal year ending after June 15, 1999.
2. *A 5 percent rule for subsystems of networks.* The actual or estimated cost of the subsystem is expected to be at least 5 percent of the total cost of all general capital assets reported in the first fiscal year ending after June 15, 1999.

If there are inadequate records of the actual historical cost of existing general infrastructure assets, governments estimate historical cost. (See Q&A 16.) They also may limit retroactive application to only those major general infrastructure assets that were acquired or significantly reconstructed, or that received significant improvements, in fiscal years ending after June 30, 1980.

During the transition, governments may partially implement retroactive reporting for general infrastructure assets. That is, they need not wait until they have actual or estimated historical cost for all the general infrastructure assets that they will capitalize. Also during transition, governments disclose descriptions of (1) the infrastructure assets being reported and those that are not and (2) any infrastructure assets that the government has decided to report using the modified approach. (¶148–151, 154, and 156)

OBSERVATION

To ease implementation efforts, GASB Statement No. 34 not only provides an extended transition period for existing general infrastructure assets, but also makes several concessions so a government need not retroactively report all those assets.

The transition provisions discussed in this Q&A do not apply to the infrastructure assets of proprietary funds and entities. Those funds and entities previously have been required to report infrastructure assets, and they apply the infrastructure provisions of Statement No. 34 when they otherwise implement the Statement.

Preparers of phase 1 and 2 governments need to determine whether they will use the additional transition time permitted for retroactively reporting major general infrastructure assets and preparers of phase 3 governments need to decide whether they will retroactively report those assets. Preparers also need to establish a policy concerning whether they will report nonmajor general infrastructure assets and whether their reporting of major general infrastructure assets will be at the network or subsystem level. Some preparers may not use these transition provisions, wanting instead to report assets to counter the effect of reporting general long-term liabilities in the government-wide financial statements.

16. How might the historical cost of general infrastructure assets at implementation be estimated?

If actual historical cost information is not available, governments may estimate the costs of existing general infrastructure assets at implementation using any approach that complies with the intent of GASB Statement No. 34.

One possible estimation approach is to calculate the current replacement cost of a similar asset and adjust that cost to the actual or estimated acquisition year by using price-level indexes. Statement No. 34 illustrates such a calculation. Alternatively, initial capitalization amounts could be estimated by using, for example, bond documents for the financing of infrastructure assets, previous capital outlay expenditures, and engineering documents. Depreciation and accumulated depreciation, if applicable, are calculated based on the estimated amount. (¶155 and 157–160)

OBSERVATION

Preparers may need to obtain the assistance of specialists to estimate the historical cost of general infrastructure assets. Guidance for auditors concerning the use of specialists is found in Statement on Auditing Standards (SAS) No. 73, *Using the Work of a Specialist* (AICPA, *Professional Standards*, vol. 1, sec. 336).

GASB Statement No. 34's provisions for estimating the historical costs of infrastructure assets apply only to general infrastructure assets—those associated with governmental activities. Infrastructure assets associated with business-type activities previously have been subject to capitalization and depreciation in enterprise funds. Those estimation provisions also apply only to general infrastructure assets acquired before Statement No. 34's effective dates. Historical cost is used for such assets acquired after the effective dates of the Statement.

17. What are the requirements for reporting works of art, historical treasures, and similar assets?

Generally, governments capitalize these assets at historical cost, or fair value when donated, whether held as individual items or in a collection.

Some collections, however, need not be capitalized. Governments are encouraged, but not required, to capitalize a purchased or donated collection (and additions to it) that meets all of three conditions. The three conditions stated in GASB Statement No. 34 are that the collection is—

1. Held for public exhibition, education, or research in furtherance of public service, rather than financial gain.
2. Protected, kept unencumbered, cared for, and preserved.
3. Subject to an organizational policy that requires the proceeds from sales of collection items to be used to acquire other items for collections.

If a collection is capitalized at June 30, 1999, that collection and any additions to it cannot use this exemption from capitalization.

Governments that receive donations of these assets recognize revenues using Statement No. 33 (see Q&A 49). If those donations are added to noncapitalized collections, an equal expense is recognized.

Some capitalized works of art, historical treasures, and similar assets are exhaustible, that is, they are "used up" as they are displayed or used for education or research. Those assets are depreciated. Works of art, historical treasures, and similar assets that are inexhaustible, including those that are not capitalized as discussed above, are not depreciated. Disclosures for collections are discussed in Q&A 53. (¶27–29)

OBSERVATION

GASB Statement No. 34 exempts certain collections from capitalization and depreciation for practical reasons: It may not be possible or cost-beneficial to establish or estimate the amount to capitalize. This exemption is similar to that established in FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made* for private-sector entities.

Statement of Net Assets

18. What are the format requirements of the government-wide statement of net assets?

Governments present this statement in either a net assets format (assets less liabilities equal net assets) or a balance-sheet format (assets equal liabilities plus net assets). GASB Statement No. 34 encourages the net asset format, which is shown in exhibit A-1 in appendix A of this Q&A Guide. Whichever format is used, the difference between assets and liabilities is labeled "net assets." Net assets are classified in three components, as discussed in Q&A 19. As discussed in Q&A 8, financial information for governmental activities, business-type activities, and component units is presented separately.

Governments either present assets and liabilities in order of their relative liquidity (which is encouraged) or classify them as between current and long-term.

- If using a liquidity presentation, governments base an asset's liquidity on its expected conversion to cash and restrictions on its use. They base a liability's liquidity on its maturity, or when it is expected to be paid in cash. Some individual items will be aggregated with others that are significantly more or less liquid; some aggregated amounts may have both current and long-term elements. However, liabilities with average maturities greater than one year are reported in two components—the amount due within one year and the amount due in more than one year. Note disclosures concerning long-term liabilities are discussed in Q&A 53.

- Q&A 42 discusses the requirements for classifying assets and liabilities as between current and long-term in proprietary funds. Those requirements also apply if the classification alternative is used in the statement of net assets. (¶30–31)

OBSERVATION

The statement of net assets reports the composition and balances of net economic resources that can be used by the government to provide future services. Even though GASB Statement No. 34 encourages the liquidity approach for presenting assets and liabilities in the government-wide statement of net assets, it requires the classification approach in the proprietary fund statement of net assets. Therefore, preparers should consider whether they wish to present different information in the proprietary funds and government-wide statements, and the effort required to change presentation methods.

19. How are net assets displayed and how are the components of net assets defined?

In the government-wide statement of net assets, net assets are displayed in three components: "invested in capital assets, net of related debt," "restricted," and "unrestricted."

- *Invested in capital assets, net of related debt.* This component consists of capital assets (as defined in Q&A 11, including capital assets that are restricted to a particular purpose), reduced by accumulated depreciation and by any outstanding debt incurred to acquire, construct, or improve those assets. This component does not include the portion of any debt with significant unspent proceeds at year end. Instead, that debt is placed in the net assets component that includes the unspent proceeds, for example, restricted for capital projects.
- *Restricted net assets.* This component is reported when limitations on the use of net assets are externally imposed, for example, by creditors, grantors, contributors, or the laws or regulations of other governments. It also is reported when limitations are imposed by the government's own constitutional provisions or enabling legislation. (For this purpose, enabling legislation is not considered an internal constraint.) Separate line items distinguish among major categories of restrictions. When permanent endowments or permanent fund principal amounts are included in this component, "restricted net assets" are displayed in two subcomponents, expendable and nonexpendable.

- *Unrestricted net assets.* This component consists of all net assets that do not meet the definition of either of the other two components.

Management designations of net assets, which are internal limitations indicating that management does not consider them to be available for general operations, are not reported in the statement of net assets. (¶32–37)

The three components of net assets also are displayed in the proprietary fund statement of net assets as discussed in Q&A 42. The governmental fund balance sheet does not display these three components of net assets; instead, governmental fund balances are segregated into reserved and unreserved amounts (see Q&A 38).

OBSERVATION

Financial statement preparers need to develop processes to classify net assets into the three components. Many may find it possible to classify net assets during their annual financial reporting process rather than by revising account codes in their accounting system, particularly for governmental activities. Preparers also need to understand that restricted net assets generally will be different from amounts that are reported as reserved fund balances in the governmental fund balance sheet. Although the terms *reserved* and *restricted* appear similar, their meanings in a governmental financial reporting context differ significantly. *Restricted* is based on external, legal constraints, whereas *reserved* is based on the amounts that a government has available for appropriation in the budgetary process and may include more than resources that are restricted. Because the net asset components are the same in the government-wide and proprietary fund statements of net assets, there is no difference in those presentations.

GASB Statement No. 34 does not provide standards for determining when a restricted resource has been spent. The GASB believes that the decision whether to first apply restricted or unrestricted resources to specific expenses is a management matter. However, disclosure of management's policy in this regard is required; see Q&A 52.

Statement of Activities

20. What are the format requirements of the government-wide statement of activities?

This statement reports the expenses, net of program revenues, of the government's individual functions. General revenues, contributions to term and permanent endowments, contributions to permanent fund principal, special and extraordinary items, and transfers are reported separately after the total net expenses of the functions, resulting in the "change in net assets" for the period. Special items are reported separately before extraordinary items, if any. (See Q&A 25 for the definitions of special and extraordinary items, Q&A 50 for a discussion of transfers, and Q&A 26 for how transfers are reported in the statement of activities) Also, as discussed in Q&A 8, financial information for governmental activities, business-type activities, and component units is presented separately. A standard format for this statement is shown in exhibit A-2 in appendix A of this Q&A Guide. Some governments may modify that standard format or use an alternative format; see the observation at the end of this Q&A.

The statement of activities presents governmental activities at least at the level of detail presented in the governmental fund statement of revenues, expenditures, and changes in fund balances. At a minimum, that level of detail is by function, which groups related activities that are aimed at accomplishing a major service or regulatory responsibility (such as general government, public safety, and public works). For business-type activities, the statement presents financial information at least by segment. Segments are discussed in Q&A 54. For simplicity, GASB Statement No. 34 and this Q&A Guide use the term *function* to refer to the minimum level of detail presented in the statement of activities for both governmental and business-type activities.

Governments are encouraged to provide data in the statement of activities at a more detailed level than function if that detail is more useful without being significantly complex. That is, additional detail could be provided by program, which is a group of activities, operations, or organizational units with common, specific purposes or objectives. For example, fire protection and police protection might be programs in the public safety function, and regular instruction, special instruction, vocational education, and adult education might be programs in the education function. There is no universally appropriate level of detail—some governments have many programs and others have only a few. Not all governments will find it practical to report in greater detail than function. (¶38–40, 53, and 56)

OBSERVATION

The net (expense) revenue for functions in the statement of activities reports the relative financial burden of each of the government's functions on its taxpayers. This format identifies the extent to which each function of the government is self-financing or instead draws from the general revenues of the government.

This format is consistent with a prime consideration of the budgetary process—how much the programs will cost and how the government will pay for them.

GASB Statement No. 34 allows governments to decide the level of detail, beyond the minimum requirements, to report in the statement of activities. The statement is presented at least at the same level of detail as in the governmental fund financial statements and the enterprise fund segment disclosures. Linking the requirement for the government-wide financial statements to the fund-based details could discourage governments from providing more detail in the governmental fund statements but will make developing the government-wide financial statements easier.

Financial statement preparers need to develop processes to format financial information as needed for the statement of activities. Generally, the net (expense) revenue format itself should not present difficulties because it is based on a functional presentation, as are the fund financial statements. However, as discussed later, classifying revenues and allocating expenses will involve new processes and thus implementation costs.

Statement No. 34 states that some governments may modify the standard format or use alternative formats for the statement of activities and refers to financial statement presentations by special-purpose governments that have a single governmental program as discussed in Q&A 62. Paragraph 347 of the Basis for Conclusions also states that "governments with only a few programs could present their functional categories in columns rather than rows to make the statements appear less complex. Also, large, complex governments that want to present more functions than would comfortably fit on a single page could use two pages—the first containing the net program cost information and the second presenting the general revenues and changes in net assets information." Illustrations of these final two presentations are shown in Statement No. 34.

21. What are the presentation requirements for expenses in the statement of activities?

All expenses—for both governmental activities and business-type activities—are reported by function except those that are special or extraordinary items, as discussed in Q&A 25. Each function, at a minimum, reports direct expenses—those specifically associated with a service, program, or department and therefore clearly identifiable to a particular function.

Any expense that is not a direct expense is an indirect expense. Many indirect expenses are reported with the direct expenses of a "general" function, such as "general government" or "administration." (Certain depreciation and interest expenses also are indirect expenses; see Q&As 22 and 23.) Indirect expenses need not be allocated among other functions; however, some or all of them may be. If indirect expenses are allocated, a column showing those allocations is presented in the statement of activities. A total column showing each function's expenses after those allocations is optional.

Some charges from the general fund or internal service funds to other funds or programs for "centralized" expenses may include an administrative overhead component. For example, the general fund may charge other funds for printing expenses, and those charges may include an increment to cover salaries and office expenses that are not directly related to the printing. Governments need not identify and eliminate those administrative overhead charges; however, if they are not eliminated, the government discloses in the summary of significant accounting policies that direct expenses include those charges. (¶41–43)

OBSERVATION

Financial statement preparers already should have policies and processes in place to classify direct expenses by function. New policies and processes will be required to classify expenses for depreciation and interest on general long-term debt, as discussed further in this Q&A Guide.

Preparers need to establish a policy for whether they will allocate indirect expenses. Some may opt not to allocate because of the additional effort required. Others will want to, believing the additional information will be useful to financial statement users. If the decision is made to allocate, preparers need to establish procedures for such allocations. GASB Statement No. 34 includes an illustrative statement of activities that reports indirect expenses allocated to functions.

22. *How is depreciation expense reported in the statement of activities?*

Depreciation expense for capital assets (except for general infrastructure assets) for both governmental activities and business-type activities is reported in a function's direct expenses if the depreciation is specifically identifiable with the function. Except as discussed in the next paragraph, if these capital assets are shared by more than one function, the depreciation expense is prorated among those functions as a direct expense.

Depreciation expense for capital assets that serve essentially all functions (such as a multipurpose building) need not be included in the direct expenses of the various functions. Instead, it may be included as a separate line item in the statement of activities or as part of a "general" function. That amount then could be allocated as an indirect expense to other functions, as discussed in Q&A 21. If this depreciation expense is reported in a separate line item and not subsequently allocated, information on the statement indicates that this line item excludes direct depreciation expenses of the various functions.

Depreciation expense for general infrastructure assets is reported as a direct expense of the function that the government normally uses to report capital outlay and maintenance for infrastructure assets (for example, public works or transportation) or as a separate line item. It is not allocated as an indirect expense to other functions. (¶44–45)

Required disclosures about depreciation expense are discussed in Q&A 53.

OBSERVATION

Preparers will have to develop policies and procedures for identifying those capital assets for which depreciation expense is reported as a direct expense and for allocating depreciation expense as an indirect expense. They also will have to establish policies for the financial statement presentation of unallocated depreciation expense, including that for general infrastructure assets.

GASB Statement No. 34's provision concerning the reporting of depreciation expense on certain multipurpose capital assets requires that essentially all government functions be served by those assets. Determining the point at which "essentially all" is met will involve the application of professional judgment. Professional judgment also is needed to develop policies for prorating depreciation expense on "shared" capital assets; relative square footage of the noncommon areas used by each function is one possibility. Preparers should consider obtaining input from their auditors when establishing policies on these issues.

23. How is interest on general long-term liabilities reported in the statement of activities?

Generally, interest on general long-term liabilities is reported as a separate line item rather than included in the direct expenses of any function. If, however, any direct interest expense is reported in other functions (see the next paragraph), the separate "interest on general long-term debt" line item is labeled to explain that situation, and the amount of direct interest expense that it excludes is disclosed in the notes to the financial statements or on the statement. The separate line item for interest on general long-term debt may be allocated as an indirect expense to other functions as discussed in Q&A 21.

There are limited instances when interest on general long-term liabilities is included in direct expenses. This involves situations when borrowing is needed to create or continue a program and it would be misleading to exclude the interest from the program's direct expenses. (¶46)

OBSERVATION

Generally, a government will not have to identify interest expense on general long-term liabilities with its functions or programs. However, because such identification occasionally has to be done, preparers should consider developing policies and procedures to do so.

GASB Statement No. 34's provisions relating to interest on general long-term liabilities relate only to governmental activities. Long-term liabilities that are expected to be repaid by enterprise funds are reported as liabilities of those funds and liabilities of the business-type activities. The interest on those liabilities are direct expenses of the functions associated with them.

24. What are the different types of revenues and how are they reported in the statement of activities?

In the statement of activities, revenues are classified as program or general. A revenue's source generally indicates how it is classified. The four basic sources of governmental revenues and whether they are considered program or general revenues are described in the following table.

Revenue Source	*Revenue Type*
Those who purchase, use, or directly benefit from the program's goods, services, or privileges, whether or not part of the government's taxpayers or citizens	Always program revenue
Parties outside the reporting government's citizens as a whole (such as other governments and nongovernmental entities or individuals)	Program revenue if restricted to a specific program; general revenue if unrestricted
All the reporting government's taxpayers, whether or not they benefit from a particular program	Always general revenue, even if restricted to a specific program
The governmental entity itself, for example, through investing	Usually general revenue

Program revenues (1) originate from the program or from parties other than the government's taxpayers or citizens as a whole and (2) reduce the expenses of the function to be financed by general revenues. Three categories of program revenues that are separately reported in the statement are (1) charges for services, (2) program-specific operating grants and contributions, and (3) program-specific capital grants and contributions. These categories are defined as follows:

- Charges for services are revenues from exchange or exchange-like transactions with external parties that purchase, use, or directly benefit from the program's goods, services, or privileges. These revenues include fees charged for specific services, licenses and permits, and operating special assessments, as well as payments from exchange transactions with other governments.

- Program-specific operating and capital grants and contributions are revenues from mandatory and voluntary nonexchange transactions[6] with external parties and that are restricted for use in a particular program. (See Q&A 19 for the definition of *restrictions*.)

  — Program-specific capital grants and contributions are capital assets and other resources that are restricted for capital purposes for a specific program.

  — Program-specific operating grants and contributions are resources that are restricted for operating purposes of a program. They also are grants and contributions with restrictions that permit the resources to be used for a program's operating or capital needs at the recipient government's discretion.

  Multipurpose contributions and grants that provide financing for more than one program are reported as program revenues if the amounts restricted to each program are specifically identified in (1) the grant award or (2) the grant application on which the award is based. If a multipurpose grant does not specifically identify the programs and amounts involved, it is not reported as program revenues but as general revenues.

Earnings on investments of endowments and permanent funds are program revenues if those earnings are restricted to a program specifically identified in the agreement or contract governing the endowment or fund. (However, if those earnings are for general purposes, they are

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6 The terms *mandatory nonexchange transaction* and *voluntary nonexchange transaction* are new terms resulting from the standards established in GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*.

general revenues.) Similarly, if the investment earnings on the accumulated resources of a program are legally restricted to be used for that same program, they are program revenues.

All other revenues are general revenues, including all taxes, even if levied for a specific purpose. Taxes are reported by type of tax. General revenues are reported at the bottom of the statement of net assets after the total net (expense) revenue of the government's functions. (¶47–52)

OBSERVATION

Classifying amounts as program and general revenues is a new concept in governmental accounting. Preparers need to develop policies and procedures for revenue classification. The task may be time-consuming but should not be overly difficult; GASB Statement No. 34 clearly defines the distinctions between the two revenue types.

The use of the term *program* in referring to revenues is intended in a generic sense to refer to revenues within a category. That is, the term is not used in the same manner that National Council on Governmental Accounting (NCGA) Statement No. 1, *Governmental Accounting and Financial Reporting Principles*, paragraph 112, uses the term to refer to expenditures—as groups of activities, operations, or organizational units that are directed to the attainment of specific purposes or objectives. Instead, for revenues, the term *program* depends on the level of detail at which an individual government presents its statement of activities. If the statement of activities is presented at a functional level, *program revenues* are revenues that originate from that function. If the statement of activities is presented at a program level, *program revenues* are revenues that originate from that program.

For example, assume a school district presents its statement of activities at a program level—presenting separate line items for regular instruction, special instruction, and vocational education. For this school district to report a grant as program revenue, the grant has to be restricted for use within an individual program. If a grant or contribution is provided for the education function in general, it is general revenue, unless it is allocable among the programs as described above for multipurpose contributions and grants.

The definition of program-specific capital grants and contributions could encompass a grant to reimburse debt service expenditures for capital facilities. The portion of such a grant that applies to interest, however, would be program revenue of the "interest on long-term debt" line item.

Because the statement of activities does not report capital outlay expenditures, program revenues for capital grants and contributions will not "match" the associated capital outlay. It is for this reason that GASB Statement No. 34 requires program revenues from capital grants to be reported separately from program revenues from operating grants.

All taxes are general revenues, even if they are levied for a specific purpose, such as a sales tax increment to finance a county convention facility or liquid fuel taxes to finance highway maintenance. Even though there is a relationship between those revenues and the costs they will cover, the amounts do not originate from the program. Instead, the government is "dedicating" part of its general revenues to a particular purpose.

25. *What are special and extraordinary items?*

Special items are significant transactions or other events within the control of management that are either (1) unusual in nature or (2) infrequent in occurrence. A transaction or event is *unusual in nature* if it is highly abnormal and is of a type unrelated to, or only incidentally related to, the entity's ordinary and typical activities, taking into account the environment in which the entity operates. A transaction or event is *infrequent in occurrence* if it is of a type that would not reasonably be expected to recur in the foreseeable future, taking into account the environment in which the entity operates. APB Opinion 30, *Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*, as amended and interpreted, provides additional guidance for these definitions. *Extraordinary items* are transactions or other events that are both (1) unusual in nature and (2) infrequent in occurrence. (¶55–56)

OBSERVATION

One of the reasons for the separate reporting of special and extraordinary items is to highlight significant "one-shot" financing measures, such as certain sales of capital assets. In applying the definition of special items, *significant* involves abnormally large amounts. However, *significant* also connotes qualitative features; the political environment and legal and contractual provisions surrounding the situation may lead a preparer to conclude that a small dollar transaction or event is significant. Preparers should consider developing policies and procedures for identifying special and extraordinary items. These items may not be easily captured by the accounting system and may require a focused "search" each year.

As discussed in Q&A 5, extraordinary items are not included in total revenues in determining the required implementation date for GASB Statement No. 34. They also are not considered in determining major funds; see Q&A 35.

Internal Activity and Balances

26. How do governments report internal activity and balances in the government-wide financial statements?

Internal activity and balances are the results of resource flows between the funds of the primary government (including its blended and fiduciary component units). In aggregating data for the government-wide financial statements, some of those internal amounts are reclassified or eliminated.

In the statement of net assets—

- Amounts that the primary government owes to fiduciary funds and fiduciary component units are reported as receivable from and payable to external parties rather than as internal balances.
- Amounts owed between the funds included in the governmental activities column are eliminated, as are amounts owed between funds included in the business-type activities column.
- The only internal balances (receivables and payables) that remain in the statement are those owed by a fund included in the governmental activities column to a fund included in the business-type activities column (and visa versa). That net residual amount is presented as an "internal balance" and eliminated in the total primary government column.

In the statement of activities—

- Eliminations remove the "doubling-up" effect of internal service fund activity. See the further discussion in Q&A 28 and in the observation at the end of this Q&A.
- The effect of similar internal events that are allocations of overhead expenses (such as administrative salaries) between or within functions are eliminated, so the allocated expenses are only reported by the function to which they were allocated. (However, see the exception in the third paragraph of Q&A 21.)
- Interfund services provided and used between functions (such as the sale of sewer services from a utility to the general government) are not eliminated. (Interfund services provided and used are defined in Q&A 50.) (¶57–60)

OBSERVATION

Internal activity and balances, for purposes of the government-wide financial statements, are those items reported as interfund activity and balances in the fund financial statements. (See Q&A 50.) Certain internal activities and balances are eliminated in the government-wide financial statements to avoid the inappropriate "doubling-up" effects those activities and balances would otherwise have on aggregated amounts.

Eliminating and reclassifying interfund activities and balances may require extensive effort when financial statements are prepared. Preparers should consider developing policies and procedures for handling these items, including revising the account structure in the accounting system as needed to identify different types of interfund activities and balances.

Elimination means that the amount is not reported in the financial statements or is adjusted out. For example, amounts owed between two funds that are both included in governmental activities are eliminated by not reporting the receivable and payable in the statement of net assets. The internal balance between governmental and business-type activities can be eliminated in the total primary government column by one of two methods. First, the internal receivables and payables can be reported on a single line item as "internal balances" (reported with either assets or liabilities) that offset each other in the process of aggregating the governmental and business-type activities columns to arrive at the total primary government column. This elimination method is presented in exhibit A-1 in appendix A of this Q&A Guide. Second, the balances could be reported separately as assets and liabilities and adjusted out of the combined total, accompanied by a notation on the statement about the elimination.

Internal service fund activity is naturally doubled in the fund financial statements—once as expenses in the internal service fund and once as expenses/expenditures in the "participating" funds (with an offsetting revenue in the internal service fund). Eliminating internal service fund activity in the statement of activities involves not reporting the internal service fund revenues and expenses as well as allocating the interfund "profit" or "loss" among the participating functions. Paragraph 314 of the Basis for Conclusions of GASB Statement No. 34 says, "In essence, eliminating the 'effect' of internal service fund activity requires preparers to 'look back' and adjust the internal service fund's internal charges to break even. Internal service fund net income would cause a pro rata *reduction* in the charges made to the participating funds/functions. Conversely, an internal service fund net loss would require a pro rata *increase* in the amounts charged to the participating funds/functions."

A similar "doubling-up" effect occurs when expenses are allocated. That is, the expense/expenditure is reported in two places and a revenue is created. Paragraph 315 of the Basis for Conclusions of Statement No. 34 gives guidance on applying this requirement when the allocation is within a single function. That paragraph notes that the result of eliminating an allocation within a single function "would be an equal reduction in both direct expenses and program revenues—with no effect on the net (expense) revenue of the function." That paragraph concludes, "as a practical matter, eliminations of this kind are not necessary unless the effect on direct expenses or program revenues is material."

Statement No. 34 does not specifically state that intra-activity transfers (for example, a transfer from the general to a special revenue fund, both of which are included as governmental activities) are eliminated in the statement of activities. However, such eliminations are consistent with the elimination concept expressed in the Statement. In addition, such eliminations are effectively shown in exhibit A-2 in appendix A of this Q&A Guide by the reporting of a single "transfers" line item (which reports "transfers in" net of "transfers out").

27. How are activity and balances between the primary government and its nonfiduciary component units reported in the government-wide financial statements?

With one exception, resource flows between a primary government and its discretely presented, nonfiduciary component units are reported as revenues and expenses. The exception is balance-sheet transactions, such as loans and repayments. Amounts payable and receivable between the primary government and those component units (or between those components) are reported as a separate line item.

Resource flows and balances between the primary government and its blended component units are reclassified as internal activity and balances and thus reported in the same manner as any transactions between the funds of the primary government. (See Q&A 26 for a discussion of the reporting of internal activity and balances. See also Q&A 50 for a discussion of the reporting of interfund activity, which affects the reporting of internal activity between the primary government and its blended component units.) (¶61)

OBSERVATION

Under previous standards, many transactions between the primary government and its discretely presented component units were reclassified as transfers. Under GASB Statement No. 34, those transactions will stand as revenues and expenses. This approach provides a more complete picture of the cost of services and net cost of services of the primary government.

Transactions between the primary government and its blended component units are reported as revenues and expenses in separately issued reports of those component units but are reclassified as internal activity when included in the reporting entity's financial statements.

28. How are internal service fund activities and balances reported in the government-wide financial statements?

As discussed in Q&A 26, internal activities and balances relating to the internal service funds are eliminated. For example, if internal service fund assets and liabilities are reported as governmental activities, any interfund balances with governmental funds are not reported in the statement of net assets and any interfund balances with enterprise funds are netted or adjusted out in aggregating the total primary government column.

Internal service fund assets and liabilities that are not eliminated normally are reported with governmental activities in the statement of net assets. Such assets and liabilities might include, for example, capital assets and accounts payable. However, if the internal service fund's predominant or only participants are enterprise funds, that internal service fund's residual assets and liabilities are reported with business-type activities. (¶58–59 and 62)

Fund Financial Statements—Fund Definitions and Overview

29. What fund types are used in the fund financial statements?

Governments report governmental, proprietary, and fiduciary funds when their activities meet the criteria for using those funds.

The governmental fund types are as follows:

- *General fund.* This fund accounts for all financial resources except those required to be reported in another fund.
- *Special revenue funds.* These funds account for the proceeds of specific revenue sources (other than trusts for individuals, private organizations, or other governments or for major capital projects) that are legally restricted to expenditure for specific purposes. Also, general funds of blended component units are special revenue funds.
- *Capital projects funds.* These funds account for financial resources, including the proceeds of general obligation bonds, to be used for the acquisition or construction of major capital facilities (other than those financed by proprietary funds or trusts for individuals, private organizations, or other governments).

- *Debt service funds.* These funds account for the accumulation of resources for, and the payment of, general long-term debt principal and interest. Debt service funds are required if financial resources are being accumulated for principal and interest payments maturing in future years. The debt service transactions of special assessment debt for which the government is not obligated in any manner are not reported in this fund type; they are reported in agency funds.

- *Permanent funds.* These funds report resources that are legally restricted in that only earnings, and not principal, may be used to support the government's programs for the benefit of the government or its citizens. An example is a trust whose earnings finance the maintenance of a public park. (See the additional discussion of these funds at Q&A 31.)

The proprietary fund types are as follow:

- *Enterprise funds.* These funds report activities for which fees are charged to external users for goods or services. (See the additional definition of these funds at Q&A 30.)

- *Internal service funds.* These funds may be used to report any activity that provides goods or services to other funds, departments, or agencies of the primary government and its component units, or to other governments, on a cost-reimbursement basis. This fund type is used only if the reporting government is the predominant participant in the activity. Otherwise, the activity is reported in an enterprise fund.

Fiduciary funds report assets that are held in a trustee or agency capacity for external parties and that cannot be used to support the government's own programs. The fiduciary fund types are as follow:

- *Pension (and other employee benefit) trust funds.* These funds report resources that are required to be held in trust for the members and beneficiaries of defined benefit pension plans, defined contribution plans, other postemployment benefit plans, and other employee benefit plans.

- *Investment trust funds.* These funds report the external portions of the investment pools a government sponsors.

- *Private-purpose trust funds.* These funds report all other trust arrangements for which principal and income benefit individuals, private organizations, or other governments. An example is a fund that reports escheat property. (See the additional discussion of these funds at Q&A 31.)

- *Agency funds.* These funds report resources held by the reporting government in a purely custodial capacity. These funds typically involve only the receipt, temporary investment, and remittance of the resources to external parties. (See the additional discussion of these funds at Q&A 32.) (¶63–73)

The three trust funds report resources held and administered by the reporting government when it acts in a fiduciary capacity. Those funds generally are distinguished from agency funds by the existence of a trust agreement, the degree of management involvement, and the length of time that the resources are held.

OBSERVATION

GASB Statement No. 34 has not changed the definitions of the general, special revenue, capital projects, debt service, pension trust, and investment trust fund types. The changes that were made in the other fund types' definitions are discussed here and in later Q&As.

Although governments will no longer present combined financial statements based on fund types, they will have to apply different recognition and reporting standards depending on fund category. Also, the proprietary and fiduciary fund financial statements distinguish between the different fund types of those categories, and the unreserved fund balances of nonmajor governmental funds are displayed by fund type on the face of the balance sheet. Further, the CAFR requirement to present individual fund and combining financial statements by fund type continues in effect. Therefore, funds still need to be classified by type.

There are changes in the fund types in which governments report some activities for financial reporting purposes. Statement No. 34 eliminated expendable and nonexpendable trust funds. (See Q&A 31.) Instead, those activities are reported in special revenue, permanent, enterprise, or private-purpose trust funds. Changes in the definitions of enterprise and internal service funds also may require some fund reclassification. For example, previous standards generally did not require the reporting government to be the predominant participant in an activity for the purpose of using an internal service fund.

It may seem inconsistent or confusing to report internal service funds as proprietary funds in the fund financial statements and generally as governmental activities in the government-wide financial statements. They are classified as proprietary funds to achieve an accrual basis of accounting; they generally are reported as governmental activities based on the nature of the activities. Statement No. 34 diffuses the potential difficulties that could have been caused by such a reclassification by the way it handles the reconciliations between the fund and government-wide financial statements. (See Q&A 51.)

The previous requirement that governments establish the minimum number of funds consistent with legal requirements, operating requirements, and the definitions of funds continues in effect. For example, unless separate debt service funds are required by legal requirements, a government could maintain control over the assets of separate debt issues by using separate accounts within a single fund instead of separate funds. Using too many funds makes financial reporting unduly complex.

30. When do governments report activities in enterprise funds?

The use of enterprise funds is permitted for some activities and required for others. Their use is permitted for any activity that charges a fee to external users for goods or services. Their use is required if any one of the following is met:

- The activity's net revenues from fees and charges is the sole security for the activity's debt, even though the debt may be secured in part by a portion of the debt's proceeds. If the debt also is secured by the full faith and credit of a related primary government or component unit, however, the use of an enterprise fund is not required.
- Laws or regulations require the activity's costs of services to be recovered through fees and charges. For this purpose, *costs* includes capital costs such as depreciation or debt service.
- The activity's pricing policies (not just management intent) establish fees and charges intended to recover its costs, including capital costs.

These criteria are applied in the context of an activity's principal revenue sources, and governments need not report insignificant activity as enterprise funds. For example, a city's police department may charge a fee for copies of accident reports. However, taxes, not fees, provide the principal financing for that department. The city need not remove its police department or the copying activity from its general fund and report it in an enterprise fund.

Further, governments that report as of June 30, 1999, using the AICPA not-for-profit (NFP) model, as defined in GASB Statement No. 29, *The Use of Not-for-Profit Accounting and Financial Reporting Principles by Governmental Entities,* may use enterprise fund accounting and financial reporting—even if they do not meet the criteria for reporting as an enterprise fund. (¶67 and 147)

OBSERVATION

The revised criteria for using enterprise funds are intended to provide more interperiod consistency and greater inter-entity comparability in the use of those funds.

GASB Statement No. 34 supersedes the AICPA's Statement of Position (SOP) 78-7, *Financial Accounting and Reporting by Hospitals Operated by a Governmental Unit,* which was incorporated by reference into NCGA Statement No. 1 and required governmental hospitals to use enterprise fund accounting and reporting. Under Statement No. 34, governmental health care organizations may use governmental funds unless they meet one of the three criteria established by the new definition of enterprise funds.

GASB Statement No. 34 requires that state unemployment compensation funds always be reported as enterprise funds because laws or regulations require the activity's costs be recovered through fees and charges (even though those charges are referred to as unemployment compensation taxes.) Previous standards required those funds to be reported as expendable trust funds.

Some governmental entities have applied NFP accounting and financial reporting principles by following SOP 78-10, *Accounting Principles and Reporting Practices for Certain Nonprofit Organizations,* or the AICPA Industry Audit Guide *Audits of Voluntary Health and Welfare Organizations,* as permitted by the now-superceded GASB Statement No. 29. Those NFP principles used (1) a fund-based structure that differed from the governmental fund accounting structure and (2) the accrual basis of accounting. Without the provision in Statement No. 34 permitting entities that used those NFP principles to use enterprise funds, many might have had to create governmental fund and modified accrual information to provide the required fund-based statements. Governmental entities that previously used the governmental model or that are created after June 30, 1999, are not permitted this option.

31. What are the two new fund types—permanent funds and private-purpose trust funds—and why were they created? What happened to the expendable and nonexpendable trust funds?

Permanent funds report resources that are legally restricted in that only earnings, and not principal, may be used to support the government's programs for the benefit of the government or its citizens. These funds are governmental funds. Private-purpose trust funds report all trust arrangements (other than pension and other employee benefit trust funds and investment trust funds) for which principal and income benefit individuals, private organizations, or other governments. These funds are fiduciary funds. (¶65 and 72)

OBSERVATION

These two new fund types resulted from the GASB's consideration of the appropriate accounting and financial reporting for the activities previously reported for the most part in expendable and nonexpendable trust funds.

GASB Statement No. 34 excludes fiduciary activities from the government-wide financial statements because the government cannot use the resources of fiduciary activities to support its programs. Therefore, the GASB had to distinguish between those "trusts" that support the government's programs and those that do not. Consistent with the narrowed definition of fiduciary funds in Statement No. 34, public-purpose funds previously classified as expendable and nonexpendable trust funds generally are reclassified to special revenue and permanent funds, respectively. (As explained in Q&A 30, unemployment compensation benefit plans are reported as enterprise funds.) These reclassifications are needed not only to avoid understating the resources that the government can use for its governmental and business-type activities but also to avoid overstating fiduciary funds.

Some "trusts" may benefit both private and public purposes. For example, some of the earnings of a "trust" may be used for a governmental operation and some may be distributed to individuals or private organizations. Statement No. 34 does not specifically address this situation and preparers need to apply professional judgment given the facts and materiality of a particular situation. It may be possible to segment the principal of the "trust" into two funds for reporting purposes. If that is not possible (for example, because the relative benefit of the earnings to public and private purposes is not fixed), the preparer could consider classifying the "trust" by fund type based on its primary beneficiary. The preparer also could consider the need to disclose the nature of the "trust" and its fund type classification.

32. What are the changes in the definition of agency funds?

Agency funds now involve accounting for amounts held as an agent only for individuals, private organizations, or other governments. Under previous standards, those funds also could have been used to account for amounts held as an agent for other funds of the government. For example, property tax collectors often collect and distribute property taxes to their own government's funds as well as to other governments. When this occurs, the portion that pertains to other funds now is reported as assets in the appropriate funds, not in agency funds. (¶73 and 111)

OBSERVATION

This is another example of the concept explained in Q&A 31 of distinguishing between those "fiduciary" activities that support the government's programs and those that do not.

Fund Financial Statements—Governmental and Proprietary Funds

33. *What financial statements are presented for governmental and proprietary funds?*

Separate financial statements are presented for the primary government's governmental and proprietary funds. The two financial statements for governmental funds are (1) the balance sheet and (2) the statement of revenues, expenditures, and changes in fund balances. The three financial statements for proprietary funds are (1) the statement of net assets (or balance sheet), (2) the statement of revenues, expenses, and changes in fund net assets (or fund equity), and (3) the statement of cash flows. (¶74, 78, and 91)

OBSERVATION

Each fund category now has its own complete set of financial statements. A single combined balance sheet is no longer presented.

34. *How are governmental and proprietary funds aggregated for presentation in the fund financial statements?*

Governmental and proprietary fund financial statements focus on major funds. Each major governmental fund is reported in a separate column in the governmental fund financial statements. Each major enterprise fund is reported in a separate column in the proprietary fund financial statements. Internal service funds are not reported as major funds. (See the definition of major funds in Q&A 35.)

Nonmajor governmental funds are aggregated and displayed in a single column, and a combined total column is presented for all governmental funds (major and aggregate nonmajor), in the governmental fund financial statements. Nonmajor enterprise funds are aggregated and displayed in a single column, and a combined total column is presented for all enterprise funds (major and aggregate nonmajor), in the proprietary fund financial statements. The combined total for all internal service funds are reported in a separate column on the proprietary fund financial statements to the right of the total enterprise funds column.

Combining financial statements for nonmajor funds are not required but may be presented as supplementary information. (¶75, 83, and 96)

OBSERVATION

Previous fund financial statements presented information by fund type. GASB Statement No. 34 replaces that presentation with information about major funds—those funds that are large or otherwise important. The GASB found that users' interest in details did not relate to fund types, but to individual funds. When the GASB tested its definition of major funds, it found that many governments report a high percentage of their fund assets, liabilities, revenues, and expenses/expenditures in the general and other major funds.

Internal service funds are exempt from the major fund reporting requirements. This is because the internal service fund operating statement "double-counts" amounts charged to other funds—amounts that already are considered when applying the major fund criteria. Similarly, internal service fund assets and liabilities are government-wide assets and liabilities, not fund assets and liabilities.

Governments will have to determine whether they wish to present nonmajor funds as supplementary information. That presentation will be required if the government is preparing a CAFR.

35. What are the definitions of major funds?

The government's main operating fund—the general fund or its equivalent—always is a major fund. Other individual governmental and enterprise funds are major funds if they meet both of the following criteria:

1. Total assets, liabilities, revenues, or expenditures/expenses of the individual fund are at least 10 percent of the corresponding total (assets, liabilities, and so forth) for all funds of that category or type (that is, total governmental or total enterprise funds).

2. Total assets, liabilities, revenues, or expenditures/expenses of the individual fund are at least 5 percent of the corresponding total for all governmental and enterprise funds combined.

Revenues and expenditures/expenses for extraordinary items (see Q&A 25) are not considered in these calculations.

Besides the funds that meet the major fund criteria, any other governmental or enterprise fund may be a major fund. (¶76)

OBSERVATION

Governments will have to develop policies and procedures to identify funds as major. GASB Statement No. 34's criteria for when governmental and enterprise funds have to be reported as major are minimum requirements; governments are able to designate other funds as major. This was done, among other reasons, because of concerns that a government's financial statements may present different funds as major each year.

Some have questioned whether fund reporting by major funds will require more or less audit effort than previously required for reporting by fund-type. As discussed in Q&A 5, the AICPA is considering the audit issues relating to the new financial reporting model and plans to address those issues before the first required implementation date of Statement No. 34.

Governmental Funds

36. What measurement focus and basis of accounting do governmental funds use and how is it applied?

The measurement focus and basis of accounting (MFBA) is current financial resources/modified accrual, which is the same MFBA governmental funds previously used. This MFBA focuses on reporting the sources, uses, and balances of current financial resources; the amounts available for appropriation; and fiscal compliance. GASB Statement No. 34 does not change the previous application of this MFBA. According to the statement of principle in GASB *Codification of Governmental Accounting and Financial Reporting Standards*, as of June 30, 1998 (Codification), section 1600, *Basis of Accounting*, under this MFBA (1) revenues are recognized in the accounting period in which they become available and measurable and (2) expenditures are recognized in the accounting period in which the fund liability is incurred, if measurable, except for unmatured interest on general long-term debt, which is recognized when due. Additional details about the application of this MFBA are in the Codification. (¶64 and 79)

OBSERVATION

Because of the retention of the current financial resources/modified accrual MFBA, implementation of GASB Statement No. 34 for governmental funds should present few issues. As noted in Q&A 49, however, the implementation of GASB Statement No. 33 changes the standards for how governmental funds recognize revenues and expenditures from such transactions as taxes, contributions, certain grants, and fines.

On June 30, 1999, the GASB issued an ED of a proposed Interpretation, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmen-*

tal Fund Financial Statements. That ED concerns modified accrual recognition of expenditures for certain liabilities, addressing inconsistencies in the current standards and clarifying certain imprecisely defined terms. The effective date of the proposed Interpretation will coincide with the effective date of Statement No. 34. Preparers and auditors should consider monitoring the GASB's progress on this project for possible changes as they plan to implement Statement No. 34.

37. *What are general capital assets and general long-term liabilities, and how are they reported in the governmental fund financial statements?*

General capital assets are capital assets of the government that are not specifically related to activities reported in proprietary or fiduciary funds. They are associated with and generally arise from governmental activities and most often result from governmental fund expenditures.

General long-term liabilities are those long-term liabilities associated with governmental funds that are not reported as governmental fund liabilities. They include the unmatured principal of debt instruments (such as bonds, warrants, and notes) as well as the noncurrent portion of capital leases, operating leases with scheduled rent increases, compensated absences, claims and judgments, pensions, special termination benefits, and landfill closure and postclosure care liabilities. Interfund liabilities, even if noncurrent, are not general long-term liabilities.

General capital assets and general long-term liabilities are not reported as assets or liabilities in governmental funds or with the fund financial statements; they only are reported with governmental activities in the government-wide statement of net assets. (¶80–82)

OBSERVATION

The definitions of general capital assets and general long-term liabilities are unchanged from previous standards, although the terms are changed from *general fixed assets* and *general long-term debt*. One change, however, is that these assets and liabilities are no longer reported with the fund financial statements; that is, Statement No. 34 eliminated the General Fixed Assets Account Group and the General Long-term Debt Account Group. The information previously presented in those account groups is replaced with information in the government-wide financial statements.

38. How are fund balances reported for governmental funds?

Governmental fund balances are segregated into reserved and unreserved amounts. The definitions of reserved and unreserved fund balances, which are in the Codification, section 1800, *Classification and Terminology*, paragraph 123, and the reporting standards for fund balance designations and reservations, which are in section 1800, paragraphs 125 and 126, are unchanged from previous standards. Reserved fund balances of the nonmajor governmental funds are displayed by reservation purposes. Unreserved fund balances of those funds are displayed by fund type. (¶84)

OBSERVATION

The display of the reserved and unreserved fund balances of governmental funds provides information different from that provided by the three components of net assets that are displayed in the government-wide statement of net assets. The presentation of governmental fund balances focuses attention on the net unreserved current financial resources available for appropriation in future periods for the general purposes of the funds.

GASB Statement No. 34 requires the unreserved fund balances of nonmajor governmental funds to be displayed by fund type to replace information lost because of the elimination of fund-type reporting. With fund-type reporting, some reservations were indicated by the fund type in which fund balances were reported.

39. What are the format and classification requirements for the governmental fund statement of revenues, expenditures, and changes in fund balances?

The statement uses the following elements, format, and sequence:

Revenues (detailed)
Expenditures (detailed)
    Excess (deficiency) of revenues over expenditures
Other financing sources and uses, including transfers (detailed)
Special and extraordinary items (detailed)
    Net change in fund balances
Fund balances (both reserved and unreserved amounts)—beginning of period
Fund balances (both reserved and unreserved amounts)—end of period

Revenues are classified by major source, and expenditures are classified at a minimum by function. Other financing sources and uses include proceeds of long-term debt (including debt refundings), debt issuance premiums and discounts, certain payments to escrow agents for debt refundings, transfers (as discussed in Q&A 50), and sales of capital assets (unless a special item).

If special and extraordinary items as discussed in Q&A 25 both occur in the same period, they are reported together in a "special and extraordinary items" classification separately from each other. Significant transactions or other events that are beyond the control of management but that are either unusual in nature or infrequent in occurrence (and thus not special or extraordinary items) are separately identified in revenues or expenditures or disclosed in the notes to the financial statements. (¶86–89)

OBSERVATION

GASB Statement No. 34 limits the format for the governmental fund statement of revenues, expenditures, and changes in fund balances to one of the three formats permitted by previous standards. However, because the format selected is the one most often used in practice, most governments will not need to change the format they use for that financial statement.

Proprietary Funds

40. What MFBA do proprietary funds use and how is it applied?

Proprietary funds continue to use the economic resources/accrual MFBA. Proprietary fund reporting focuses on the determination of operating income, changes in net assets (or cost recovery), financial position, and cash flows. Revenues are recognized when they are earned and become measurable. Revenue recognition for capital contributions and additions to permanent and term endowments (as well as all other nonexchange revenues) are based on GASB Statement No. 33 (see Q&A 49). Expenses are recognized when incurred, if measurable. (¶66, 92, and 103)

41. What is the applicability of private-sector pronouncements in proprietary fund financial statements?

See Q&A 10. The requirements for enterprise funds are the same as for business-type activities. The requirements for internal service funds are the same as for governmental activities. Governments are encouraged to use the same application of post-November 30, 1989, FASB pronouncements for all enterprise funds. (¶93–95)

OBSERVATION

GASB Statement No. 34 no longer gives internal service funds the option to follow post-November 30, 1989, FASB pronouncements. Because few internal service funds adopted such a policy, however, this should have little effect. Those governments that chose that option for internal service funds usually can continue to apply those FASB pronouncements as "other accounting literature." (See SAS No. 69, *The Meaning of* Present Fairly in Conformity With Generally Accepted Accounting Principles *in the Independent Auditor's Report* [AICPA, *Professional Standards*, vol. 1, AU sec. 411] for the hierarchy of generally accepted accounting principles [GAAP] for governmental entities.)

Statement No. 34 retains the option for enterprise funds to follow post-November 30, 1989, FASB pronouncements because some governmental entities (such as utilities and hospitals) have private-sector counterparts and wish to maintain as much inter-industry financial reporting comparability as possible.

42. What are the format and classification requirements for the proprietary fund statement of net assets (or balance sheet)?

Proprietary funds may use either a net assets format or a balance-sheet format. The difference between fund assets and liabilities may be labeled either "net assets" or "fund equity." This Q&A Guide uses the term *net assets* to refer to that difference.

Assets and liabilities are classified as between current and long-term using the standards in Chapter 3 of ARB 43, *Restatement and Revision of Accounting Research Bulletins*. Assets are reported as restricted when the nature or normal understanding of their availability is changed by restrictions (as defined in Q&A 19).

Net assets are displayed in the same three components as in the government-wide statement of net assets. (See Q&A 19.) Because restricted assets may include assets that are offset by liabilities rather than equity (such as debt proceeds), the amount reported as restricted assets will not necessarily equal the amount reported as restricted net assets. Net asset designations are not reported on the face of the statement. (¶91, 97–99, and 103)

OBSERVATION

Proprietary funds previously have not been required to present classified balance sheets, although many have. Governments that have not done so need to establish policies and procedures for classifying assets and liabilities.

Net asset classification in the proprietary fund financial statements is the same as in the government-wide financial statements. The policies and procedures that financial statement preparers develop to classify net assets into the three components will work at both financial statement levels. Although designations of net assets are not reported on the face of the proprietary fund financial statement, disclosure in the notes is permitted.

Proprietary funds' equity accounts will no longer report contributed capital and retained earnings. In paragraph 430 of the Basis for Conclusions, GASB Statement No. 34 says this is because the focus of reporting is on net assets available to finance future services, not a historical record of equity transactions. However, it also says that "governments that wish to continue to provide information about the extent to which a particular enterprise fund has received capital subsidies may do so in the notes to the financial statements."

43. What are the format and classification requirements for the proprietary fund statement of revenues, expenses, and changes in fund net assets (or fund equity)?

This statement classifies revenues by major source and identifies revenues that are security for revenue bonds. Revenue discounts and allowances are reported as a separate line item following the related revenues or as part of the revenue amount (with the discount and allowance amount disclosed parenthetically in the statement or in a note to the financial statements).

The statement is presented using the following elements, format, and sequence:

Operating revenues (detailed). (See Q&A 44 for a discussion of operating revenues and expenses)

    Total operating revenues

Operating expenses (detailed)

    Total operating expenses

        Operating income (loss)

Nonoperating revenues and expenses (detailed)

    Income before other revenues, expenses, gains, losses, and transfers

Revenues from capital contributions (grant, developer, and other), revenues from additions to permanent and term endowments, special and extraordinary items (detailed), and transfers (Each of these elements is separately presented.)

    Increase (decrease) in net assets

Net assets—beginning of period

Net assets—end of period

(¶100–101 and 103)

OBSERVATION

Proprietary funds no longer report capital contributions as a direct change in equity; they are now separately presented revenues. Previous standards for expense classification are unchanged; generally, expenses are classified by object.

44. How do governments define operating revenues and expenses?

Governments define operating revenues and expenses for each proprietary fund based on the nature of the fund's activity and considering how transactions are categorized in the fund's statement of cash flows. Normally, operating revenues and expenses are those transactions for which cash flows are reported as operating activities. However, revenues and expenses normally classified as other than cash flows from operating activities are classified as operating revenues and expenses if those transactions represent the proprietary fund's principal ongoing operations. Nonoperating revenues include most revenues from other than exchange and exchange-like transactions, such as taxes and nonexchange fees and charges. (¶102)

OBSERVATION

GASB Statement No. 34 does not establish definitions or detailed criteria for distinguishing between operating and nonoperating revenues and expenses. Instead it provides general guidelines that tie the elements of operating income to the fund's principal purpose and to the categorization in the statement of cash flows. Financial statement preparers need to establish policies for defining operating revenues and expenses for each proprietary fund. Different funds, with different operations, may have different policies.

45. What are the format and classification requirements for the proprietary fund statement of cash flows?

Governments present a statement of cash flows for proprietary funds based on the provisions of GASB Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*, using the direct method of presenting cash flows from operating activities (including a reconciliation of operating cash flows to operating income). (¶105)

OBSERVATION

Financial statement preparers that previously used the indirect method of reporting cash flows need to establish policies and procedures for using the direct method. Paragraphs 115 through 118 of the Basis for Conclusions of

FASB Statement No. 95, *Statement of Cash Flows*, provide guidance on indirectly determining amounts of operating cash receipts and payments.

Fund Financial Statements—Fiduciary Funds and Fiduciary Component Units

46. What financial statements are presented for fiduciary funds and fiduciary component units?

Fiduciary funds and fiduciary component units present (1) a statement of fiduciary net assets and (2) a statement of changes in fiduciary net assets. The statements have separate columns for each fiduciary fund type. Fiduciary component units are included with the appropriate fund type.

Financial statements for individual pension and postemployment health care plans are presented in the notes to the financial statements if separate, GAAP financial reports are not issued. If such reports are issued, the notes disclose how to obtain those separate reports. GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, paragraph 19, already requires condensed financial statements for individual external investment pools to be presented in the notes if separate financial reports are not issued. (¶106)

OBSERVATION

The fiduciary funds are exempt from the "major funds" requirements of GASB Statement No. 34 primarily because information about "major" funds is made available by the separate financial statement and note disclosure requirements for pension and postemployment health care plans and external investment pools.

47. What is the MFBA for fiduciary funds?

These funds use the economic resources/accrual MFBA, except for the recognition of certain liabilities of defined benefit pension plans and certain postemployment health care plans. GASB Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*, paragraph 26, and GASB Statement No. 26, *Financial Reporting for Postemployment Healthcare Plans Administered by Defined Benefit Pension Plans*, paragraph 7, require that plan liabilities for benefits and refunds due to plan members and beneficiaries be recognized when due and payable in accordance with the terms of the plan. (¶107)

48. What are the format and classification requirements for the fiduciary fund financial statements?

The statement of fiduciary net assets uses a net assets format. Agency fund assets equal liabilities. The components of net assets discussed in Q&A 19 need not be presented in this statement. Except for agency funds (which have no net assets), the statement of changes in fiduciary net assets includes information about the additions to, deductions from, and net increase (or decrease) in net assets for the year.

The detailed display requirements of previous standards for pension and other employee benefit trust funds and investment trust funds (GASB Statement Nos. 25, 26, and 31) continue to apply. (¶108–110)

Nonexchange Transactions

49. How are nonexchange transactions recognized in a government's financial statements?

Recognition and reporting standards for many nonexchange transactions, including for income, sales, property, and other taxes; contributions; certain grants; and fines, are in GASB Statement No. 33. That Statement provides standards for both the government-wide and the fund financial statements.

The provisions of Statement No. 33 are effective for financial statements for periods beginning after June 15, 2000, meaning that, in many cases, Statement No. 33 will be implemented before GASB Statement No. 34. However, Statement No. 34 requires that governments that implement Statement No. 34 for periods beginning before June 15, 2000, also implement Statement No. 33 at the same time. (¶142)

OBSERVATION

Because of its focus on underlying economic events and transactions, GASB Statement No. 33 may change the way many governments recognize and report assets, liabilities, revenues, and expenditures/expenses from nonexchange transactions in their fund financial statements. Many governments will have implemented Statement No. 33 before they implement Statement No. 34. However, they will apply Statement No. 33 to governmental fund revenues using a modified accrual basis of accounting. Therefore, they will have to develop additional policies and procedures to recognize that revenue using an accrual basis of accounting for governmental activities in the government-wide financial statements. This should not involve substantial additional effort because, in many cases, Statement No. 33 requires accrual-based revenue to be recognized at the same time that receivables are reported, and those governments will have implemented the receivable reporting standards in the governmental funds. (Statement No. 33 does not "modify" accrual accounting for purposes of recognizing nonexchange transaction expenditures in governmental funds.)

Those governments that are considering implementing Statement No. 34 for periods before their fiscal year 2001 need to plan adequately to implement Statement No. 33 at the same time.

Interfund Activity

50. *What is interfund activity, and how is it classified and reported in the fund financial statements?*

Interfund activity is a new term for *interfund transactions*. Interfund activity is a resource flow between funds, including between a primary government and its blended component units. There are two categories of interfund activity—reciprocal and nonreciprocal. *Reciprocal interfund activity* is the internal counterpart to exchange and exchange-like transactions. *Nonreciprocal interfund activity* is the internal counterpart to nonexchange transactions.

There are two types of reciprocal interfund activity:

- *Interfund loans.* These are amounts that are required to be repaid. Lender funds report interfund loans as interfund receivables; borrower funds report them as interfund payables. If repayment is not expected within a reasonable time (which is not defined in GASB Statement No. 34), the interfund balances are reduced and the lender fund reports a transfer (see the following discussion) to the borrower fund.
- *Interfund services provided and used.* These are sales and purchases of goods and services between funds for a price close to their external exchange value. With one exception, interfund services are reported as revenues in seller funds and expenditures/expenses in purchaser funds. The exception is when the general fund is used to account for risk-financing activity; GASB Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, paragraph 64, requires those interfund charges to be accounted for as reimbursements (see the following discussion).

There are two types of nonreciprocal interfund activity:

- *Interfund transfers.* These are flows of assets between funds without equivalent flows of assets in return and without a requirement for repayment. Transfers include payments in lieu of taxes (PILOTs) if they are not payments for interfund services (see the previous discussion). In governmental funds, transfers are reported as other financing uses in transferor funds and as other financing sources in transferee funds. In proprietary funds, transfers are reported after nonoperating revenues and expenses as discussed in Q&A 43.
- *Interfund reimbursements.* These are repayments from the funds responsible for particular expenditures/expenses to the funds that initially paid for them. Reimbursements reduce expenditures/expenses in the funds that originally paid them and increase them in the funds responsible for them. (¶112)

OBSERVATION

In its discussion of interfund activity, GASB Statement No. 34 does not use the term *transaction* because it implies a matter that is conducted with an external party.

There should be little change in how governments account for and report those events that current standards call *quasi-external transactions, reimbursements,* and *operating transfers.* Also, Statement No. 34 establishes standards for interfund loans that are consistent with the current practice of many governments, as well as for PILOTs between the primary government's funds and blended component units. Statement No. 34 eliminates the category of residual equity transfers—nonrecurring or nonroutine transfers of equity. Now, those transfers are not distinguished from other transfers.

Interfund activity does not include transactions with discretely presented, nonfiduciary component units, which Statement No. 34 considers external transactions. As discussed in Q&A 27, most transactions between a primary government and its discretely presented, nonfiduciary component units are reported as revenues and expenditures/expenses.

Financial Statement Reconciliations

51. Why and how do governments present reconciliations between the fund financial statements and the government-wide financial statements? What are typical differences that are reconciled?

The amounts reported in the fund financial statements may differ from those presented in the government-wide financial statements because of MFBA differences and because the activities included, for example, in the governmental fund financial statements are different from those included in governmental activities of the government-wide financial statements.

To explain these differences, summary reconciliations to the government-wide financial statements are presented at the bottom of the fund financial statements or in an accompanying schedule. Brief explanations on the face of the statements or schedule usually give users enough information to understand the relationship between the statements. However, if not, governments provide more detail in the notes to the financial statements.

For governmental funds, (1) total fund balances in the governmental fund balance sheet is reconciled to (2) the net assets of governmental activities in the statement of net assets. In addition, (1) the total change in fund balances in the statement of revenues, expenditures, and changes in fund balances is reconciled to (2) the change in net assets of governmental activities in the statement of activities. Following are typical differences that are reconciled:

Item	*Governmental Funds*	*Governmental Activities*
Capital assets	Expenditures when acquired	Capitalized at historical cost and depreciated
Revenues	Recognized on a modified accrual basis; deferred for amounts that are not available to pay current-period expenditures	Recognized on an accrual basis, regardless of when "available"
General long-term liabilities	Generally not expenditures or liabilities if not due and payable in the current period; other financing sources for debt proceeds; expenditures for principal payments	Expenses and liabilities regardless of when due; no effect in the statement of activities when debt is issued or debt principal is paid
Internal service funds	Not reported as a governmental fund	Reported as a governmental activity, unless business-type in nature

For enterprise funds, (1) total enterprise fund net assets in the proprietary fund statement of net assets is reconciled to (2) the net assets of business-type activities in the statement of net assets. In addition, (1) the total change in enterprise fund net assets in the proprietary fund statement of revenues, expenses, and changes in fund net assets is reconciled to (2) the change in net assets of business-type activities in the statement of activities.

Generally, there are no reconciling items between the enterprise funds and business-type activities, and thus no reconciliation is required. That is, the amounts reported as total enterprise fund net assets and changes in net assets in the proprietary fund financial statements usually are the same as net assets and changes in net assets of business-type activities in the government-wide financial statements. However, there may be differences that require reconciliation. For example, in the process of eliminating internal service fund activities for the statement of activities, some of the fund's net income or loss may be allocated to business-type activities. Further, the residual assets and liabilities of internal service funds are reported with business-type activities in certain situations. (See Q&A 28.) (¶77, 85, 90, and 104)

OBSERVATION

The reconciliations on the financial statements (or in accompanying schedules) are highly aggregated. If explanations are complex, the notes to the financial statements will provide additional information. The reconciliations will help users to understand how funds relate to the government as a whole.

The required reconciliations are between the "bottom line" numbers on the financial statements. Line-by-line reconciliations between the fund and government-wide financial statements are not required. However, such line-item reconciliations are not prohibited and are illustrated in GASB Statement No. 34.

There is no reconciliation relating to the proprietary fund statement of cash flows because the government-wide financial statements do not include a statement of cash flows. In addition, there is no reconciliation between the fiduciary fund financial statements and the government-wide financial statements because fiduciary activities are not reported in the government-wide financial statements.

The reconciliations between the fund and government-wide financial statements could have been complicated by the reclassification of internal service funds from the proprietary fund category to governmental activities in the government-wide financial statements. However, Statement No. 34 diffuses that potential difficulty by requiring that the reconciliations between the proprietary fund financial statements and the government-wide financial statements be based on the total enterprise funds, which generally leads to few if any reconciling items. In addition, the separate display of the internal service funds on the proprietary fund financial statements provides the detail for the reconciling item on the governmental fund financial statements.

Preparers will have to develop policies and procedures for presenting these reconciliations. During the financial reporting process, many governments may first develop their fund financial statements and then make adjustments to those amounts to develop their government-wide financial statements. During that "conversion" process, differences can be identified and documented to support the reconciliations.

Notes to the Financial Statements

52. What are GASB Statement No. 34's note disclosure requirements?

GASB Statement No. 34 brings forward note disclosures from previous standards (see NCGA Interpretation 6, *Notes to the Financial Statements Disclosure*, as amended). The disclosures required by Statement No. 34 (which are discussed in this Q&A and in Q&As 53 through 55) are directly related to the new requirements of Statement No. 34. The GASB has a project to review existing note disclosure requirements and may propose or require other changes in note disclosures before Statement No. 34 is required to be implemented.

The notes focus on the primary government's governmental activities, business-type activities, major funds, and aggregate nonmajor funds. Determining whether to provide disclosures for discretely presented component units, including the disclosures discussed in Q&As 53 and 55, is a matter of professional judgment. The decision to make disclosures for those component units is based on (1) the unit's significance relative to the total discretely presented component units and (2) the nature and significance of the unit's relationship to the primary government.

The additional disclosures required for the summary of significant accounting policies based on Statement No. 34 are—

1. A description of the government-wide financial statements, noting that fiduciary funds and fiduciary component units are not included. (See Q&A 8.)
2. The MFBA used in the government-wide financial statements. (See Q&A 9.)
3. The policy for eliminating internal activity in the statement of activities. (See Q&As 26 through 28.)
4. The policy for applying post-November 30, 1989, FASB pronouncements to business-type activities and enterprise funds. (See Q&As 10 and 41.)

5. The policy for capitalizing assets and for estimating their useful lives. (See Q&As 11 and 12.) Governments that use the modified approach for reporting infrastructure assets describe that approach. (See Q&A 13.)
6. A description of the types of transactions included in program revenues (see Q&A 24) and the policy for allocating indirect expenses in the statement of activities (see Q&As 21 through 23).
7. The policy for defining operating and nonoperating revenues of proprietary funds. (See Q&A 44.)
8. The policy regarding whether to first apply restricted or unrestricted resources when an expense is incurred for purposes for which both restricted and unrestricted net assets are available. (See Q&A 19.)

Statement No. 34 details certain disclosure requirements for donor-restricted endowments relating to investment appreciation and income available for spending. Governments also disclose significant transactions or other events that are beyond the control of management but that are either unusual in nature or infrequent in occurrence (and thus not special or extraordinary items). Further, governments disclose, for each major component unit, significant transactions with the primary government and other component units. (¶56, 113–115, 120–122, and 128)

OBSERVATION

Preparers can develop many of the newly required disclosures as they develop policies and procedures to implement GASB Statement No. 34.

53. What note disclosures are made for capital assets and long-term liabilities?

Disclosures are made about the primary government's capital assets and long-term liabilities reported in the government-wide financial statements. The information distinguishes between (1) major classes of capital assets and long-term liabilities, (2) governmental activities and business-type activities, and (3) capital assets that are being depreciated and those that are not.

The disclosures that GASB Statement No. 34 requires about major classes of capital assets, including for capitalized collections of works of art, historical treasures, and similar assets, are—

1. Beginning- and end-of-year balances, presenting accumulated depreciation separately from historical cost.

2. Capital acquisitions.

3. Sales or other dispositions.

4. Current-period depreciation expense, including the amounts charged to each of the functions in the statement of activities.

For noncapitalized collections of works of art, historical treasurers, and similar assets, governments describe the collection and the reasons those assets are not capitalized.

Disclosures about long-term liabilities include long-term debt instruments as well as other long-term liabilities, except that disclosures about net pension obligations are in a separate pension note using the requirements of GASB Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers*. The disclosures that GASB Statement No. 34 requires about long-term liabilities are—

1. Beginning- and end-of-year balances.

2. Increases and decreases (separately).

3. The portions of each item that are due within one year of the statement date.

4. Which governmental funds typically have been used to liquidate nondebt long-term liabilities in prior years. (¶116–119)

See also Q&A 52 for a discussion of when these disclosures are made for discretely presented component units. Statement No. 34 includes illustrative note disclosures for capital assets and long-term liabilities.

54. When are segment disclosures made?

Segment disclosures are made for an activity that has outstanding revenue bonds or other revenue-backed debt if the activity is reported as or within (1) an enterprise fund or (2) a stand-alone entity that uses enterprise fund accounting and reporting standards. (For this purpose, revenue-backed debt does not include conduit debt for which the government is not obligated beyond the resources provided by related leases or loans.) A segment has a specific identifiable revenue stream pledged in support of its debt and has related assets, liabilities, expenses, gains, and losses that can be identified. Segment disclosures are not required for an individual fund that is both a segment and a major fund. (¶122)

OBSERVATION

Previous standards required segment disclosures for enterprise funds. For example, a single fund that reported two or more different activities was defined as one segment. GASB Statement No. 34 redefines the term *segment* so that it is no longer tied solely to the use of enterprise funds or enterprise fund accounting. It now is defined in relation to the needs of users for additional financial information about separately identifiable activities that relate to certain types of debt.

Preparers need to develop policies for defining segments. They could consider those policies at the same time as they consider policies for defining major enterprise funds to make the reporting process more efficient.

55. What segment disclosures are required in the notes to the financial statements?

Required segment disclosures are condensed statements of net assets, changes in net assets, and cash flows, as well as descriptions of the type of goods or services provided by the segments. GASB Statement No. 34 provides details on the individual elements that are presented in the condensed financial statements.

Governments that want to present disaggregated data for their multiple-function enterprise funds beyond what is required for segment reporting (such as the net [expense] revenue of segments) are encouraged to present a statement of activities as supplementary information. Special-purpose governments that have only business-type activities (as discussed in Q&A 63) also are encouraged to present that information. (¶122–123)

See also Q&A 52 for a discussion of when these disclosures are made for discretely presented component units. Statement No. 34 includes illustrative segment disclosures.

OBSERVATION

Segment disclosures have been revised to make them consistent with the information GASB Statement No. 34 requires for major funds and component units.

Component Unit Reporting

56. What component units are included in the basic financial statements and how? What information do they present?

All component units as defined by GASB Statement No. 14 are included in the basic financial statements. Blended component units are reported in the government-wide and fund financial statements as if they were part of the primary government's activities or funds. Fiduciary component units are included only in the fund financial statements. Discretely presented, nonfiduciary component units are presented in the government-wide financial statements, generally aggregated in a single column.

For each discretely presented, nonfiduciary component unit that meets the definition of major (as defined in Statement No. 14), governments provide information about the component unit in one of the three following ways:

1. Presenting each major component unit in a separate column in the government-wide financial statements. The nonmajor component units are then aggregated into a single column.
2. Including combining statements of major component units in the basic statements after the fund financial statements. Those statements include nonmajor component units aggregated in a single column. A combining statement for the nonmajor component units is not required but may be presented as supplementary information.
3. Presenting condensed financial statements in the notes to the financial statements. The individual elements that are required to be presented in those condensed statements are listed in GASB Statement No. 34. (¶124–127)

The data presented for each discretely presented, nonfiduciary component unit generally are the aggregated totals from its statements of net assets and activities. However, for component units that have only business-type activities and do not present a statement of activities (see Q&A 63), data are taken from the unit's statement of revenues, expenses, and changes in net assets.

OBSERVATION

The three methods of reporting information about major component units are those already provided for in GASB Statement No. 14. Governments with only one or two component units often choose the separate-columns approach; those with more often use one of the two other approaches.

Guidance for determining which component units are "major" is in Statement No. 14—a finding that a component unit is "major" depends on a component unit's significance to the other component units and the nature and significance of its relationship with the primary government. The definition of *major* in GASB Statement No. 34 for purposes of reporting major governmental and enterprise funds does not apply to the reporting of major component unit information.

Required Supplementary Information, Including Budgetary Comparison Information

57. What is required supplementary information, and what new information of that type does GASB Statement No. 34 require?

Required supplementary information (RSI) is financial information that GASB standards require to be presented with, but outside of, the financial statements. The new RSI that GASB Statement No. 34 requires is MD&A (see Q&As 6 through 7), budgetary comparison schedules for certain governmental funds (see Q&A 58), and information about infrastructure assets for which the government uses the modified approach (see Q&A 14). (¶129)

58. What budgetary information is required and how is it presented?

Budgetary comparison schedules for the general fund and each major special revenue fund with a legally adopted annual budget are presented as RSI. The schedules compare the period's original and final appropriated budgets to actual budget results. The information is presented using the government's budgetary basis. Governments are encouraged (but not required) to present the variance between the final budget and actual amounts. They also may report the variance between original and final budget amounts.

GASB Statement No. 34 provides definitions of *original budget* and *final budget.*

Governments may present the budgetary comparison schedules using the same format, terminology, and classifications as in their budget documents. Alternatively, they may use the format, terminology, and classifications in the governmental fund statement of revenues, expenditures, and changes in fund balances. Accompanying information (either in a separate schedule or in notes to RSI) reconciles the actual budget results to GAAP results. Notes to RSI disclose the excess of expenditures over appropriations for the individual funds presented in the schedule.

As an option, governments may present a budgetary comparison statement as part of their basic financial statements. That statement includes (through display and disclosure in the notes to the financial statements) the information described previously. (¶130–131)

OBSERVATION

GASB Statement No. 34 does not require budgetary comparison information to be a basic financial statement (as did previous standards) because the GASB does not believe that information is essential to an understanding of a government's financial position and results of operations. However, because some governments will find that information to be essential, the Statement permits presentation as a basic financial statement. In considering this choice, preparers could consider consulting with their auditors on the additional audit effort required if the budgetary comparison information is presented as a basic financial statement rather than as RSI. Preparers should consider establishing policies relating to this choice as well as the choice concerning the formatting of the information.

Previous standards required budgetary comparison reporting for all governmental fund types with legally adopted annual budgets. This change may reduce the amount of information to be presented. Increasing the amount of information to be presented, however, is the requirement to include the original budget, which was not previously required.

59. *What is an auditor's responsibility for examining RSI and for reporting on it when it is presented outside the basic financial statements and the auditor is not engaged to examine and express an opinion on it?*

OBSERVATION

The auditor's responsibility for examining and reporting on RSI is discussed in SAS No. 52, *Omnibus Statement on Auditing Standards—1987* (AICPA, *Professional Standards*, vol. 1, AU sec. 558, Required Supplementary Information). The SAS describes certain limited procedures that ordinarily should be applied to RSI (AU sec. 558.07).

The auditor adds an explanatory paragraph to the report on the audited financial statements if one of these four circumstances described in SAS No. 52 (AU sec. 558.08) exist: (1) the RSI is omitted, (2) the auditor has concluded that the measurement or presentation of the RSI departs materially from prescribed guidelines, (3) the auditor is unable to complete the prescribed procedures, or

(4) the auditor is unable to remove substantial doubts about whether the RSI conforms to prescribed guidelines. Examples of explanatory paragraphs that an auditor might use in these circumstances are illustrated in SAS No. 52 (AU sec. 558.08). Because the RSI does not change the standards of financial accounting and reporting used for the preparation of the entity's basic financial statements, the four circumstances described here do not affect the auditor's opinion on the fairness of presentation of such financial statements in conformity with GAAP.

Further auditor reporting on RSI varies depending on whether the RSI is included in a client-prepared document or an auditor-prepared document. If the RSI is included in a client-prepared document, the auditor need not add an explanatory paragraph to the report on the audited financial statements to refer to the RSI or to the limited procedures, except if any of the four previously mentioned circumstances exist.

When RSI is presented in an auditor-submitted document, SAS No. 29, *Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents* (AICPA, *Professional Standards*, vol. 1, AU sec. 551), provides that the auditor should disclaim an opinion on the information. Example language is in SAS No. 29 (AU sec. 551.15). Also, the auditor's report on the RSI should be expanded if any of the four circumstances described in SAS No. 52 (AU sec. 558.08) are present.

Special-Purpose Governments

60. *Statement No. 34 provides that special-purpose governments may have different basic financial statements than do general-purpose governments. What are special-purpose governments?*

Special-purpose governments are legally separate entities that perform only one activity or only a few activities, such as cemetery districts, levee districts, assessment districts, drainage districts, school districts, utilities, hospitals or other health care organizations, public employee retirement systems (PERS), governmental external investment pools, and public entity risk pools. Special-purpose governments are legally separate entities and may be component units or other stand-alone governments as defined and discussed in GASB Statement No. 14. (¶134)

OBSERVATION

GASB Statement No. 34 provides special requirements for certain special-purpose governments because the GASB believes that the basic financial statements should be appropriate to the nature and mix of activities a government performs. Even though some special-purpose governments may present different basic financial statements (see Q&As 61 through 63), they still have to present notes to the financial statements, MD&A, and other appropriate RSI.

61. What are the basic financial statements presented by special-purpose governments that have more than one governmental program or that have both governmental and business-type activities?

Special-purpose governments that have more than one governmental program or a combination of governmental and business-type activities present the same basic financial statements as would a general-purpose government. That is, they provide both the government-wide financial statements and the fund financial statements discussed previously in this Q&A Guide. (¶135)

OBSERVATION

In considering what financial statements special-purpose governments should present, the GASB applied the notion that both government-wide and fund-based financial statements should be presented when they would provide different information, not just have different formats and details. Therefore, special-purpose governments that have more than one governmental program or a combination of governmental and business-type activities present both government-wide and fund financial statements because different MFBAs are required in those financial statements.

62. What are special-purpose governments that have a single governmental program? What are the basic financial statements they present?

GASB Statement No. 34 limits those special-purpose governments considered to have a single governmental program. It states that a government is not considered "'single-program' if it budgets, manages, or accounts for its activities as multiple programs." Statement No. 34 cites a school district with regular instruction, special instruction, vocational education, and adult education programs as an example of a special-purpose entity that is not single purpose. The Statement illustrates a fire protection district as a special-purpose government with a single governmental program.

Special-purpose governments that have a single governmental program can present their fund and government-wide financial statements in one of two ways.

First, the fund and the government-wide financial statements may be combined with a reconciliation of the individual line items in a separate column on the financial statements.

OBSERVATION

To apply this alternative—

- The governmental fund balance sheet and the government-wide statement of net assets (which for these entities includes only governmental activities) are presented together in the same financial statement. An "Adjustments" column after the "Total Governmental Funds" column displays the changes needed to adjust the balance sheet line items to the line items in the statement of net assets. See exhibit A-3 in appendix A of this Q&A Guide.
- The governmental fund statement of revenues, expenditures, and changes in fund balances and the government-wide statement of activities (which again includes only governmental activities) are presented together in the same financial statement. Using this combination approach requires either the statement of revenues, expenditures, and changes in fund balances or the statement of activities to be reformatted. For example, the governmental fund statement could be formatted using the net (expense) revenue format. (See exhibit B-6 in appendix C of GASB Statement No. 34.) Alternatively, the statement of activities could be formatted in the same manner as the fund statement—revenues, less expenditures, adjusted for other financing sources and uses. (See exhibit A-4 in appendix A of this Q&A Guide.) Neither format is preferred over the other, but preparers who use this combination approach need to consider the significance of program revenues in determining which format better suits their particular situation. That is, if there are insignificant program revenues, the format of the statement of revenues, expenditures, and changes in fund balances might be the better choice. If program revenues are significant, the net (expense) revenue format might be better. An "Adjustments" column after the "Total Governmental Funds" column shows the changes that are needed to adjust the line items in the statement of revenues, expenditures, and changes in fund balances to the line items in the statement of activities.
- Descriptions of the reconciling items in the "adjustments column" are presented either on the financial statements, in an accompanying schedule, or in the notes to the financial statements.

Second, such special-purpose governments may present separate government-wide and fund financial statements but present their government-wide statements of activities using a different format. Statement No. 34 states, "For example, the statement of activities may be presented in a single column that reports expenses first, followed by revenues (by major sources). The difference between these amounts is net revenue (expense) and should be followed by contributions to permanent and term endowments, special and extraordinary items, transfers, and beginning and ending net assets." This format is illustrated in exhibit B-5 in appendix C of Statement No. 34. (¶136–137)

OBSERVATION

Under the new financial reporting model, some special-purpose governments that have only a single governmental program would report only a general fund or would report no other major funds. Therefore, presenting separate fund and government-wide statements could be redundant or confuse users. Thus, these entities may combine their government-wide and fund financial statements. However, if they present separate statements, they may use a format for the statement of activities that may make it appear less complex.

63. *What are the basic financial statements presented by special-purpose governments that have only business-type activities or only fiduciary activities?*

Governments that have only business-type activities present only enterprise fund financial statements, that is, an enterprise fund (1) statement of net assets (or balance sheet); (2) statement of revenues, expenses, and changes in net assets (or fund equity); and (3) statement of cash flows. However, these entities are encouraged to present a statement of activity as supplementary information. (See Q&A 55.)

Governments that have only fiduciary activities present only the fiduciary fund financial statements, that is, (1) a statement of fiduciary net assets and (2) a statement of changes in fiduciary net assets. Statement No. 34 provides additional details for reporting PERS that administer more than one pension or other employee benefit plan. (¶123 and 138–141)

OBSERVATION

Governments that have only business-type activities need not present a statement of activities in a net (expense) revenue format because that statement would not provide enough additional information over the fund financial statements. However, because a statement of activities format may provide additional useful information for such governments that have multiple programs, they are encouraged to present that statement as supplementary information.

Governments that have only fiduciary activities do not present government-wide financial statements because a government-wide notion is not relevant for those entities.

Transition

64. How is the transition to the new financial reporting model handled?

Adjustments to the funds because of GASB Statement No. 34 are prior-period adjustments, and any prior-period financial statements that are presented are restated unless impractical. If such restatement is impractical, beginning fund balance (or fund net assets) is restated for the cumulative effect of applying the Statement for the earliest period restated (which generally is the current period). The nature of the restatement and its effect are disclosed in the first period the Statement is applied.

APB Opinions 12, *Omnibus Opinion—1967*, and 21, *Interest on Receivables and Payables*, as amended, require deferral and amortization of debt issue premiums and discounts. They may be applied prospectively to governmental activities in the government-wide financial statements, except for deep-discount or zero-coupon debt. Deep-discount debt is debt originally sold at a discount of 20 percent or more from its face or par value. Zero-coupon debt pays no interest until maturity.

FASB Statement No. 34, *Capitalization of Interest Cost*, as amended, requires the capitalization of interest cost in the historical cost of capital assets. It may be applied prospectively by governmental activities (that is, for general capital assets). Finally, GASB Statement No. 23, *Accounting and Financial Reporting for Refundings of Debt Reported by Proprietary Activities*, which applies to debt-refunding transactions, may be applied prospectively by governmental activities (that is, for general long-term liabilities). (¶144 and 146)

Other transition provisions are discussed in Q&As 7 and 13 through 15.

OBSERVATION

GASB Statement No. 34 exempts certain APB, FASB, and GASB standards from retroactive application, to ease implementation efforts as much as possible.

Appendix A—Illustrative Financial Statements

The nonauthoritative appendix C of GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, illustrates the display and disclosure requirements of the Statement. Some of that illustrative material is adapted as exhibits, in the following pages. They are as follows:

Exhibit Number	*Contents*
A-1	Government-wide Statement of Net Assets—Net Assets Format
A-2	Government-wide Statement of Activities—Standard Format (No Indirect Expense Allocations)
A-3	Government-wide Statement of Net Assets Combined With Governmental Fund Balance Sheet
A-4	Government-wide Statement of Activities Combined With Governmental Fund Statement of Revenues, Expenditures, and Changes in Fund Balances (Traditional Format)

Exhibit A-1

Government-wide Statement of Net Assets—Net Assets Format (Adapted from GASB Statement No. 34, Appendix C, Exhibit A-1)

Sample City
Statement of Net Assets
December 31, 2002

	Primary Government			
	Governmental Activities	**Business-type Activities**	**Total**	**Component Units**
ASSETS				
Cash and cash equivalents	$ 13,597,899	$ 10,279,143	$ 23,877,042	$ 303,935
Investments	27,365,221	—	27,365,221	7,428,952
Receivables (net)	12,833,132	3,609,615	16,442,747	4,042,290
Internal balances	175,000	(175,000)	—	—
Inventories	322,149	126,674	448,823	83,697
Capital assets, net	170,022,760	151,388,751	321,411,511	37,744,786
Total assets	224,316,161	165,229,183	389,545,344	49,603,660
LIABILITIES				
Accounts payable	6,783,310	751,430	7,534,740	1,803,332
Deferred revenue	1,435,599	—	1,435,599	38,911
Noncurrent liabilities				
Due within one year	9,236,000	4,426,286	13,662,286	1,426,639
Due in more than one year	83,302,378	74,482,273	157,784,651	27,106,151
Total liabilities	100,757,287	79,659,989	180,417,276	30,375,033
NET ASSETS				
Invested in capital assets, net of related debt	103,711,386	73,088,574	176,799,960	15,906,392
Restricted for:				
Capital projects	11,705,864	—	11,705,864	492,445
Debt service	3,020,708	1,451,996	4,472,704	—
Community development projects	4,811,043	—	4,811,043	—
Other purposes	3,214,302	—	3,214,302	—
Unrestricted (deficit)	(2,904,429)	11,028,624	8,124,195	2,829,790
Total net assets	$123,558,874	$ 85,569,194	$209,128,068	$19,228,627

Exhibit A-2
Government-wide Statement of Activities—
Standard Format (No Indirect Expense Allocations)
(Adapted from GASB Statement No. 34, Appendix C, Exhibit B-1)

Sample City
Statement of Activities
For the Year Ended December 31, 2002

		Program Revenues		
Functions/Programs	**Expenses**	**Charges for Services**	**Operating Grants and Contributions**	**Capital Grants and Contributions**
Primary government:				
Governmental activities:				
General government	$ 9,571,410	$ 3,146,915	$ 843,617	$ —
Public safety	34,844,749	1,198,855	1,307,693	62,300
Public works	10,128,538	850,000	—	2,252,615
Engineering services	1,299,645	704,793	—	—
Health and sanitation	6,738,672	5,612,267	575,000	—
Cemetery	735,866	212,496	—	—
Culture and recreation	11,532,350	3,995,199	2,450,000	—
Community development	2,994,389	—	—	2,580,000
Education (payment to school district)	21,893,273	—	—	—
Interest on long-term debt	6,068,121	—	—	—
Total governmental activities	105,807,013	15,720,525	5,176,310	4,894,915
Business-type activities:				
Water	3,595,733	4,159,350	—	1,159,909
Sewer	4,912,853	7,170,533	—	486,010
Parking facilities	2,796,283	1,344,087	—	—
Total business-type activities	11,304,869	12,673,970	—	1,645,919
Total primary government	$ 117,111,882	$28,394,495	$5,176,310	$6,540,834
Component units:				
Landfill	$ 3,382,157	$ 3,857,858	$ —	$ 11,397
Public school system	31,186,498	705,765	3,937,083	—
Total component units	$ 34,568,655	$ 4,563,623	$3,937,083	$ 11,397

General revenues:
Taxes:
Property taxes, levied for general purposes
Property taxes, levied for debt service
Franchise taxes
Public service taxes
Payment from Sample City
Grants and contributions not restricted to specific programs
Investment earnings
Miscellaneous
Special item—Gain on sale of park land
Transfers
Total general revenues, special items, and transfers
Change in net assets
Net assets—beginning
Net assets—ending

Net (Expense) Revenue and Changes in Net Assets			
Primary Government			
Governmental Activities	Business-type Activities	Total	Component Units
$ (5,580,878)	$ —	$ (5,580,878)	$ —
(32,275,901)	—	(32,275,901)	—
(7,025,923)	—	(7,025,923)	—
(594,852)	—	(594,852)	—
(551,405)	—	(551,405)	—
(523,370)	—	(523,370)	—
(5,087,151)	—	(5,087,151)	—
(414,389)	—	(414,389)	—
(21,893,273)	—	(21,893,273)	—
(6,068,121)	—	(6,068,121)	—
(80,015,263)	—	(80,015,263)	—
—	1,723,526	1,723,526	—
—	2,743,690	2,743,690	—
—	(1,452,196)	(1,452,196)	—
—	3,015,020	3,015,020	—
(80,015,263)	3,015,020	(77,000,243)	—
—	—	—	487,098
—	—	—	(26,543,650)
—	—	—	(26,056,552)
51,693,573	—	51,693,573	—
4,726,244	—	4,726,244	—
4,055,505	—	4,055,505	—
8,969,887	—	8,969,887	—
—	—	—	21,893,273
1,457,820	—	1,457,820	6,461,708
1,958,144	601,349	2,559,493	881,763
884,907	104,925	989,832	22,464
2,653,488	—	2,653,488	—
501,409	(501,409)	—	—
76,900,977	204,865	77,105,842	29,259,208
(3,114,286)	3,219,885	105,599	3,202,656
126,673,160	82,349,309	209,022,469	16,025,971
$123,558,874	$85,569,194	$209,128,068	$ 19,228,627

Exhibit A-3
Government-wide Statement of Net Assets
Combined with Governmental Fund Balance Sheet
(Adapted from GASB Statement No. 34, Appendix C, Exhibit A-4)

Sample County Fire Protection District
Governmental Funds Balance Sheet/Statement of Net Assets
June 30, 2002

	General Fund	Other Funds	Total	Adjustments	Statement of Net Assets
ASSETS					
Cash and investments	$6,505,557	$1,211,192	$7,716,749	$ —	$ 7,716,749
Taxes receivable	1,427,885	52,651	1,480,536	—	1,480,536
Other receivables	567,607	6,874	574,481	—	574,481
Internal receivables	—	12,293	12,293	(12,293)	—
Prepayments	7,763	—	7,763	—	7,763
Inventories	197,308	—	197,308	—	197,308
Capital assets, net of accumulated depreciation	—	—	—	5,519,206	5,519,206
Total assets	$8,706,120	$1,283,010	$9,989,130	5,506,913	15,496,043
LIABILITIES					
Accounts payable	$ 73,828	$ 33,171	$ 106,999	—	106,999
Salaries and benefits payable	273,367	—	273,367	—	273,367
Accrued interest payable	—	1,294	1,294	217	1,511
Internal payables	12,293	—	12,293	(12,293)	—
Deferred revenues	1,534,321	42,791	1,577,112	(1,303,366)	273,746
Long-term liabilities					
Due within one year	—	—	—	636,655	636,655
Due after one year	—	—	—	3,396,506	3,396,506
Total liabilities	1,893,809	77,256	1,971,065	2,717,719	4,688,784
FUND BALANCES/NET ASSETS					
Fund balances:					
Reserved for inventories	197,308	—	197,308	(197,308)	—
Unreserved, reported in:					
General fund	6,615,003	—	6,615,003	(6,615,003)	—
Debt service funds	—	468,167	468,167	(468,167)	—
Capital projects funds	—	737,587	737,587	(737,587)	—
Total fund balances	6,812,311	1,205,754	8,018,065	(8,018,065)	—
Total liabilities and fund balances	$8,706,120	$1,283,010	$9,989,130		
Net assets:					
Invested in capital assets, net of related debt				2,087,848	2,087,848
Restricted for debt service				468,167	468,167
Unrestricted				8,251,244	8,251,244
Total net assets				$10,807,259	$10,807,259

Exhibit A-4

Government-wide Statement of Activities Combined with Governmental Fund Statement of Revenues, Expenditures, and Changes in Fund Balances (Traditional Format) (Adapted from GASB Statement No. 34, Appendix C, Exhibit B-7)

Sample County Fire Protection District
Statement of Governmental Fund Revenues, Expenditures, and Changes in Fund Balances/Statement of Activities
For the Year Ended June 30, 2002

	General Fund	Other Funds	Total	Adjustments	Statement of Activities
Revenues:					
Property taxes	$10,750,111	$ 391,442	$11,141,553	$ 270,601	$11,412,154
Investment earnings	526,079	71,582	597,661	—	597,661
Charges for services	622,590	—	622,590	—	622,590
Miscellaneous	29,245	—	29,245	—	29,245
Total revenues	11,928,025	463,024	12,391,049	270,601	12,661,650
Expenditures/expenses:					
Current:					
Personal services	9,434,005	—	9,434,005	6,018	9,440,023
Materials and services	1,250,788	—	1,250,788	—	1,250,788
Depreciation	—	—	—	306,623	306,623
Capital outlay	76,090	219,175	295,265	(295,265)	—
Debt service:					
Principal	5,452	220,000	225,452	(225,452)	—
Interest	1,534	204,028	205,562	217	205,779
Total expenditures/ expenses	10,767,869	643,203	11,411,072	(207,859)	11,203,213
Excess (deficiency) of revenues over expenditures	1,160,156	(180,179)	979,977	478,460	—
Other financing sources/uses:					
Transfers—internal activities	(500,000)	500,000	—	—	—
Excess (deficiency) of revenues and transfers in over expenditures and transfers out	660,156	319,821	979,977	(979,977)	—
Change in net assets	—	—	—	1,458,437	1,458,437
Fund balances/net assets:					
Beginning of the year	6,152,155	885,933	7,038,088	—	9,348,822
End of the year	$ 6,812,311	$1,205,754	$ 8,018,065	$ 0	$10,807,259

Appendix B—Government-wide Financial Statements: Table of Basic Features

The following table describes the basic features of the government-wide financial statements. See the referenced Q&As for additional details.

Feature	*Description and Q&A Number*
Required financial statements	Statement of net assets and statement of activity (Q&A 8)
Measurement focus and basis of accounting	Economic resources and accrual (Q&A 9)
Scope	The primary government and its component units, except for fiduciary funds and fiduciary component units; all assets and liabilities, including capital assets and infrastructure and long-term liabilities (Q&As 8 and 9)
Level of aggregation	Primary government governmental activities Primary government business-type activities Total primary government Discretely presented, nonfiduciary component units (Q&A 8)
Format—statement of net assets	Net assets format or balance sheet format (Q&A 18)
Classifications—statement of net assets	Assets and liabilities: either in order of their relative liquidity or classified as between current and long-term (Q&A 18) Net assets (the difference between assets and liabilities): classified in three components—"invested in capital assets, net of related debt," "restricted," and "unrestricted" (Q&As 18 and 19)
Format—statement of activities	Net (expense) revenue of individual functions, followed by the general revenues, contributions to term and permanent endowments, contributions to permanent fund principal, special and extraordinary items, and transfers, resulting in the change in net assets for the period (Q&A 20)

Feature	*Description and Q&A Number*
Classifications—statement of activities	Expenses: reported at a minimum by function or segment, except special and extraordinary items. At a minimum, expenses include direct expenses; they also may include some or all of the function's indirect expenses. Depending on the circumstances, depreciation on capital assets and infrastructure and interest on general long-term liabilities may be reported as direct expenses, indirect expenses, or separate line items. (Q&As 21 through 23)
	Revenues: separately reported as program revenues and general revenues (Q&A 24)
Internal activity and balances	Generally, eliminated or reclassified (Q&A 26)
Other	Activity and balances between the primary government and its discretely presented, non-fiduciary component units: reported like external transactions (Q&A 27)

Appendix C—Fund Financial Statements: Table of Basic Features

The following table describes the basic features of the fund financial statements. See the referenced Q&As for additional details.

Feature	*Description and Q&A Number*
Fund categories and types	Governmental funds: general, special revenue, capital projects, debt service, and permanent Proprietary funds: enterprise and internal service Fiduciary funds: pension (and other employee benefit) trusts, investment trusts, private-purpose trusts, and agency (Q&A 29)
Required financial statements	Governmental funds: balance sheet and statement of revenues, expenditures, and changes in fund balances (Q&A 33) Proprietary funds: statement of net assets (or balance sheet); statement of revenues, expenses, and changes in fund net assets (or fund equity); and statement of cash flows (Q&A 33) Fiduciary funds: statement of fiduciary net assets and statement of changes in fiduciary net assets (Q&A 46)
Measurement focus and basis of accounting	Governmental funds: current financial resources and modified accrual (Q&A 36) Proprietary funds: economicresources and accrual (Q&A 40) Fiduciary funds: generally, economic resources and accrual (Q&A 47)
Scope	All funds of the primary government, including its blended component units, as well as all fiduciary component units, but not general capital assets or general long-term liabilities (Q&As 3 and 37)

Feature	*Description and Q&A Number*
Aggregation	Governmental funds: general fund, other major governmental funds, aggregate nonmajor governmental funds, and total governmental funds (Q&A 34)
	Proprietary funds: major enterprise funds, aggregate nonmajor enterprise funds, total enterprise funds, and aggregate internal service funds (Q&A 34)
	Fiduciary funds: fund type (Q&A 46)
"Position statement" format and classifications	Governmental funds: balance sheet format, with fund balances segregated into reserved and unreserved amounts (Q&As 33 and 38)
	Proprietary funds: net assets or balance sheet format, with the difference between assets and liabilities labeled either "net assets" or "fund equity." Assets and liabilities—classified as between current and noncurrent. Net assets classified in three components—"invested in capital assets, net of related debt," "restricted," and "unrestricted" (Q&A 42)
	Fiduciary funds: net assets format (Q&A 48)
"Operating statement" format and classification	Governmental funds: a specifically sequenced format of revenues, expenditures, other financing sources and uses, and extraordinary items, special and changes in fund balances. Classify revenues by major source and expenditures at a minimum by function (Q&A 39)
	Proprietary funds: A specifically sequenced format that distinguishes operating and nonoperating revenues and expenses. Classify revenues by major source and expenses by object (Q&A 43)
	Fiduciary funds: Additions to, deductions from, and net increase (or decrease) for the year in net assets (except for agency funds) (Q&A 48)
Interfund activity	Loans, services provided and used, transfers, and reimbursements (Q&A 50)

Appendix D—Definitions of Selected Terms

Following are brief definitions of selected terms used in the financial reporting model required by Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments.*

Balance sheet format—A format for the statement of financial position that displays assets equal liabilities plus net assets.

Basis of accounting—When the effects of transactions or events are recognized for financial reporting purposes. For example, the effects of transactions or events can be recognized on an accrual basis (when the underlying transactions or events take place) or on a cash basis (when cash is received or paid).

Business-type activities—Activities financed wholly or partially by fees charged to external parties for goods or services and usually reported in enterprise funds.

Component unit—A legally separate entity that is included in a primary government's financial reporting entity using the criteria of GASB Statement No. 14, *The Financial Reporting Entity.*

Direct expenses—Expenses that are specifically associated with a service, program, or department and thus clearly identifiable to a particular function (or some lower classification level presented in the statement of activities).

Extraordinary items—Transactions or other events that are both (1) unusual in nature and (2) infrequent in occurrence.

Function—Groups of related activities that are aimed at accomplishing a major service or regulatory responsibility (such as general government, public safety, and public works).

General revenues—All revenues that do not qualify as program revenues, including all taxes.

Governmental activities—Activities generally financed through taxes, intergovernmental revenues, and other nonexchange revenues and usually reported in governmental and internal service funds.

Indirect expenses—Expenses related to a function (or some lower classification level presented in the statement of activities) that are not direct expenses. For example, the general government function includes expenses that are, in essence, indirect expenses of other functions.

Internal (and interfund) activity and balances—Resource flows between the funds of the primary government, including its blended component units, fiduciary funds, and fiduciary component units.

Invested in capital assets, net of related debt—A component of net assets that consists of capital assets, reduced by accumulated depreciation and by any outstanding debt incurred to acquire, construct, or improve those assets.

Measurement focus—What is being expressed in reporting an entity's financial performance and position. A particular measurement focus is accomplished by considering not only which resources are measured, but also when the effects of transactions or events involving those resources are recognized (the basis of accounting).

Modified approach—Provisions that permit infrastructure assets that are part of a network or subsystem of a network not to be depreciated as long as certain management and documentation requirements are met.

Net assets—The difference between assets and liabilities.

Net assets format—A format for the statement of financial position that displays assets less liabilities equal net assets.

Net (expense) revenue—The expenses of functions (or some lower classification level presented in the statement of activities), reduced by program revenues relating to those functions.

Program revenues—Revenues that (1) originate from the program or from parties other than the government's taxpayers or citizens as a whole and (2) reduce the expenses of the function that has to be financed by general revenues.

Restricted net assets—A component of net assets that represents limitations on net asset use that are either (1) externally imposed by creditors, grantors, contributors, or laws or regulations of other governments or (2) imposed by the government's own constitutional provisions or enabling legislation.

Segment—An activity that has outstanding revenue bonds or other revenue-backed debt and that is reported as or within an enterprise fund or a stand-alone entity that uses enterprise fund accounting and reporting standards. A segment has a specific identifiable revenue stream pledged in support of its debt and has related assets, liabilities, expenses, gains, and losses that can be identified.

Special items—Significant transactions or other events within the control of management that are either (1) unusual in nature or (2) infrequent in occurrence.

Unrestricted net assets—A component of net assets that includes all net assets that do not meet the definition of either "invested in capital assets, net of related debt" or "restricted net assets."

About the Author

Venita M. Wood, CPA, CGFM, is an independent consultant in governmental accounting and auditing issues. Her practice involves technical writing and editing, developing and presenting training programs, and special projects. Her recent projects include an AICPA publication on applying OMB Circular A-133 and a GASB publication on applying Statement No. 31. Ms. Wood has experience as technical staff for the GASB and auditing governments with both an international accounting firm and a state auditor's office.

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