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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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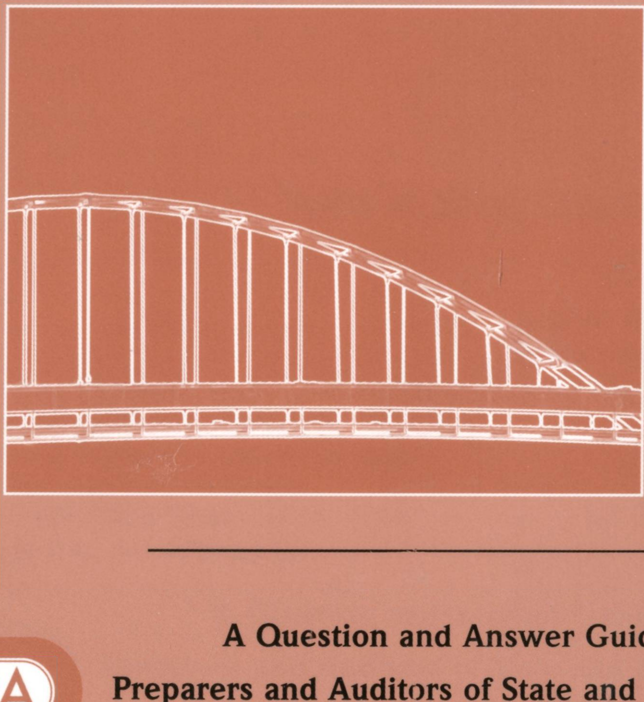
Leslye Givarz

Understanding and Implementing GASB's New Financial Reporting Model

Revised Edition



AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

AICPA

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

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AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Understanding and Implementing GASB's New Financial Reporting Model

Revised Edition

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AICPA

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Foreword

The AICPA's Accounting and Auditing Publications group thanks Venita M. Wood for revising *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.* We believe this publication is a valuable resource to our members and others involved with governmental accounting and auditing. We received many positive comments about the original version of this publication. Following is an excerpt of comments from Pamela W. Baker, CPA, a partner with Barbacane, Thornton & Company in Wilmington, Delaware.

> When the AICPA issued *Understanding and Implementing GASB's New Financial Reporting Model,* we immediately ordered several copies to provide our staff with a user-friendly and easy-to-follow format for understanding the basics of the new standard. This Q&A Guide has been the most complete, yet uncomplicated, explanation of the relevant aspects of GASB Statement No. 34. Of particular usefulness are the observations included throughout the text. These interpretations of how the new reporting standards affect the "real world" provide our staff with useful tools to assist our governmental clients in assessing the benefits of the new model.
>
> When hosting a client seminar to explain Statement No. 34, we turned to this Guide for use in putting a presentation together. The reception was overwhelming because our clients wanted the condensed, easy-to-follow Guide as opposed to the actual statement. Not only did we have a useful resource to make available to our clients, but it made for a great marketing tool as well when we affixed a sticker with our firm logo.
>
> The timeliness of the publication, the reader appeal, and the ability to take the technical matters further, through author observations, made the original edition of this publication one of the most used resource materials on the implementation of Statement No. 34. We look forward to this revised edition.

The AICPA is publishing this revised version to help you to keep abreast of the "latest and greatest" information about Statement No. 34. We hope that you, also, will find this to be a valuable resource.

Leslye Givarz
Technical Manager
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Preface

The Governmental Accounting Standards Board (GASB) issued Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments,* in 1999, after an almost decade-long effort to reexamine the financial reporting model for state and local governments. That Statement significantly changes the way state and local governmental entities report their financial statements. The most notable change is the presentation of a set of highly aggregated, "full accrual" financial statements. At the same time, however, the Statement retains many familiar features of previous governmental financial reporting standards, in particular fund-based financial statements.

Since Statement No. 34 was issued, the GASB and its staff have issued additional guidance about the new model. In addition, numerous governmental entities and other organizations have invested substantial time and money in considering the standards, communicating with others about them, and moving toward implementing them. A number of governments have implemented the standards early. Financial statement users with varying degrees of knowledge about financial reporting have found the new information resulting from Statement No. 34 to be useful.

Despite the progress made to date on implementing the Statement, there remains a long row to hoe. Many preparers and auditors still need to comprehend and implement Statement No. 34. These professionals will have to explain the changes to financial reporting to persons who are unfamiliar not only with the particulars of accounting, but also with 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 have already developed and provided materials to assist in that process, and they will continue to do so.

I wrote the original edition of this Question and Answer (Q&A) Guide as one of the first efforts to help preparers and auditors understand and implement Statement No. 34. The Accounting and Auditing Publications group of the AICPA has issued this revised edition, which considers additional guidance that has been issued and knowledge that has been attained since 1999, to provide nonauthoritative practical guidance. I hope you will find this revised Q&A Guide helpful in understanding and implementing Statement No. 34, whether you are new to the issues or already have given substantial thought to the process.

I wish to acknowledge those who reviewed drafts of this Q&A Guide and gave many helpful suggestions for improving it: Anna Maria Anderson, Mary McKnight Foelster, Mary Jo Koschay, Roberta Reese, Kenneth R. Schermann, and Jon Wise.

Venita M. Wood, CPA, CGFM
July 2001

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INTRODUCTION

Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments,* and the following related GASB pronouncements establish the standards for the new financial reporting model for state and local governments:

- Statement No. 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities*
- Statement No. 37, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Omnibus*
- Statement No. 38, *Certain Financial Statement Note Disclosures*
- Interpretation No. 6, *Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements*

The GASB staff also has issued *Guide to Implementation of GASB Statement 34 on Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments* (the Statement 34 Implementation Guide).[1]

The following questions and answers (Q&As) digest the contents of Statement No. 34 and its related pronouncements. The answers have parenthetical references to the relevant paragraphs in the standards section of the pronouncements. Commentary labeled "Observation" follows the digests to analyze the standards, refer to relevant items in the Statement 34 Implementation Guide, and present planning and implementation issues.

This Q&A Guide includes several appendixes. Appendix A shows a few of the numerous illustrative financial statements included in the

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

Statement 34 Implementation Guide. 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. It might be a good idea to review the features in those appendixes and the Glossary of Selected Terms before beginning to read through the questions and answers. Appendix D presents basic implementation steps as a starting point to develop an implementation plan. Appendix E lists some of the accounting and financial reporting policies that governments may need to establish or reconsider while implementing the new model. Appendixes B, C, and E are cross-referenced to the Q&As for additional detail.

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. The new model achieves that purpose by providing information that will meet or partially meet the accountability and other objectives in GASB Concepts Statement No. 1, *Objectives of Financial Reporting*. GASB Statement No. 34, appendix B, Basis for Conclusions, provides an extensive, nonauthoritative discussion of the concepts underlying the new financial reporting model. (GASB 34, ¶1-2)

2. To which 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). GASB Statement No. 35 made Statement No. 34 applicable to public (governmental) colleges and universities. (GASB 34, ¶3; GASB 35, ¶5)

OBSERVATION

Paragraph 1.12 of the AICPA Audit and Accounting Guide *Audits of State and Local Governmental Units* with Conforming Changes as of May 1, 2001, defines *governmental entities*. 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.

Certain component units[2] do not meet the definition of a government and consequently do not follow GASB standards in presenting their separate financial statements. However, GASB standards govern the presentation of financial information for component units, including nongovernmental component units, in a reporting entity's financial statements.

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). Appendixes B and C of this Q&A guide present the basic features of those financial statements.

The basic financial statements for general-purpose governments include the following:

- *Government-wide financial statements* report information for the reporting government as a whole (including its component units), 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.
- *Fund financial statements* for the primary government's governmental, proprietary, and fiduciary funds (including blended and fiduciary component units) 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 fund financial statements follow the government-wide financial statements.
- *Notes to the financial statements* disclose information essential for the fair presentation of the basic financial statements that

[2] Component units are defined in GASB Statement No. 14, *The Financial Reporting Entity*.

is not displayed in the financial statements. The notes are an integral part of the basic financial statements, and follow the fund financial statements.

See the further discussion of the basic financial statements and the notes in Q&As 8–57. Q&As 61–66 discuss the basic financial statements required for special-purpose governments.

MD&A is RSI that precedes and introduces the basic financial statements. (See Q&As 6–7.) Other RSI required by the new financial reporting model—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. (See Q&A 58.) (GASB 34, ¶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 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 financial reporting model continues to include fund-based financial statements, but with changes, as discussed later in this Q&A Guide. The new model also adds a highly aggregated set of government-wide financial statements. The government-wide financial statements 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 60.

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 that governments prepare and publish a comprehensive annual financial report (CAFR).[3] The scope of Statement No. 34 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. However, Statement No. 34 changes previous requirements for the CAFR[4] as needed to implement the basic financial statements. For example, 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 be presented in the CAFR's combining financial statements. (This is discussed in the Statement 34 Implementation Guide, item 158.) As another example, there likely will be changes in the CAFR's letter of transmittal because of the presentation of MD&A. See the discussion in the observation section at Q&A 6.

5. *When are governments required to implement GASB Statement No. 34 and its related pronouncements?*

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 enterprise 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 or more	2001
2	$10 million to $100 million	2002
3	Less than $10 million	2003

For public colleges and universities, revenues include all revenues of the primary institution. For purposes of identifying the appropriate implementation phase, revenues do not include extraordinary items as defined in Q&A 26 or other financing sources (or, for public colleges

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[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, 2001), section 2200, "Comprehensive Annual Financial Report."

and universities, additions to investment in plant). A special-purpose government that has only fiduciary activities (such as a public employee retirement systems—PERS) uses total annual additions, rather than revenues, to determine its implementation phase.

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 the unit's total revenues and even if its primary government implements the Statement early.

The effective dates of GASB Statement No. 37 and No. 38 and Interpretation No. 6 generally coincide with the effective date of Statement No. 34 for individual governments. As discussed in Q&A 56, some of the disclosures required by Statement No. 38 are delayed by one year for phase 1 governments, and earlier application of many of the disclosures is encouraged, even though Statement No. 34 is not yet applied. (GASB 34, ¶142-143; GASB 35, ¶6-8; GASB 37, ¶20; GASB 38, ¶16; GASBI 6, ¶19)

Q&A 67 discusses the transition requirements for Statement No. 34 and its related pronouncements. Special effective date and transition rules apply for reporting general infrastructure assets. See Q&A 17.

OBSERVATION

GASB Statements No. 34, No. 37, and No. 38 and GASB Interpretation No. 6 affect reported financial information as of the first date of the fiscal year in which the pronouncements are applied. For example, phase 2 governments with June 30 fiscal year ends have to capture beginning balances using the new standards as of July 1, 2002; their independent auditors have to audit those beginning balances. Preparers also need to decide whether to implement early.

A government's implementation phase is based on its total annual revenues in the first fiscal year ending after June 15, 1999. Different annual revenues in subsequent years cannot move it to a different phase.

Some governments did not prepare their financial statements in conformity with generally accepted accounting principles (GAAP) in the first fiscal year ending after June 15, 1999. They may have presented their financial statements using a cash or modified cash basis of accounting (an other comprehensive basis of accounting—OCBOA) or they may not have included all of the funds, organizations, or other parts of the primary government and blended component units as defined in GASB Statement No. 14, *The Financial Reporting Entity.* Therefore, those governments do not have the GAAP-based measure of total annual revenues that they need to determine their appropriate implementation phase. The presumption of the effective date provisions of Statement No. 34 is that the revenue amounts are measured in conformity with GAAP. Even governments that intend to continue to present cash or modified cash OCBOA financial statements have to determine their implementation phase. This situation occurs because SAS No. 62, *Special Reports* (AICPA, *Professional Standards,* vol. 1, AU sec. 623.10), requires that OCBOA financial statements communicate the information required by GAAP format and disclosure requirements. Such format and disclosure requirements include those arising from Statement No. 34 when that Statement becomes effective for the government.

Governments that did not prepare GAAP-basis financial statements in the first fiscal year ending after June 15, 1999, have to determine (for example, through estimation procedures) the GAAP-basis revenues for their governmental and enterprise funds for that period. (Component units also need to know their primary government's implementation phase to determine their own phase.) However, in the absence of unusual events, such as nonrecurring revenues or significant changes in cash collection patterns, a government's cash- or modified cash-basis revenues may not differ significantly from GAAP-basis revenues. Why? Because all measures of annual revenues usually contain twelve months of activity. Further, a government may not have to be precise in determining GAAP-basis annual revenue if its revenues are significantly above or below the threshold for a particular implementation phase. For example, if a government had $50 million in cash-basis revenues in its governmental and enterprise funds in the first fiscal period after June 15, 1999, highly unusual events would have had to occur to move that entity out of the $10 million to $100 million implementation phase (phase 2).

Planning Tips

Primary governments and component units need to coordinate the implementation of Statement No. 34. Coordinating implementation is especially important if the primary government is considering early implementation or if the component unit's fiscal year ends during the primary government's fiscal year.

The three implementation phases apply separately to component units by reference to the units' own annual revenues. In addition, Statement No. 34 encourages component units to implement its standards earlier than their required phase. Therefore, some component units may implement the Statement before their primary governments do. However, that should not cause significant problems with incorporating a component unit's financial information into the reporting entity's financial report as discussed in the Statement 34 Implementation Guide, item 265.

There are several "big picture" implementation issues about the new financial reporting model that preparers and auditors should consider immediately, even though implementation for individual governments or for particular provisions of the standards may be a few years off. (Appendix D of this Guide lists basic implementation steps as a starting point for developing an implementation plan.) Preparers and auditors could obtain training on the new model from the AICPA, state CPA societies, or other professional organizations. They also could gain insights from others who have implemented or are in the process of implementing the new model; various organizations are publishing articles about implementation experiences or sponsoring question and answer bulletin boards on their Internet sites. In some states, regulatory agencies (such as state auditors' offices) or professional organizations are developing uniform implementation guidance for local governments that address, for example, how to classify certain federal and state grants as program revenues and what roads should be reported by different types of governments. The GASB Internet site at www.gasb.org has a Statement No. 34 implementation area that includes a calendar of training sessions, a bibliography of relevant articles, links to relevant Internet sites, and a list of governments that have implemented the Statement, with links to electronic versions of many of their financial statements.

Further, preparers and auditors could discuss the requirements and implications of the new model with the government's management and governing 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 new standards.

The financial statement preparer should consider developing an implementation plan that includes input from and consultation with the government's independent auditor, management and the governing board, individual agencies and departments, and component units and their independent 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 one-time and ongoing effects of implementation. Finally, preparers and auditors should watch for the GASB's issuance of additional implementation guidance. The GASB staff is planning to issue another implementation guide on Statement No. 34 during the winter of 2001–2002.

Further Considerations

Some individuals 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 how audit planning and reporting materiality might change. The AICPA is considering those issues and plans to issue a revised Audit and Accounting Guide for state and local governments, including public colleges and universities, during 2002.

Finally, implementing Statement No. 34 might not be a single-year issue. Processes and policies adopted in the initial year may need adjustment as understandings of the standards deepen with experience. Deepened understanding may require corrections of errors or changes in estimates in future years. Further, some governments may want to keep it simple in the first year and tackle additional "enhancements" later. For example, although a government may want to allocate indirect expenses among functions in the government-wide statement of activities, it may decide to wait until the second or third year, after it has mastered the "fundamentals."

Detailed Discussion

Management's Discussion and Analysis

6. What information does MD&A present?

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. The MD&A discussion is confined to the specific topics required by GASB Statement No. 34, although governments can provide additional details about those required topics. A government can present information that does not relate to the required topics elsewhere, such as in the letter of transmittal or in other forms of supplementary information. Among the topics that Statement No. 34 requires for the 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 (or its equivalent).
- A description of currently known facts, decisions, or conditions that are expected to have a significant effect on financial position or results of operations.

MD&A focuses on the primary government (including its blended component units). However, MD&A also includes information relating to discretely presented, nonfiduciary component units based on professional judgment and on an individual unit's significance to the total of all such units and that individual unit's relationship with the primary government. MD&A distinguishes between primary government and component unit information. When appropriate, MD&A refers to the component unit's separately issued financial statements. (GASB 34, ¶8–11; GASB 37, ¶4 and 5)

OBSERVATION

The previous listing highlights only some of the GASB's MD&A requirements. Preparers and auditors should consult GASB Statement No. 34, as amended by Statement No. 37, for additional requirements and details. They also should be careful to note that nonrequired information should not be presented in MD&A.

A government's MD&A should include only those required discussions that are relevant or applicable. For example, the MD&A of a stand-alone business-type activity that does not have a budget cannot present the budgetary analysis, and need not explain the reason for not making that presentation.

A government's MD&A should not attempt to predict the future. The discussion of currently known facts, decisions, or conditions should be based on events that have already occurred, or decisions that have been enacted, adopted, agreed upon, or contracted for as of the date of the auditor's report. Item 13 in the Statement 34 Implementation Guide gives examples of items that are and are not currently known facts, decisions, or conditions.

MD&A requires 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.

Some governments issue their financial statements with a letter of transmittal. Some information previously presented in a letter of transmittal could be similar to the information Statement No. 34 requires to be presented in MD&A. Statement No. 34 recommends against redundancy, and the Statement 34 Implementation Guide, item 7, suggests that, in areas where duplication could occur, the letter of transmittal could refer to the relevant discussion in MD&A and add insights that may go beyond the boundaries of MD&A. That Implementation Guide item also says that the letter of transmittal could be used to discuss plans and other information that may not meet the "currently known facts, conditions, or decisions" criterion for MD&A. Preparers could plan to review the structure of their letters of transmittal to identify potential overlap with the MD&A requirements. The GASB has not established authoritative requirements for letter of transmittal contents, but organizations that administer financial reporting certification programs are revising their guidelines for letters of transmittal.

The Statement 34 Implementation Guide, item 6, indicates that in a CAFR, the letter of transmittal should precede the MD&A. There is no requirement about where MD&A should be 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 implies that it is covered by the opinion on the financial statements.

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 they implement GASB Statement No. 34. 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 in the implementation year. (GASB 34, ¶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); the statement of activities presents its activities during a period (like an operating statement). 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 PERS). 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) discretely 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 in part 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 57. 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. (GASB 34, ¶12–15)

See Q&As 19–21 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 consolidate all of a government's activities and balances as a single entity. However, those financial statements also do not disaggregate financial information into separate funds.

GASB Statement No. 34 describes governmental and business-type activities in terms of their sources of financing. However, it also indicates that fund classification generally 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. However, governments could realign their activities (for example, reporting an enterprise fund operation with governmental activities) if they believe that realignment more faithfully represents operating activities and philosophies. A government would explain such realignments in the reconciliations from the fund financial statements to the government-wide financial statements as discussed in Q&A 51.

Although Statement No. 34 does not change the organizations that are component units, it does change how component units are presented by treating fiduciary component units differently than nonfiduciary component units. Q&A 47 discusses 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. In addition, 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 MFBAs. Statement No. 34 does not combine different MFBAs in a single financial statement.

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, *Accounting and Financial Reporting for Nonexchange Transactions,* as amended. Q&As 11–18 discuss the accounting for capital assets. (GASB 34, ¶12e and 16)

OBSERVATION

Recognition and reporting standards for many nonexchange transactions, including income, sales, property, and other taxes; contributions; certain grants; and fines, are established in GASB Statement No. 33, as amended. That Statement provides standards for both the government-wide and the fund financial statements. Governments have implemented Statement No. 33 in their fund financial statements. However, when Statement No. 34 is implemented, they have to apply Statement No. 33 in the government-wide financial statements.

Governments have applied Statement No. 33 to governmental fund revenues using a modified accrual basis of accounting. Therefore, they 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 governments 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.)

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

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. (GASB 34, ¶17)

Governments do not have to apply all previous GASB and nonconflicting, noncontradictory private-sector pronouncements retroactively to governmental activities. See the discussion at Q&A 67.

OBSERVATION

GASB Statement No. 34's requirements for applying GASB and private-sector pronouncements to business-type activities are the same as those previously established for proprietary activities by GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting.* The Statement 34 Implementation Guide, item 20, clarifies that the option to apply post-November 30, 1989, FASB pronouncements to business-type activities is based on the election made for the underlying enterprise funds. (That is, governments do not make an additional separate election to apply post-November 30, 1989, FASB pronouncements to business-type activities in the government-wide statements.) Therefore, governments already have policies in place and experience in applying those pronouncements to business-type activities.

There are, however, issues relating to applying GASB and private-sector pronouncements to governmental activities. Because governmental activities report transactions using a different MFBA than do the governmental funds, some GASB and private-sector pronouncements that are required to be applied to governmental activities can not be applied to the same transactions when they are reported in the governmental funds. However, certain private-sector pronouncements that are required to be used to report governmental activities still could be applied in the governmental funds, even though there is no requirement to do so, because they represent other accounting literature that does not conflict with or contradict GASB standards. Applying those nonconflicting, noncontradictory private-sector standards in the governmental funds will minimize complexities in accounting policies and the required reconciliations between governmental funds and governmental activities (see Q&A 51).

Statement No. 34 does not extend the option to apply post-November 30, 1989, FASB pronouncements to governmental activities, even though governmental activities are 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. (Statement No. 34 also does not extend the option to apply post-November 30, 1989, FASB pronouncements to internal service funds. See Q&A 42.)

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 based on the application of those pronouncements in the units' own government-wide financial statements.

GASB publications do not provide a comprehensive listing of whether and how individual GASB and private-sector pronouncements apply in the government-wide financial statements. Occasionally, GASB publications address individual pronouncements. For example, footnotes 12 and 13 of Statement No. 34 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.* Further, on its Internet site 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 can be a useful resource for preparers and auditors as new FASB pronouncements become effective.

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. Capital assets 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.

Several of the standards in GASB Statement No. 34 are applied to networks or subsystems of capital assets, as discussed later in this Q&A Guide. GASB Statement No. 34 defines a *network of capital 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." The Statement also defines a *subsystem of a network of capital 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."

Capital assets are reported in the statement of net assets at historical cost (or estimated fair value, if donated). The amount capitalized includes ancillary charges to place the assets into their intended location and condition for use, such as freight and transportation charges, site preparation costs, and professional fees. Q&A 12 discusses how to estimate the historical costs of capital assets.

Capital assets are depreciated in the statement of activities over their estimated useful lives unless they are (1) inexhaustible, as discussed in Q&A 13; (2) infrastructure assets accounted for using the modified approach, as discussed in Q&A 15; or (3) noncapitalized collections of works of art, historical treasures, and similar assets, as discussed in Q&A 18. Q&As 14 and 23 discuss the calculation and reporting of depreciation expense.

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. Q&A 53 discusses capital asset disclosures. (GASB 34, ¶18-22 and 154; GASB 37, ¶6)

OBSERVATION

Although capital assets are assets with useful lives that extend beyond a single reporting period, in practice they usually are only those assets with useful lives of more than one year. For example, 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. However, preparers generally do not report such an asset as a capital asset because of materiality considerations.

Statement No. 34 does not prescribe a minimum level (threshold) for the capitalization of assets. Typically, a government's capitalization threshold correlates with its size. Governments may establish different capitalization thresholds for different classes of assets, subsystems, or networks. For example, they may establish a higher threshold for infrastructure assets (given their large dollar cost and normally stationary nature) and a lower one for vehicles, machinery, and equipment. The government also may establish different thresholds for management control purposes or for compliance with laws and regulations, such as grant requirements. For example, a government may tag and inventory certain capital assets, such as computers and other electronic equipment, that cost less than the capitalization threshold but that are susceptible to misappropriation. (As discussed in Q&A 52, GASB Statement No. 34 requires that a government disclose its policy for capitalizing assets. That disclosure would include information about the capitalization threshold.)

In considering the requirements of 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.

Reporting Considerations for General Capital Assets

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 management and the governing board, departments and agencies, component units, independent auditors, and others involved with the financial reporting process as they plan the policies and procedures needed to implement those requirements. In addition, preparers should consider the extent to which they need consultants and new accounting systems to implement those requirements and the types of documentation they should retain to support recorded amounts.

Although the GASB recognizes that capitalizing and depreciating general capital assets will require substantial implementation efforts, it believes that this process is an essential element of preparing the government-wide financial statements using the long-term, economic focus. Statement No. 34 establishes various provisions, including special transition provisions, as discussed in Q&As 12–18, to minimize the effort and cost of capitalizing and depreciating 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 (1) the threshold for capitalizing assets, (2) the types of costs to capitalize as improvements versus the types of costs to expense as maintenance, and (3) the types of ancillary costs to capitalize. In addition to those costs listed in Statement No. 34, ancillary costs might include, for example, closing costs on the purchase of land and buildings; attorney and architect fees; internal costs of labor and material to construct or install the assets; and building permits and inspection fees. Many governments previously have reported capital assets in their financial statements, except perhaps for general infrastructure assets. However, those governments previously may not have included the ancillary costs 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.

Statement No. 37 deletes the requirement in paragraph 18 of Statement No. 34 that the cost of capital assets include capitalized interest. The GASB made that deletion because it found that allocating construction-period interest expense to the cost of general capital assets would be contradictory to other provisions of Statement No. 34. However, even though Statement No. 34, as amended, no longer specifically states so, governments should capitalize construction-period interest on business-type capital assets. Capitalization requirements concerning construction-period interest arise from FASB Statements issued before November 30, 1989, that do not conflict with or contradict GASB pronouncements. The Statement 34 Implementation Guide, item 31, explains the relevant provisions of FASB Statement No. 34, *Capitalization of Interest Cost*, and No. 62, *Capitalization of Interest Cost in Situations Involving Certain Tax-Exempt Borrowings and Certain Gifts and Grants.*

Although footnote 67 to paragraph 154 of Statement No. 34 states that a government with the primary responsibility for managing an infrastructure asset reports that asset, the Statement 34 Implementation Guide, item 286, clarifies that the "responsibility" provision applies only if ownership of the asset is unclear. Therefore, as is the case with other capital assets, the government that owns the infrastructure assets should report them. Various sources—title documents, plat maps, capital grant agreements, accounting records for maintenance and repair costs, board minutes, engineering department logs, and maintenance department work orders—could provide support for the government's ownership of or (if ownership is unclear) responsibility for managing infrastructure assets.

The Statement 34 Implementation Guide, item 32, clarifies that construction in progress is a capital asset and is reported in the statement of net assets with other assets that are not being depreciated. ("Construction in progress" generally is a separate asset class that might be displayed in the statement of net assets and that is disclosed in the notes to the financial statements.) Further, item 33 indicates that accumulated depreciation in the statement of net assets may be netted against capital assets or may be reported separately. This item also clarifies that, regardless of the presentation in the statement of net assets, the notes to the financial statements should disclose accumulated depreciation as described in Q&A 53.

Preparers need to consider intangible capital assets during the implementation process. Statement No. 34 does not provide examples of intangible capital assets. Generally, however, intangible capital assets include capital leases and may include natural resource rights, such as water, oil, natural gas, and timber rights. Intangible capital assets, like other capital assets, are capitalized at historical cost or estimated fair value, if donated.

12. How might the historical cost of capital assets be determined?

GASB Statement No. 34 states that if determining actual historical cost is not practical because of inadequate records, governments may estimate the costs of existing general infrastructure assets at implementation using any approach that complies with the intent of the Statement.

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. (GASB 34, ¶149, 155, and 157–160)

OBSERVATION

GASB Statement No. 34 only addresses methods of estimating the historical cost of general infrastructure assets—infrastructure assets associated with governmental activities. Some governments may not have capitalized other capital assets (such as infrastructure assets associated with business-type activities or noninfrastructure assets associated with governmental activities) as previously required by GAAP. If a government has to capitalize previously owned capital assets other than general infrastructure assets to conform to GAAP, estimates that materially represent historical cost may have to be used if determining the actual historical cost is not practical. For that purpose, governments could use the estimating techniques described for general infrastructure assets in Statement No. 34 and illustrated in exercises 8 and 9 in appendix 4 of the Statement 34 Implementation Guide. Or, governments could use other appropriate estimating techniques. However, Statement No. 34, paragraph 155, states that general infrastructure assets acquired after the effective dates of the Statement should be reported using historical costs. Therefore, a government's ultimate objective should be to record actual historical cost for its capital assets as they are acquired or constructed.

Besides the alternative sources described in Statement No. 34, other sources for estimating the historical cost of capital assets are prior-year governing board minutes and reports filed with the grantor agencies that financed the assets.

Preparers may need to obtain the assistance of specialists to estimate the historical cost of capital assets. Statement on Auditing Standards (SAS) No. 73, *Using the Work of a Specialist* (AICPA, *Professional Standards,* vol. 1, AU sec. 336), provides guidance to auditors concerning the use of specialists.

13. What are inexhaustible capital assets that are not depreciated?

OBSERVATION

The Statement 34 Implementation Guide, item 27, defines an inexhaustible capital asset as one whose economic benefit or service potential is used up so slowly that its estimated useful life is extraordinarily long. GASB Statement No. 34, paragraph 21, identifies land and land improvements as inexhaustible assets that are not depreciated. The Implementation Guide, item 25, states that land improvements are betterments, other than buildings, that ready land for its intended use and include, for example, site improvements such as excavation, fill, grading, and utility installation; removal, relocation, or reconstruction of property of others, such as railroads and telephone and power lines; retaining walls; parking lots; fencing; and landscaping. Item 27 of the Implementation Guide clarifies that only *certain* land improvements are inexhaustible. Item 46 of the Implementation Guide states that fill and grading costs that ready land for the erection of structures and landscaping produce permanent benefits and are not depreciable. Alternatively, parking lots and fencing are considered part of a structure or deteriorate with use or the passage of time and, therefore, are depreciable. Certain works of art, historical treasures, and similar assets also are inexhaustible capital assets. See Q&A 18.

14. 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) groups of assets of the same class, (3) networks of assets, or (4) subsystems of networks. (Q&A 11 defines *networks* and *subsystems.*)

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. Statement No. 34 discusses methods of calculating a composite depreciation rate. 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. (GASB 34, ¶22, 161, and 163–166)

OBSERVATION

The Statement 34 Implementation Guide provides additional guidance on depreciation. The Implementation Guide uses the term *residual value* instead of the term *salvage value* as was used in Statement No. 34 and defines *residual value* as the estimated fair value of a capital asset remaining at the conclusion of its estimated useful life. Item 45 of the Implementation Guide states that, in most cases, many infrastructure assets probably will have no residual value, given the cost of demolition or removal.

GASB Statement No. 34 indicates that to estimate useful lives, a government could look to the lives used by other governments for comparable assets. A "comparable" asset would be a similar asset used in a similar manner under similar conditions. For example, a school district that uses a bus to transport school children for a few hours each weekday in a rural area is not used in a similar manner or under similar conditions as a transit district uses a bus to transport passengers throughout each day of the week in an urban area.

Item 47 of the Implementation Guide clarifies that even though it may be useful to consider the useful lives established by other governments or suggested by organizations, property management practices, asset usage, and other variables (such as weather) may significantly affect the useful lives that an individual government should use. Item 48 indicates that schedules of depreciable lives established by federal or state tax regulations generally are not intended to represent useful lives. Further, item 50 states that because many factors may affect the useful life of an asset, it may be appropriate for governments to periodically reassess the estimated useful lives they have assigned their capital assets.

GASB Statement No. 34 permits governments to use any established depreciation method. Such methods are discussed in various accounting textbooks and, as indicated in the Statement 34 Implementation Guide, item 44, include the straight-line method, decreasing-charge methods (declining balance, double-declining balance, and sum-of-the-years'-digits), increasing-charge methods (sinking fund and annuity methods), and unit of production or service methods.

The Statement 34 Implementation Guide provides an expanded explanation of composite depreciation methods in items 51 and 52 and illustrates their use in exercises 1 and 2 of appendix 4.

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. (See also exercise 8 in appendix 4 of the Statement 34 Implementation Guide.) 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. (A government does not record accumulated depreciation through the implementation date for general infrastructure assets accounted for using the modified approach. See Q&A 15.)

Governments may need to adjust their accounting systems to record the information needed to depreciate general capital assets, in particular, estimated salvage (residual) value and useful lives. However, some governments may not need to adjust their accounting systems. That is, some governments previously have calculated depreciation for general capital assets, but never reported the amounts in their financial statements because it was not required.

15. 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 that the government manage the infrastructure assets using a system with certain features. The asset-management 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 government itself may perform the condition assessments, or it may contract with another party to do them. 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 performs condition assessments on a cyclical basis, 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, a government capitalizes expenditures for additions and improvements to the infrastructure assets. Additions and improvements increase the original capacity or efficiency of assets rather than preserve their useful lives. All other expenditures are expensed in the period incurred.

If a government that has been using the modified approach no longer meets either of the two requirements discussed above, it depreciates the assets beginning with the next reporting period. That change, as well as a change from the depreciation method to the modified approach, is reported as a change in accounting estimate, meaning that depreciation is applied (or not) only prospectively, not retroactively.

For transition purposes, a government may begin to use the modified approach as long as at least one complete condition assessment is available and it documents that it is preserving the assets approximately at or above the intended condition level. (GASB 34, ¶23–26 and 152; GASB 37, ¶8)

Q&A 16 discusses RSI requirements when using the modified approach. Q&As 17, 52, and 53 discuss disclosures for governments that use or will use the modified approach.

OBSERVATION

During due process on GASB Statement No. 34, some respondents 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 has indicated it will 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 are not "used up" and, therefore, need not be depreciated. However, because Statement No. 34 does not require particular condition assessment methods or a particular or consistent condition level, infrastructure assets accounted for using the modified approach may experience some measure of "using up." However, the RSI information for those assets will provide certain information in that regard. See Q&A 16.

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 and business-type activities. (In fact, the modified approach has to be applied to a complete network or subsystem of infrastructure assets, even if some of the assets in the network or subsystem are reported with governmental activities and other of the assets in that network or subsystem are reported with enterprise funds and business-type activities.)

A government applies the modified approach to a complete network or subsystem of infrastructure assets. As a government is deciding how to group capital assets for reporting purposes, it should consider whether and how it would be applying the modified approach. For example, if a government is going to use the modified approach for some but not all of the infrastructure assets in a network, it should separate those it will depreciate from those to which it will apply the modified approach in a manner consistent with the definition of a subsystem.

The Statement 34 Implementation Guide, item 281, indicates that, if a government decides to use the modified approach for general infrastructure assets when implementing Statement No. 34, it capitalizes those assets at full estimated historical cost. That is, the government does not record accumulated depreciation on those assets. A government that chooses to use the modified approach for infrastructure assets that it previously has reported and depreciated in enterprise funds applies the approach prospectively. That is, the change has no retroactive equity effect and the government does not depreciate the assets in the future. It would be appropriate for any accumulated depreciation on those infrastructure assets to be netted with or closed into the capital asset account. If that is done, the effect of past depreciation is transparent when the government separately classifies the assets as nondepreciable assets in the statement of net assets (as discussed in Q&A 11).

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

Statement No. 34's use of the term *approximately* to describe the requirement for meeting the intended condition level allows flexibility. The actual condition levels do not have to equal or exceed the intended condition level; a small variance below the established level is permissible. Further, Statement No. 34 does not specify that a single complete condition assessment below the intended level breaches the condition requirement. The requirement to consider the results of the three most recent complete condition assessments requires a broader perspective for the evaluation and consideration of those three assessments together as a whole. Item 65 in the Statement 34 Implementation Guide discusses this point.

Statement No. 34 requires governments to perform complete condition assessments in a consistent manner. The Statement 34 Implementation Guide, item 255, states that consistency is achieved if the entire condition assessment is performed using the same condition assessment method, basis for the condition measurement, and measurement scale.[5] A government may change the method, basis, or scale before beginning the subsequent complete assessment. For example, if a government performs its condition assessment over a three-year cycle, and changes the method during the third year of the cycle, it would have to perform a condition assessment on all (or a statistical sample) of the subject assets during that third year using the new method. Alternatively, the government could complete the cyclical condition assessment using the old method and make the change at the beginning of the next assessment cycle.

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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."

If a government does not meet the requirements for continued use of the modified approach, it should begin depreciating the assets in the year after the year the requirement is not met, as a change in accounting estimate. (Item 63 of the GASB 34 Implementation Guide explains the reasons for treating this as a change in estimate.) Alternatively, if the government has not preserved the assets approximately at or above their intended condition level, it could establish and disclose a lower intended condition level and continue to use the modified approach.

With the modified approach, governments expense asset preservation costs, whereas they would capitalize those costs if they were depreciating the assets. The Statement 34 Implementation Guide, item 58, defines *preservation costs* as outlays that extend the useful life of an asset beyond its original estimated useful life, but do not increase the capacity or efficiency of the asset. Items 59 and 60 in the Implementation Guide explain that a government using the modified approach should use a reasonable approach to allocate the costs of reconstruction projects that both preserve and improve the infrastructure assets between expense and the cost basis of the asset.

Statement No. 34 permits governments to begin to use the modified approach with only one complete condition assessment. The Statement also requires governments to perform complete condition assessments at least every three years. Therefore, a government may adopt the modified approach with a single condition assessment that it completed up to two years before the year it implements the modified approach. It also may complete the condition assessment in the year it implements the modified approach. Because Statement No. 34 requires governments to capitalize newly acquired general infrastructure assets prospectively and other infrastructure assets retroactively when it otherwise implements the provisions of the standard, a government has to establish policies and procedures for applying the modified approach to those infrastructure assets at that time, or begin to depreciate those assets. That is, the extended transition provisions in Statement No. 34 (as discussed in Q&A 17) relate only to the capitalization and subsequent accounting for general infrastructure assets existing at the beginning of the period that Statement No. 34 is implemented. However, governments may adopt the modified approach instead of depreciation accounting in a later period as a change in accounting estimate, applied prospectively.

In considering whether to use the modified approach, preparers should consider consulting with those responsible for managing infrastructure assets. Those managers need to understand the management and documentation requirements of the standard. Preparers also should consult with management and the governing board about establishing and disclosing the condition level at which the government will maintain the infrastructure assets. Further, preparers should consider consulting with their independent auditors about policies and procedures relating to the modified approach. Auditors can expect an extensive discussion of the auditing issues relating to the modified approach in the 2002 revision of the AICPA Audit and Accounting Guide for state and local governments.

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

A government that uses the modified approach 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 15, those assessments have to be performed at least every three years.)
2. For the past five reporting periods, the annual estimate from 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 the modified approach, it presents the information for as many periods as it is available.

To support the information presented about the condition assessments, the government discloses in notes to the RSI (1) the basis for the condition measurement, (2) the measurement scale used to assess and report the condition, and (3) the intended condition level for preserving the assets. The government also discloses factors that significantly affect trends in the reported information, such as changes in the measurement basis, scale, and methods and in 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. (GASB 34, ¶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 have to obtain multiple years of information for RSI. However, if retroactive information is not available, GASB Statement No. 34 permits governments to present that information prospectively. Exhibit G-5 in appendix C of Statement No. 34 illustrates this RSI and the note disclosures. Q&A 60 discusses auditor involvement with RSI.

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17. 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 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. All governments are encouraged to report networks of nonmajor general infrastructure assets, but they are not required to do so.

Major general infrastructure assets are networks or subsystems of infrastructure assets (as defined in Q&A 11) 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.

Governments may limit retroactive application to only those major general infrastructure assets that they acquired, significantly reconstructed, or significantly improved in fiscal years ending after June 30, 1980.

During the transition, governments may partially implement retroactive reporting for networks of general infrastructure assets. That is, they may capitalize the actual or estimated historical cost of networks of general infrastructure assets for which they have information, without waiting until they have information for all the networks that they will capitalize. During the transition, governments also are required to 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. (GASB 34, ¶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.

A government's implementation phase for retroactive capitalization of general infrastructure assets is determined based on its total annual revenues in the first fiscal year ending after June 15, 1999. (See Q&A 5.) Different annual revenues in subsequent years do not move it to a different phase. Further, the Statement 34 Implementation Guide, item 270, explains that if a discretely presented component unit is a phase 3 government, it is not required to retroactively capitalize general infrastructure assets even though its primary government is in an earlier implementation phase.

Many governments did not report general capital assets in their financial statements in conformity with GAAP in the first fiscal year ending after June 15, 1999. Although the definition of major general infrastructure assets is based on a percentage of all general capital assets *reported* in the first fiscal year ending after June 15, 1999, the presumption of the standard is that the amounts were reported in conformity with GAAP. Therefore, phase 1 and 2 governments that did not report general capital assets in conformity with GAAP at that date do not qualify to limit retroactive capitalization to major general infrastructure assets unless they estimate the amount of GAAP-basis general capital assets that should have been reported. Auditors will have to perform procedures on those estimated prior-period amounts to determine whether they are in conformity with GAAP.

The Statement 34 Implementation Guide illustrates how to determine major general infrastructure assets in exercise 10 of appendix 4, including how preliminary cost estimates may be used to make that determination.

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. Further, Statement No. 34 requires governments to report certain activities in enterprise funds. (See Q&A 31.) Accordingly, some governments may report activities in enterprise funds that they previously reported in governmental funds. Some of those activities, such as water and sewer operations, have infrastructure assets that previously may not have been capitalized. In those situations, the infrastructure assets are *not* general infrastructure assets and, consequently, the Statement No. 34 concessions for general infrastructure assets do not apply to those assets. A government should capitalize all infrastructure assets of those enterprise funds when it first implements Statement No. 34, subject to materiality considerations.

Statement No. 34 permits the retroactive reporting of general infrastructure assets in stages based on networks of those assets. The Statement 34 Implementation Guide, item 275, points out that other phase-in strategies, such as by year of acquisition or by individual asset, are not permitted.

Preparers need to determine whether to use the additional transition time and other concessions that limit the retroactive capitalization of general infrastructure assets. 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.

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

Generally, GASB Statement No. 34 requires governments to capitalize these assets at historical cost, or fair value when donated, whether held as individual items or in a collection. However, governments are not required (although they are encouraged) to capitalize a purchased or donated collection (and additions to it) that meets all of three conditions. The three conditions 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 was capitalized at June 30, 1999, the government has to continue to capitalize that collection and any additions to it.

Governments that receive donations of works of art, historical treasures, and similar assets recognize revenues using the provisions of Statement No. 33. If a government adds those donations to noncapitalized collections, it also recognizes an equal expense.

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. Governments depreciate those assets.

Governments do not depreciate works of art, historical treasures, and similar assets that are inexhaustible, including those that they do not capitalize as discussed above. (See Q&A 13.) Q&A 53 discusses disclosures for collections. (GASB 34, ¶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 for previously owned collections. 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

19. What are the format requirements for 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 this Q&A Guide shows in exhibit A-1 in appendix A. 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 20. As discussed in Q&A 8, the statement of net assets presents financial information for governmental activities, business-type activities, and component units 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 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.
- If assets and liabilities in the statement of net assets are classified as between current and long-term, governments use the same

guidance as provided for that display in proprietary funds. See Q&A 43. (GASB 34, ¶30–31)

Q&As 53 and 56 discuss note disclosure requirements concerning long-term liabilities and aggregations of receivables and payables.

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. Although 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.

The Statement 34 Implementation Guide, items 82–84, provide additional guidance on the presentation of certain assets and liabilities under the liquidity and classification methods.

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

The government-wide statement of net assets displays net assets in three components: "invested in capital assets, net of related debt," "restricted," and "unrestricted."

1. *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.

2. *Restricted net assets.* This component is reported when constraints on the use of net assets are externally imposed, for example, by creditors, grantors, contributors, or the laws or regulations of other governments. This component also is reported when constraints are imposed by the government's own constitutional provisions or enabling legislation. *Enabling legislation* (1) authorizes a government to assess, levy, charge, or otherwise mandate payment of resources from external

resource providers and (2) includes a legally enforceable requirement that those resources be used only for the specific purposes in the legislation. For this purpose, enabling legislation is not 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.

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

The statement of net assets does not report management designations of net assets, which are internal constraints indicating that management does not consider them available for general operations. (GASB 34, ¶32–37)

Governments also display the three components of net assets in the proprietary fund statement of net assets (see Q&A 43). 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 39).

OBSERVATION

Restricted net assets generally will be different from amounts 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. Restrictions are based on external, legal constraints, whereas reserves are based on the amounts that a government has available for appropriation in the budgetary process and may include more than resources that are restricted. (See the further discussion about the difference between *reserved* and *restricted* in the Statement 34 Implementation Guide, item 200.) 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.

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. Exercise 3 in appendix 4 of the Statement 34 Implementation Guide illustrates how to convert fund balances in governmental funds to the components of net assets for the statement of net assets.

When governments issue debt to finance capital assets for other governments, the issuing government has a liability, but the other governments report the capital assets. The Statement 34 Implementation Guide, item 94, explains that the effect of such debt, which is not "capital-related debt," should be reported in the unrestricted component of net assets.

GASB Statement No. 34 does not provide standards for determining when a government has spent a restricted resource. 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 that regard is required. (See Q&A 52.)

The Statement 34 Implementation Guide, item 99, explains that the restricted component of net assets includes liabilities related to restricted assets. The Implementation Guide's appendix 4, exercise 3, indicates that a liability relates to restricted assets if (1) the asset results from incurring the liability or (2) the liability will be liquidated with the restricted assets. However, no category of restricted net assets can be negative. If liabilities related to restricted assets exceed those assets, no balance is reported and the negative amount is reported as part of unrestricted net assets.

Unexpendable restricted net assets should not include the effect of term endowments. The Statement 34 Implementation Guide, item 98, explains that although term endowments may be nonexpendable currently, they will become expendable in the future when the term expires.

Statement of Activities

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

The statement of activities 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 (expense) revenue of the functions, resulting in the "change in net assets" for the period. The statement reports special items separately before extraordinary items, if any. (See Q&A 26 for the definitions of special and extraordinary items, Q&A 50 for a discussion of transfers, and Q&A 27 for how transfers are reported in the statement of activities.) In addition, as discussed in Q&A 8, the statement of activities presents financial information for governmental activities, business-type activities, and component units separately. Exhibit A-2 in appendix A of this Q&A Guide shows a standard format for the statement of activities. 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 the activities accounted for in governmental funds at a minimum by function (which is the minimum level of detail required in the governmental fund statement of revenues, expenditures, and changes in fund balances). Functions group related activities that are aimed at accomplishing a major service or regulatory responsibility (such as general government, public safety, and public works). The statement of activities also presents the activities accounted for in enterprise funds at a minimum by "different identifiable activities." An enterprise fund activity is "identifiable" if it has a specific revenue stream and related expenses and gains and losses that are accounted for separately. Determining whether an activity is "different" generally is based on the goods, services, or programs provided by an activity, but may require professional judgment. Providing natural gas differs from supplying water or electricity, although all three are utility services. Conversely, separate water districts are not "different" activities, although they may serve different areas.

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 at a more detailed level than function if that detail is more useful without being significantly complex. That is, the statement could present information 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. (GASB 34, ¶38, 40, 53, and 56; GASB 37, ¶10 and 11)

OBSERVATION

The net (expense) revenue[6] for functions in the statement of activities reports the relative financial burden of each of the government's functions on its

[6] The net (expense) revenue of a function or program is sometimes referred to as its *net cost*.

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, paragraph 39, originally required the statement of activities to present business-type activities at least by segment. However, GASB Statement No. 37 superseded that requirement by replacing segments with "different identifiable activities." The GASB made that change because it found that the use of segments as the minimum requirement could provide either too much or too little detail for business-type activities.

Statement No. 37 also addresses the application of "different identifiable activities" by public colleges and universities reported in enterprise funds. It states that the various activities of those institutions—food service, bookstore, residence halls, and student unions—generally would not be required to be reported separately. Those various activities do not necessarily deliver a different product or service. Instead, those activities might be supplementary or secondary to the delivery of the primary service of higher education.

GASB Statement No. 34 allows governments to decide the level of detail, beyond the minimum requirements, to report in the statement of activities. Presenting additional detail in the statement of activities does not evoke a requirement to present similar, additional detail in the fund financial statements. Similarly, presenting additional detail in the fund financial statements does not evoke a requirement to present similar, additional detail in the statement of activities.

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 governmental fund financial statements. However, as discussed in Q&As 22–29, classifying revenues, classifying and allocating expenses, and reclassifying and eliminating internal activity involve new processes and, thus, implementation effort.

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 64. Paragraph 347 of the Basis for Conclusions of Statement No. 34 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 those final two presentations are shown on exhibits B-3 and B-4 in appendix C in Statement No. 34 and on exhibits 3 and 4 in appendix 3 in the Statement 34 Implementation Guide.

22. *What are the requirements for presenting expenses in the statement of activities?*

The statement of activities reports all expenses—for both governmental activities and business-type activities—by function except those that are special or extraordinary items, as discussed in Q&A 26. 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. The statement of activities reports many indirect expenses 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 23 and 24.) Governments need not allocate indirect expenses among other functions; however, they may allocate some or all of them. If indirect expenses are allocated, the statement of activities presents a column showing those allocations. It is optional to present a total column showing each function's expenses after those allocations.

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 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. (GASB 34, ¶41–43)

OBSERVATION

Financial statement preparers should review their existing expenditure and expense classification policies and processes to determine whether they are consistent with the GASB Statement No. 34 requirements for classifying direct expenses. Preparers also need to establish new policies and processes to classify expenses for depreciation and interest on general long-term debt, as discussed further in this Q&A Guide.

Further, 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 indirect expenses are allocated, preparers need to establish procedures for such allocations. Exhibit B-2 in appendix C of GASB Statement No. 34 and exhibit 2 in appendix 3 of the Statement 34 Implementation Guide include illustrative statements of activities that report indirect expenses allocated to functions.

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

The statement reports depreciation expense for capital assets (except for general infrastructure assets) for both governmental activities and business-type activities 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 22. 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. (GASB 34, ¶44–45)

Q&A 53 discusses required disclosures about depreciation expense.

OBSERVATION

The following table summarizes the requirements for reporting depreciation expense:

Type of Capital Asset	Reporting Requirement
General infrastructure assets	Separate line item (with appropriate account title) or direct expense of the "infrastructure" function (do not allocate as an indirect expense)
Other capital assets	
Capital assets specifically identified with a function or program	Direct expense of the function or program
"Shared" capital assets	Allocated among direct expenses of functions or programs
Capital assets that serve "essentially all" functions	Separate line item (with appropriate account title) or an expense of a "general" function (may be allocated as an indirect expense)

Preparers should develop policies and procedures for identifying those capital assets for which depreciation expense is a direct expense and for allocating depreciation expense as an indirect expense. They also should 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 an asset serves "essentially all" functions involves professional judgment. Guidance is provided in the Statement 34 Implementation Guide, item 107, which says that an asset that serves "essentially all" functions may be one that serves "many" functions, thus decreasing the ease, practicality, and usefulness of allocating depreciation among functions. Professional judgment also will affect 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 independent auditors when establishing policies on these issues.

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

Generally, the statement reports interest on general long-term liabilities as a separate line item rather than including it in the direct expenses of any function. If, however, any direct interest expense is reported in other functions (see the next paragraph), the separate line item, for example "interest on general long-term debt," is labeled to explain that situation. In addition, the government discloses the amount of direct interest expense that the separate line item excludes in the notes to the financial statements or on the statement. The government may allocate the separate line item for interest on general long-term debt as an indirect expense to other functions as discussed in Q&A 22.

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. (GASB 34, ¶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 is sometimes required, preparers should develop policies and procedures to do so. The Statement 34 Implementation Guide, items 111–113, provides examples of when reporting interest expense as a direct expense is and is not appropriate. For example, the interest on a lease of a capital asset is not a direct expense of the function that uses the capital asset. That is because the use of a capital lease was a financing decision and not essential to the creation or continuation of a program.

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 costs on those liabilities are direct expenses of the functions associated with them.

25. 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 (unless they are contributions to term or permanent endowments, contributions to permanent fund principal, or special or extraordinary items). A revenue's source generally indicates whether it is program or general revenues. The following table describes the four basic sources of revenues and indicates whether they are program or general revenues.

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) derive directly 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. These revenues are charges or fees and fines that derive directly from the function or program, and grants and contributions that are restricted to the function or program. The statement reports three categories of program revenues using the following or more-descriptive column headings: (1) charges for services, (2) program-specific operating grants and contributions, and (3) program-specific capital grants and contributions. Those categories are as follows:

- *Charges for services* is a broad category of program revenues that arises from charges to customers, applicants, or others who purchase, use, or directly benefit from the goods, services, or privileges provided, or are otherwise directly affected by the services. These revenues include fees charged for specific services, licenses and permits, operating special assessments, any other amounts charged to service recipients, and payments from exchange transactions with other governments. They also include fines and forfeitures because those amounts result from direct charges to those who are "otherwise directly affected" by a program or service, even though they receive no benefit.
- *Program-specific operating and capital grants and contributions* are revenues from mandatory and voluntary nonexchange trans-

actions[7] with external parties that are restricted for use in a particular program. (Q&A 20 discusses restrictions.)

- 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 recipient government discretion to use the resources for a program's operating or capital needs.
- Program-specific capital grants and contributions are capital assets and other resources that are restricted for capital purposes for a specific program.

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. A multipurpose grant that does not specifically identify the programs and amounts involved is reported as general revenues and not program revenues.

Charges for services are program revenues of the function that generates the revenue. (If the function that generates charges for service is not clear, governments need to adopt a classification policy for assigning those revenues and apply it consistently.) Grants and contributions are program revenues of the function to which the revenues are restricted.

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 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. The statement of activities reports general revenues at the bottom after the total net (expense) revenue of the government's functions. It also reports taxes by type of tax. (GASB 34, ¶47–48 and 50–53; GASB 37, ¶11–13)

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

OBSERVATION

Classifying amounts as program and general revenues is a new concept in governmental accounting, but GASB Statement No. 34, as amended, clearly defines the distinctions between the two revenue types. Preparers need to develop policies and procedures for revenue classification. That task may be time-consuming and require some judgments.

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 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 derive directly from that function. If the statement of activities is presented at a program level, *program revenues* are revenues that derive directly 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 finances 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 the statement reports program revenues from capital grants separately from program revenues from operating grants.

All taxes that a government levies or imposes on its own taxpayers 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. Although 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.

The Statement 34 Implementation Guide provides various examples of and explanations about when governments should classify particular revenues as program revenues, general revenues, or some other revenue type.

26. 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. (GASB 34, ¶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 develop policies and procedures for identifying special and extraordinary items. A government's accounting system may not easily capture these items and the government may need to make 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 36. The statement of activities reports special and extraordinary items separately after the total net expenses of the functions; see Q&A 21.

The Statement 34 Implementation Guide, item 141, provides various examples of transactions or other events that may qualify as special or extraordinary items. For example, a large, private bequest to a small government or the costs relating to the cleanup of a large chemical spill in a small city might be extraordinary items. Sales of certain general capital assets and the costs of an early-retirement program might be special items. The Implementation Guide, item 205, explains that a government could report a transaction as a special or extraordinary item in the fund financial statements but not in the statement of activities (or vice versa). For example, a general capital asset could be sold for a large amount (and reported as a special item in the governmental funds), but result in a negligible gain or loss (and thus not be significant enough for separate reporting as a special item in the statement of activities).

Internal and Intra-entity Activity and Balances

27. 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, governments reclassify or eliminate some of those internal amounts.

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 vice 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 29 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 that 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 22.)

- 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.) (GASB 34, ¶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.) Governments eliminate certain internal activity and balances in the government-wide financial statements to avoid the inappropriate "doubling up" effects those activities and balances would otherwise have on aggregated amounts. However, because not all internal activity is eliminated, the aggregation in the statement of activities is not equivalent to a consolidation.

Eliminating and reclassifying interfund activities and balances may require extensive effort when the financial statements are prepared. Preparers should develop policies and procedures for handling these items and revise 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. Exhibit A-1 in appendix A of this Q&A Guide presents this elimination method. 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. Item 147 in the Statement 34 Implementation Guide states that "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." Exercise 4 in appendix 4 of the Implementation Guide illustrates how to eliminate the effect of internal service fund activity and discusses the effect of immaterial items in making the required eliminations.

A similar "doubling up" effect results from allocating expenses. 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").

The Statement 34 Implementation Guide discusses various situations concerning eliminations and reclassifications in the government-wide financial statements in items 148–156.

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28. How do the government-wide financial statements report activity and balances between the primary government and its nonfiduciary component units?

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 treated as internal activity and balances and thus reported in the same manner as any transactions between the funds of the primary government. (Q&A 27 discusses the reporting of internal activity and balances. Q&A 50 discusses the reporting of interfund activity, which affects the reporting of internal activity between the primary government and its blended component units.) (GASB 34, ¶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 interfund and internal activity when those units are included in the reporting entity's financial statements.

29. How do the government-wide financial statements report internal service fund activity and balances?

As discussed in Q&A 27, internal activity 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. Further, 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 an 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. (GASB 34, ¶58–59 and 62)

Fund Financial Statements—Fund Definitions and Overview

30. 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. In addition, 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 the government is accumulating financial resources for principal and interest payments maturing in future years. This fund type does not report the debt service transactions of special assessment debt for which the government is not obligated in any manner; those transactions 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 32.)

The proprietary fund types are as follows:

- *Enterprise funds.* These funds report activities for which the government charges fees to external users for goods or services. (See the additional discussion of these funds at Q&A 31.)
- *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 follows:

- *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 32.)
- *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 33.)

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 government holds the resources. (GASB 34, ¶63–73)

GASB Statement No. 38 requires note disclosure of activities accounted for in the various funds. See Q&A 56.

OBSERVATION

GASB Statement No. 34 has not changed the definitions of the general, special revenue, capital projects, debt service, and investment trust fund types. The Statement expands the pension trust fund type to include other employee benefit trust funds. (For example, the Statement 34 Implementation Guide, item 171, states that if Internal Revenue Code Section 457 plans are reported, they are presented as a pension and other employee benefit trust fund.) This observation and later Q&As discuss the changes made in the other fund types' definitions.

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

Statement No. 34 changed the fund types in which governments report some activities for financial reporting purposes. It eliminated expendable and nonexpendable trust funds (see Q&A 32), and those activities generally should be reported in special revenue, permanent, enterprise, pension (and other employee benefit) trust funds, or private-purpose trust funds. Changes in the definitions of enterprise (see Q&A 31) 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 to use 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. (See Q&A 29.) Internal service funds are classified as proprietary funds to achieve an accrual basis of accounting; however, they generally are reported as governmental activities based on the nature of the activities. Statement No. 34 diffuses the potential difficulties that such a reclassification could have caused 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 legal provisions or GAAP require separate debt service funds, 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.

31. 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 criteria, focused primarily on fees to external users, is met:

1. 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.

2. 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.

3. 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. (GASB 34, ¶67 and 147; GASB 37, ¶14)

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 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 requiring the use of enterprise funds.

Statement No. 34 requires that state unemployment compensation funds always be reported as enterprise funds because laws or regulations require the activity's costs to be recovered through fees and charges (even though those charges are referred to as unemployment compensation taxes.) Previous standards required governments to report those funds as expendable trust funds. In addition, GASB Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues,* paragraph 18, requires all public entity risk pools to account for their activities in an enterprise fund. State unemployment compensation funds and public entity risk pools are the only activities that GASB standards require governments to report in enterprise funds, even though they may not meet the criteria stated above. The Statement 34 Implementation Guide, items 166–170, discusses specific circumstances in which the use of an enterprise fund is or is not required.

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 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.

32. 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. Those 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. Those funds are fiduciary funds. (GASB 34, ¶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 31, governments report unemployment compensation benefit plans as enterprise funds.) These reclassifications not only avoid understating the resources that the government can use for its governmental and business-type activities but also avoid overstating fiduciary funds.

Some "trusts" may benefit both private and public purposes. That is, some of the earnings of a "trust" may benefit a governmental operation and some may benefit individuals or private organizations. The Statement 34 Implementation Guide, item 172, states that two separate funds may be used, but are not required. If the government itself is the predominant beneficiary, the government could classify the activity as a special revenue fund and report the private-purpose component of fund balance (if identifiable) as reserved. If private purposes are the predominant use of the resources in the fund, the Implementation Guide item states that using separate funds (a private-purpose trust and a special revenue fund) would be more appropriate.

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

Under GASB Statement No. 34, agency funds 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, tax collectors often collect and distribute property taxes to their own government's funds as well as to other governments. When this occurs, the government reports the portion that pertains to its other funds as assets in the appropriate funds, not in agency funds. (GASB 34, ¶73 and 111)

OBSERVATION

This is another example of the concept explained in Q&A 32 of distinguishing between those "fiduciary" activities that support the government's programs and those that do not.

Item 226 in the Statement 34 Implementation Guide states that if a government uses a central payroll system and reports all payroll deductions in an agency fund, the unremitted balances in the agency fund at year end are not reclassified to the funds from which the payroll deductions arose. Using an agency fund for those unremitted balances is appropriate because the agency fund assets are not pending distribution to the government's funds.

Fund Financial Statements—Governmental and Proprietary Funds

34. 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. (GASB 34, ¶74, 78, and 91)

OBSERVATION

Under GASB Statement No. 34, each fund category has its own complete set of financial statements. Governments no longer present a single combined balance sheet.

35. 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. (Q&A 36 discusses major funds.)

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. Internal service funds are not reported as major funds. Instead, the combined total for all internal service funds is 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 is not required but may be presented as supplementary information. (GASB 34, ¶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 governmental and enterprise 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.

GASB Statement No. 34's major fund reporting requirements do not apply to internal service funds. Why? 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.

The Statement 34 Implementation Guide, item 180, states that governments may (but are not required to) eliminate interfund activity and balances when combining nonmajor funds.

Governments have to determine whether they wish to present combining fund financial statements as supplementary information. That presentation is a required part of a CAFR.

36. 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 element total (assets, liabilities, and so forth) for all funds of that category or type (that is, total governmental or total enterprise funds).

2. The same element that met the 10 percent criterion in (1) is at least 5 percent of the corresponding element total for all governmental and enterprise funds combined.

Revenues and expenditures/expenses for extraordinary items (see Q&A 26) are not considered in these calculations.

Besides the funds that meet the major fund criteria, a government may report any other governmental or enterprise fund as a major fund if its officials believe the fund is particularly important to financial statement users. (GASB 34, ¶76; GASB 37, ¶15)

OBSERVATION

GASB Statement No. 34's quantitative criteria for when governmental and enterprise funds have to be reported as major are minimum requirements; governments are able to designate other governmental and enterprise funds as major. Statement No. 34 permits governments to designate additional major funds, among other reasons, because of concerns that a government's financial statements may present different funds as major each year. Some governments that have implemented Statement No. 34 early have included certain funds as major even though they did not meet the quantitative criteria because those funds were close to the major fund threshold and are likely to be slightly above or below that threshold in future years. However, presenting different funds as major from year to year is not a consistency issue, provided the major funds criteria are consistently applied. Preparers should develop procedures to identify funds that are major because they meet the quantitative criteria, as well as policies to identify the funds they want to report as major even though they do not meet the quantitative criteria.

As explained in the Statement 34 Implementation Guide, item 185, other financing sources and uses are not included in the calculation of major funds. In addition, item 181 of the Implementation Guide indicates that blended component units, which are reported as governmental and enterprise funds, are considered in the same manner as a primary government's own governmental and enterprise funds when evaluating and selecting major funds. The Implementation Guide, item 188, addresses how a government might consider interfund balances when performing the 5 percent and 10 percent tests for assets and liabilities. Finally, exercise 5 in appendix 4 of the Implementation Guide illustrates how to select major funds.

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 the observation section of Q&A 5, the AICPA is considering the audit issues relating to the new financial reporting model and plans to address those issues in a 2002 revision of its Audit and Accounting Guide for state and local governments.

Governmental Funds

37. What measurement focus and basis of accounting do governmental funds use, and how do they apply it?

Governmental funds continue to use current financial resources/modified accrual measurement focus and basis of accounting (MFBA). That MFBA focuses on reporting the sources, uses, and balances of current financial resources; the amounts available for appropriation; and fiscal compliance.

According to the summary statement of principles number 8 in NCGA Statement 1, under the current financial resources/modified accrual 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. GASB Statement No. 34 itself does not change the application of that MFBA. However, GASB Interpretation No. 6 clarifies the application of modified accrual for certain liabilities and expenditures by indicating the following:

- Unless there is an applicable accrual modification, governmental fund liabilities and expenditures are accrued. Liabilities that governments normally pay in a timely manner and in full from expendable available financial resources (for example, salaries and utilities) are recognized as governmental fund liabilities and expenditures when incurred.
- A government's unmatured general long-term indebtedness is reported as general long-term liabilities. This applies not only to formal debt issues, such as bonds, but also to compensated absences, claims and judgments, special termination benefits, landfill closure and postclosure care costs, and "other obligations" that are not due for payment in the current period. Liabilities for compensated absences, claims and judgments, special termination benefits, and landfill closure and postclosure care costs are "normally expected to be liquidated with expendable available financial resources," and recognized as governmental fund liabilities and expenditures, to the extent that they mature each period.
- A government may accrue an additional governmental fund liability and expenditure for debt service on general long-term debt, beyond the amounts matured, if it has provided financial resources to a debt service fund to pay liabilities maturing early in the following year. (GASB 34, ¶64 and 79, GASBI 6, ¶9 and 12–14)

See also the note disclosure requirement concerning the length of time to define *available* for purposes of revenue recognition in Q&A 56.

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. However, GASB Interpretation No. 6 may cause some changes in the application of that MFBA. For example, some governments have accrued governmental fund liabilities and expenditures for compensated absences as they accumulated financial resources to pay those absences when they became due in future periods. No longer will governments be able to accrue those fund liabilities and expenditures; neither will they be able to report the related fund balances as reserved (although they could report them as designated). Over time, various NCGA and GASB standards moved governmental fund accounting away from its traditional roots by introducing increased accrual measures. With Statement No. 34's requirement for government-wide financial statements with an economic resources/accrual MFBA, the accounting in the governmental funds is being moved back to a "pure" current financial resources/modified accrual MFBA. Interpretation No. 6 states that governments that would prefer accrual-basis reporting for liabilities such as compensated absences in the fund financial statements could consider reporting the activity through a trust fund or an internal service fund.

38. 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 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. (See also Q&A 37.) Interfund liabilities, even if noncurrent, are not general long-term liabilities.

Governments do not report general capital assets and general long-term liabilities as assets and liabilities in governmental funds or with the fund financial statements; they only report them with governmental activities in the government-wide statement of net assets. (GASB 34, ¶80–82)

OBSERVATION

The definitions of *general capital assets* and *general long-term liabilities* are fundamentally 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. Statement No. 34 replaces the information previously presented in those account groups with information in the government-wide financial statements.

39. How are fund balances reported in governmental funds?

Governmental fund balances are segregated into reserved and unreserved amounts. The definitions of reserved and unreserved fund balances and the reporting standards for fund balance reserves and designations, which are in NCGA Statement 1, paragraphs 118–121, 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. (GASB 34, ¶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.

The Statement 34 Implementation Guide, item 200, indicates that fund balances that are legally segregated for a specific future use are not reported as reserved if the resources are reported in a separate fund used only for that purpose. However, if legal segregations on resources are more specific than the general restrictions of the fund in which the resources are reported, a reserve is reported.

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.

40. *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 the face amount of long-term debt issued (including for 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 26 both occur in the same period, they are reported together in a "special and extraordinary items" classification separately from each other. (GASB 34, ¶86–89; GASB 37, ¶16)

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 required by Statement No. 34 is the one most governments have used for the governmental fund financial statement, few governments will have to reformat the statement.

Proprietary Funds

41. *What MFBA do proprietary funds use, and how do they apply it?*

Proprietary funds continue to use the economic resources/accrual MFBA. That MFBA focuses on the determination of operating income, changes in net assets (or cost recovery), financial position, and cash flows. 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, as amended. (GASB 34, ¶66, 92, and 103)

42. 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. (GASB 34, ¶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, elimination of this option should have little effect. Those governments that chose the option to follow post-November 30, 1989, FASB pronouncements 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, as amended [AICPA, *Professional Standards,* vol. 1, AU sec. 411] for the hierarchy of 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.

43. 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. (Q&A 20 discusses restrictions.)

Net assets are displayed in the same three components as in the government-wide statement of net assets. (See Q&A 20.) 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. (GASB 34, ¶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 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, the Statement 34 Implementation Guide, item 207, says that governments may continue to provide information about the extent to which a particular enterprise fund has received capital subsidies in the notes to the financial statements.

44. *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 uses the following elements, format, and sequence:

Operating revenues (detailed). (Q&A 45 discusses 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

(continued)

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

(GASB 34, ¶100–101 and 103)

OBSERVATION

The Statement 34 Implementation Guide, item 211, indicates that proprietary funds may report expenses using natural classifications (for example, salaries and wages, employee benefits, supplies, and utilities) or functional classifications (for example, a public university may use instruction, academic support, student services, and so forth.)

Proprietary funds no longer report capital contributions as a direct change in equity; under GASB Statement No. 34, those amounts are separately presented revenues. The Statement 34 Implementation Guide, item 213, explains that a proprietary fund's revenue reporting of a grant used for capital purposes depends on whether the grant is restricted to capital purposes. If the grant is not restricted for capital purposes, but can be used for any purpose, the fund reports the grant as nonoperating revenue. If, however, the grant is restricted to capital purposes, it is reported as a capital contribution.

45. 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 on how it categorizes the transactions 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. (GASB 34, ¶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 of the cash flow. Financial statement preparers need to establish policies for defining operating revenues and expenses for each proprietary fund. Different funds, with different operations, will have different policies.

A significant issue relating to classifying proprietary fund revenues concerns subsidies or appropriations from other governments. Many governments (such as public colleges and universities and transit districts) receive subsidies and appropriations from state and local governments. Some of those entities may want to classify those subsidies and appropriations as operating revenues because of their significance to the entity's operations. According to the Statement 34 Implementation Guide, item 215, governments should report annual operating grants and subsidies as nonoperating revenues. Further, governments should report appropriations for capital-related purposes separately after nonoperating revenues and expenses.

46. 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). (GASB 34, ¶105)

OBSERVATION

Governments that previously used the indirect method of reporting cash flows need to establish policies and procedures for using the direct method. The Statement 34 Implementation Guide, item 219, states that governments can estimate certain direct method cash flow amounts by adjusting for beginning and ending receivables and payables. Exercise 7 in appendix 4 of the Implementation Guide illustrates how to do that.

Fund Financial Statements—Fiduciary Funds and Fiduciary Component Units

47. 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 a separate column for each fiduciary fund type.

Governments present financial statements for individual pension and postemployment health care plans 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 34, ¶106)

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.

OBSERVATION

Each fiduciary component unit is included with the appropriate fund type, rather than aggregated in a separate fiduciary component units column, as clarified by the Statement 34 Implementation Guide, item 223.

The fiduciary funds are not covered by the major funds requirement 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.

48. What is the MFBA for fiduciary funds?

Fiduciary 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 governments recognize plan liabilities for benefits and refunds due to plan members and beneficiaries when due and payable in accordance with the terms of the plan. (GASB 34, ¶107)

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

The statement of fiduciary net assets uses a net assets format. In that statement, agency fund assets equal liabilities. The components of net assets discussed in Q&A 20 need not be presented in that statement.

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. However, that statement does not present changes in agency funds because those funds have no net assets.

The detailed display requirements of GASB Statement No. 25 and No. 26 apply to pension and other employee benefit trust funds. The display requirements of GASB Statement No. 31 apply to investment trust funds. (GASB 34, ¶108–110)

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 and fiduciary 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:

1. *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 about nonreciprocal interfund activity) to the borrower fund.

2. *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 accounts for risk-financing activity; GASB Statement No. 10, paragraph 64, requires those interfund charges to be accounted for as reimbursements (see the following discussion).

There are two types of nonreciprocal interfund activity:

1. *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 44.

2. *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. (GASB 34, ¶112)

Q&A 56 discusses note disclosure requirements for interfund balances and transfers.

OBSERVATION

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

There should be little change in how governments account for and report those events that previous standards termed *quasi-external transactions, reimbursements,* and *operating transfers.* In addition, Statement No. 34 establishes standards for interfund loans that are consistent with the previous practices 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. Under Statement No. 34, those transfers are not distinguished from other transfers.

Governments report interfund payments as transfers if they are not payments for interfund loans, services provided and used, or reimbursements. Therefore, governments should establish policies and procedures to identify when interfund payments are for loans, services provided and used, and reimbursements. In addition, because interfund services provided and used represent sales of goods and services between funds for a price close to their external exchange value, the government should establish procedures to document that the prices charged are close to their external exchange values.

To report interfund loans, the borrowing fund has to have both the ability and intent to repay within a reasonable time. A fund's ability to repay within a reasonable time may be evidenced by factors such as the fund's current financial position and estimates of future resources. A fund's intent to repay may be evidenced by factors such as the purpose of the loan, the established repayment terms, and the loan's current status. Governments should establish policies for defining "a reasonable time" for purposes of reporting interfund loans.

Interfund activity does not include transactions with discretely presented, nonfiduciary component units, which Statement No. 34 considers external transactions. As discussed in Q&A 28, the government-wide statement of activities reports most transactions between a primary government and its discretely presented, nonfiduciary component units as revenues and 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. They also may differ because the activities included, for example, in the governmental fund financial statements differ from those included in governmental activities in the government-wide financial statements.

To explain those differences, governments present summary reconciliations to the government-wide financial statements 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"

(continued)

Item	*Governmental Funds*	*Governmental Activities*
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

Generally, there are no reconciling items between the enterprise funds and business-type activities and, thus, no reconciliation to present. 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 requiring reconciliation. For example, in the process of eliminating an internal service fund's activities for the statement of activities, some of that 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 29.) If there are differences that require reconciliation, (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. (GASB 34, ¶77, 85, 90, and 104)

OBSERVATION

The reconciliations on the fund financial statements (or in accompanying schedules) are highly aggregated. If explanations are complex, the notes to the financial statements provide additional information. The reconciliations will help users 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 notes 4b and 5b in appendix C of 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. Similarly, there is no reconciliation between the fiduciary fund financial statements and the government-wide financial statements because the government-wide financial statements do not report fiduciary activities.

The reclassification of internal service funds from the proprietary fund category to governmental activities in the government-wide financial statements could have complicated the reconciliations between the fund and 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.

Some governments that have implemented Statement No. 34 early have found little room at the bottom of the fund financial statements to present the required reconciliation and, thus, used an "accompanying schedule." The Statement 34 Implementation Guide, item 190, explains that the accompanying schedule is a continuation of the fund financial statement and is presented on the page immediately following the statement it supports. Further, the Implementation Guide, item 191, explains that the required disclosure detailing the reconciliation should be made if a reconciling item is a combination of several similar balances or transactions, or is a net adjustment. For example, if the reconciliation includes a single amount to recognize long-term liabilities of the governmental activities in the statement of net assets, a note discloses the amounts for bonds and notes payable, compensated absences, and claims and judgments.

Exercise 6 in appendix 4 of the Statement 34 Implementation Guide explains the reconciliation process.

Preparers 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, adjust those amounts to develop their government-wide financial statements. During that "conversion" process, the preparer can identify and document the differences 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 this Q&A and Q&As 53–55 discuss) are directly related to the new requirements of Statement No. 34. GASB Statement No. 38 also has changed required note disclosures; see Q&A 56.

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 53–56, 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 27–29.)
4. The policy for applying post-November 30, 1989, FASB pronouncements to business-type activities and enterprise funds. (See Q&As 10 and 42.)
5. The policy for capitalizing assets and for estimating their useful lives. (See Q&As 11 and 14.)
6. A description of the modified approach for reporting infrastructure assets, if used. (See Q&A 15.)
7. A description of the types of transactions included in program revenues. (See Q&A 25.)
8. The policy for allocating indirect expenses in the statement of activities. (See Q&As 22–24.)
9. The policy for defining operating and nonoperating revenues of proprietary funds. (See Q&A 45.)
10. 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 20.)

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. (GASB 34, ¶56, 113–115, 120–122, and 128)

OBSERVATION

Preparers can develop many of these required disclosures for the summary of significant accounting policies as they develop policies and procedures to implement GASB Statement No. 34.

Instead of note disclosure of significant transactions or other events that are beyond the control of management but that are either unusual in nature or infrequent in occurrence, Statement No. 34, paragraph 89, and the Statement 34 Implementation Guide, item 212, indicate that information could be separately identified in the financial statements.

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 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 treasures, and similar assets, governments describe the collection and the reasons they do not capitalize those assets.

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. (GASB 34, ¶116–119)

Q&A 52 discusses when a government makes these disclosures for discretely presented component units. Appendix C of Statement No. 34 illustrates note disclosures for capital assets and long-term liabilities. Q&A 56 discusses the additional disclosures required by GASB Statement No. 38 for long- and short-term debt and for lease obligations.

OBSERVATION

As noted above, GASB Statement No. 34 requires governments to disclose which governmental funds they typically have used to liquidate nondebt long-term liabilities in prior years. The Statement 34 Implementation Guide, item 234, indicates that if a government has decided to depart from the historical trend and use other funds to liquidate those liabilities, it also should disclose that fact.

54. When are segment disclosures made?

Segment disclosures are made for an identifiable activity (or grouping of activities) that has outstanding bonds or other debt instruments (other than conduit debt for which the government is not obligated beyond the resources provided by related leases or loans) 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. A segment has a specific identifiable revenue stream pledged in support of its debt. It also has assets, liabilities, revenues, expenses, gains, and losses that an external party (for example, through a bond indenture) requires be accounted for separately. Segment disclosures are not required for an individual fund that is both a segment and a major fund. (GASB 34, ¶122; GASB 37, ¶17)

OBSERVATION

Previous standards required segment disclosures for enterprise funds. Those standards defined a single enterprise fund that reported two or more different activities as one segment. GASB Statement No. 34, as amended by GASB Statement No. 37, redefines the term *segment* so that it is no longer tied solely to the use of enterprise funds or enterprise fund accounting. Instead, Statement No. 34, as amended, defines *segment* in relation to the needs of users for additional financial information about separately identifiable activities that relate to certain types of debt.

Statement No. 37 amends Statement No. 34's definition of segments to make it clear that segment disclosures are required only when external parties require a government to maintain detailed accounts for a debt-financed activity. Paragraph 64, in the Basis for Conclusion, of Statement No. 37 states that an externally imposed requirement to separately account for some, but not all, of the required elements (for example, only revenues and expenses) does not meet the criteria to require segment disclosures. Further, Statement No. 37 amended Statement No. 34 to acknowledge that a segment is not limited to a single activity, but also could be a grouping of activities in which a government pledges the revenues of several facilities for a single debt issue.

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 a description of the type of goods or services provided by the segment. GASB Statement No. 34 provides details on the individual elements for a government to present 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 65) also are encouraged to present that supplementary information. (GASB 34, ¶122–123; GASB 37, ¶17)

Q&A 52 discusses when a government makes these disclosures for discretely presented component units. Appendix C of Statement No. 34 includes illustrative segment disclosures.

OBSERVATION

GASB Statement No. 34 revises the required segment disclosures to make them consistent with the information it requires for major funds and component units.

The Statement 34 Implementation Guide, item 238, indicates that a condensed statement of cash flows is not a required segment disclosure for a major discretely presented, nonfiduciary component unit.

56. How does GASB Statement No. 38 change note disclosure requirements?

In GASB Statement No. 38, the GASB reconsidered disclosure requirements that have been effective since 1994, except for disclosures that it will reexamine in its other projects. The Statement rescinds the requirement in NCGA Statement 1, paragraph 92, to disclose the accounting policy for encumbrances. The Statement also requires the following new or modified disclosures in the notes to the financial statements:

1. For governments that present their basic financial statements in more than a single column, descriptions of the activities accounted for in the major funds, internal service funds, and fiduciary fund types (With the exception of the general fund or its equivalent, the descriptions are specific to the particular government, rather than general definitions that could describe any government.)
2. The length of time used to define *available* for purposes of recognizing revenue in governmental fund financial statements
3. Actions taken to address significant violations of finance-related legal or contractual provisions
4. For debt obligations, principal and interest requirements to maturity, presented separately, for each of the next five fiscal years and in five-year increments after that (For variable-rate debt, interest requirements are determined using the rate in

effect at the financial statement date and the terms by which interest rates change for that debt are disclosed.)

5. For capital and noncancelable operating leases, the future minimum payments for each of the next five fiscal years and in five-year increments after that
6. A schedule of short-term debt activity during the year and a description of the purpose for which short-term debt was issued
7. Details of receivables and payables when aggregation obscures the significant components of those accounts in the statements of net assets and balance sheet
8. Significant receivable balances not expected to be collected within one year of the financial statement date
9. For interfund balances reported in the fund financial statements:
   a. The amounts due from other funds by individual major fund, nonmajor governmental funds in the aggregate, nonmajor enterprise funds in the aggregate, internal service funds in the aggregate, and fiduciary fund type,
   b. A description of the purpose for interfund balances, and
   c. Identification of interfund balances that are not expected to be repaid within one year of the financial statement date.
10. For interfund transfers reported in the fund financial statements:
    a. The amounts transferred from other funds by individual major fund, nonmajor governmental funds in the aggregate, nonmajor enterprise funds in the aggregate, internal service funds in the aggregate, and fiduciary fund type
    b. A general description of the principal purposes of the government's interfund transfers
    c. A description of the intended purpose and the amount of significant transfers that (1) do not occur on a routine basis (such as a transfer to a wastewater enterprise fund for the local match of a federal pollution control grant) or (2) are inconsistent with the activities of the fund making the transfer (for example, a transfer from a capital projects fund to the general fund)

Statement No. 38 clarifies that note disclosures are only required when the required information is not displayed on the face of the financial statements. Q&A 52 discusses when a government makes these disclosures for discretely presented component units.

The effective date of Statement No. 38 coincides with the effective date of Statement No. 34 for individual governments. However, governments that implement Statement No. 34 for fiscal periods beginning after June 15, 2001 (phase 1 governments), can delay the disclosures listed in 6–10 above for one additional year. In addition, earlier application of the disclosures (except those in 1, 9, and 10 above) is encouraged, even though Statement No. 34 is not yet applied. (GASB 38, ¶1 and 5–15)

OBSERVATION

Some of the disclosure requirements in GASB Statement No. 38 are simply modifications of existing disclosure requirements. For example, the requirement to separately disclose principal and interest requirements to maturity on debt obligations for each of the five succeeding fiscal years and in subsequent five-year increments provides detail about the disclosure of debt service requirements to maturity required by NCGA Interpretation 6.

Early implementation of these disclosures, when permitted, could lessen the effort of implementing GASB Statement No. 34 and its related pronouncements all at one time. Statement No. 38 does not permit early implementation of certain disclosures because those disclosures are based on the level of detail presented in financial statements presented in conformity with Statement No. 34.

Through its Codification instructions, Statement No. 38 eliminates the suggested (but not required) disclosure of general budget policies from NCGA Interpretation 6. Appendix C of Statement No. 38 has various illustrations of the disclosure requirements.

Component Unit Reporting

57. What component units are included in the basic financial statements and how are they reported?

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 and 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 discussed in the observation section of this Q&A), 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 on those statements.
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 statements of net assets and activities in the notes to the financial statements. GASB Statement No. 34 lists the individual elements to present in those condensed statements.

The data presented for each discretely presented, nonfiduciary component unit generally are the reporting entity totals derived from the component units' statements of net assets and activities. However, for component units that have only business-type activities and that do not present a statement of activities (see Q&A 65), data are taken from the unit's statement of revenues, expenses, and changes in net assets. (GASB 34, ¶124–127; GASB 37, ¶18)

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.

Component units may have their own component units. Financial data for a component unit that is included in a reporting entity's financial statement includes the financial data for the unit's own nonfiduciary component units.

Required Supplementary Information, Including Budgetary Comparison Information

58. 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 and 7), budgetary comparison schedules for certain governmental funds (see Q&A 59), and information about infrastructure assets for which the government uses the modified approach (see Q&A 16). (GASB 34, ¶129)

59. 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 government presents that information using its 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 any excess of expenditures over appropriations for the individual funds presented in the budgetary comparison.

As an option, governments may present budgetary comparison statements as part of their basic financial statements. Those budgetary statements include (through display and disclosure in the notes to the financial statements) the information described previously. (GASB 34, ¶130–131, GASB 37, ¶19)

OBSERVATION

Previous standards required budgetary comparison reporting for all governmental fund types with legally adopted annual budgets. The change to encompass only the general fund and each major special revenue fund with a legally adopted annual budget may reduce the amount of information presented. However, the requirement to include the original budget, which was not previously required, will increase the amount of information presented.

Presentation of any information in RSI is limited to GASB-required information. Therefore, governments do not present budgetary comparison information in RSI for funds other than the general fund and each major special revenue fund with a legally adopted annual budget. A government could present budgetary comparison information for other funds (for example, for non-major special revenue funds or for capital projects or debt service funds) as supplementary information.

The Statement 34 Implementation Guide, item 254, states that an excess of expenditures over appropriations for the individual funds presented in the budgetary comparison schedule also may be a material violation of finance-related legal provisions, making it necessary to disclose that violation in the notes to the financial statements. (See also the disclosure requirement concerning actions taken to address significant violations of finance-related legal or contractual provisions in Q&A 56.) The Implementation Guide answers various other questions relating to the budgetary comparison information.

GASB Statement No. 34 does not require budgetary comparison information to be a basic financial statement, as did previous standards. That is because the GASB does not believe that budgetary comparison information is essential to understanding a government's financial position and results of operations. However, because some governments believe that budgetary comparison information is essential, the Statement permits its presentation as a basic financial statement. In considering this choice, preparers could consider consulting with their independent auditors on the additional audit effort required if they present the budgetary comparison information as a basic financial statement rather than as RSI. Preparers should establish policies relating to this choice as well as to the formatting of the information. In item 248, the Statement 34 Implementation Guide indicates that if presented in the basic financial statements, required budgetary comparisons should be reported with the fund financial statements after the governmental funds statement of revenues, expenditures, and changes in fund balances.

Some governments may want to present budgetary comparison information as a basic financial statement because they want the auditor to render an opinion on that information. However, these governments should not present budgetary comparison information in the basic financial statements for funds other than those for which Statement No. 34 requires budgetary comparison information to be presented as RSI. That is because footnote 53 of the Statement only permits governments to move required budgetary comparison information from

RSI to the basic financial statements; it does not permit governments to present additional budgetary comparison information in the basic financial statements. Instead, governments may present budgetary comparison information for other funds as supplementary information. The government could engage the auditor to render an opinion on that supplementary information.

60. What is an auditor's responsibility for examining and reporting on RSI when 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 the auditor ordinarily should apply 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) exists: (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. SAS No. 52 (AU sec. 558.08) illustrates examples of explanatory paragraphs that an auditor might use in those circumstances. Because the RSI is not part of the basic financial statements, the four circumstances described here do not affect the auditor's opinion on the fairness of presentation of the basic financial statements in conformity with GAAP.

GASB standards specifically address the placement of RSI in relation to the financial statements (see Statement No. 34, paragraphs 6c and 8). If a government does not place RSI as required by GASB standards, the auditor should consider the effect of the placement on his or her report. Specifically, the auditor should consider whether to report that the RSI placement constitutes a presentation that departs materially from prescribed guidelines.

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 financial statements to refer to the RSI or to the limited procedures, unless any of the four previously mentioned circumstances exist. However, 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). In addition, the auditor should expand the report on the RSI if any of the four circumstances described in SAS No. 52 (AU sec. 558.08) are present.

Special-Purpose Governments

61. GASB 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. They include, for example, 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 primary governments, stand-alone governments, or component units as defined and discussed in GASB Statement No. 14. (GASB 34, ¶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. Although some special-purpose governments may present different basic financial statements (see Q&As 62–66), they still have to present notes to the financial statements, MD&A, and other appropriate RSI.

62. 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. (GASB 34, ¶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 when they provide 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.

63. What are special-purpose governments that have a single governmental program?

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. (GASB 34, ¶137)

OBSERVATION

The Statement 34 Implementation Guide, item 258, further explains this concept by explaining that a park district with multiple programs—golf, swimming, recreation leagues, tennis, skating, and so forth—would not be considered a single-program government if it budgets, manages, or accounts for those programs as separate activities. However, if it does not budget, manage, or account for those programs as separate activities, the park district would be a single-program government with a culture-recreation program.

64. What are the basic financial statements presented by special-purpose governments that have 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 government may combine the fund and the government-wide financial statements with a reconciliation of the individual line items in a separate column on the financial statements. See the additional discussion in the observation section of this Q&A.

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. GASB 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 is followed by contributions to permanent and term endowments, special and extraordinary items, transfers, and beginning and ending net assets." (GASB 34, ¶136)

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.

To combine the government-wide and fund financial statements (the first alternative described above)—

- 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 line items in the balance sheet 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 the government to reformat either the statement of revenues, expenditures, and changes in fund balances or the statement of activities. 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 and exhibit 8 in appendix 3 of the Statement 34 Implementation Guide.) Alternatively, the government could reformat the statement of activities 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 the combination approach need to consider the significance of program revenues to determine 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 displays the changes 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.

Exhibit B-5 in appendix C of GASB Statement No. 34 and exhibit 6 in appendix 3 of the Statement 34 Implementation Guide illustrate the less-complex statement of activities (the second alternative described above).

65. *What are the basic financial statements presented by special-purpose governments that have only business-type 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 fund net assets (or fund equity); and (3) statement of cash flows. However, these entities are encouraged to present a statement of activities as supplementary information. (See Q&A 55.) (GASB 34, ¶123 and 138)

OBSERVATION

The effect of GASB Statement No. 35 is to permit legally separate public colleges and universities to report as having only governmental activities, as having only business-type activities, or as having both governmental and business-type activities. Many public colleges and universities are planning to report as having only business-type activities. However, some, especially two-year institutions that have taxing power, may report as having only governmental activities or as having both governmental and business-type activities.

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. The Statement 34 Implementation Guide, item 260, indicates that if a primary government is a special-purpose government that has only business-type activities but has a discretely presented component unit that is engaged in governmental activities, the financial reporting entity has both governmental and business-type activities and should present government-wide financial statements.

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

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. A PERS that administers more than one defined benefit pension plan or postemployment healthcare plan presents (1) a separate column for each plan in the financial statements or (2) combining statements for those plans as part of the basic financial statements. Those financial statements do not present separate columns for individual employee benefit plans other than defined benefit pension and postemployment healthcare plans. However, GASB Statement No. 34 encourages, but does not require, combining financial statements for those other types of employee benefit plans. (GASB 34, ¶139–141)

OBSERVATION

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

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

Except for a change to the modified approach as discussed in Q&A 15, adjustments to the funds because of GASB Statements No. 34 and No. 37 and Interpretation No. 6 are prior-period adjustments, and any prior-period financial statements that are presented are restated unless it is impractical to do so. If such restatement is impractical, the government restates beginning fund balance (or fund net assets) for the cumulative effect of applying the standards for the earliest period restated (which generally is the current period). The government discloses the nature of the restatements and their effects in the first period the new standards are 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. A government may apply those standards 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.

GASB Statement No. 23, *Accounting and Financial Reporting for Refundings of Debt Reported by Proprietary Activities,* which applies to debt-refunding transactions, also may be applied prospectively to governmental activities (that is, for general long-term liabilities). (GASB 34, ¶144 and 146; GASB 37, ¶7 and 9; GASBI 6, ¶19)

Q&As 7 and 15–17 discuss other transition provisions.

OBSERVATION

In some situations, a government restates beginning fund balances or fund net assets in its fund financial statements when it implements the new financial reporting model. This would occur, for example, if the government (1) does not currently apply GAAP, (2) is adjusting its fund structure because of Statement No. 34 requirements (such as moving an activity from a special revenue fund to an enterprise fund), or (3) is concurrently implementing other accounting standards that result in measurement changes (such as GASB Interpretation No. 6).

Transition to Statement No. 34 requires a government to determine the amount of beginning net assets for presentation in its statement of activities. (Statement No. 34 exempts certain APB and GASB standards from retroactive application to ease implementation efforts as much as possible.) For many governments, that equity presentation will be affected by large amounts of assets and liabilities that previously have not had an equity effect and infrastructure assets that previously have not been reported. Some governments may determine the amount of beginning net assets for presentation in the statement of activities by determining the beginning balances of individual asset and liability accounts. A simpler approach, however, is to determine the amount of beginning net assets by calculating the difference between ending net assets and the change in net assets for the period.

Appendix A—Illustrative Financial Statements

Appendixes of GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments,* and *Guide to Implementation of GASB Statement 34 on Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments* (the Statement 34 Implementation Guide) illustrate the display and disclosure requirements of Statement No. 34. 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 Allocation)
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 34 Implementation Guide, Appendix 2, Exhibit 1)

Exhibit 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	$ 10,516,820	$ 24,114,719	$ 303,935
Investments	27,365,221	64,575	27,429,796	7,428,952
Receivables (net)	12,833,132	3,609,615	16,442,747	4,042,290
Internal balances	313,768	(313,768)	—	—
Inventories	322,149	126,674	448,823	83,697
Capital assets				
Land, improvements, and construction in progress	28,435,025	6,408,150	34,843,175	751,239
Other capital assets, net of depreciation	141,587,735	144,980,601	286,568,336	36,993,547
Total capital assets	170,022,760	151,388,751	321,411,511	37,744,786
Total assets	224,454,929	165,392,667	389,847,596	49,603,660
LIABILITIES				
Accounts payable and accrued expenses	7,538,543	786,842	8,325,385	1,803,332
Deferred revenue	1,435,599	—	1,435,599	38,911
Long-term 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	101,512,520	79,695,401	181,207,921	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	11,290,079	—	11,290,079	492,445
Debt service	3,076,829	1,451,996	4,528,825	—
Community development projects	6,886,663	—	6,886,663	—
Other purposes	3,874,736	—	3,874,736	—
Unrestricted (deficit)	(5,897,284)	11,156,696	5,259,412	2,829,790
Total net assets	$122,942,409	$ 85,697,266	$208,639,675	$19,228,627

Exhibit A-2
Government-wide Statement of Activities—
Standard Format (No Indirect Expense Allocation)
(Adapted from GASB 34 Implementation Guide, Appendix 2, Exhibit 2)

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	$ 9,709,509	$ 3,333,265	$ 843,617	$ —
Public safety	34,782,144	1,198,855	1,307,693	62,300
Public works	10,131,928	850,000	—	2,252,615
Engineering services	1,299,645	704,793	—	—
Health and sanitation	6,705,675	5,612,267	575,000	—
Cemetery	735,866	212,496	72,689	—
Culture and recreation	11,534,045	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	6,242,893	—	—	—
Total governmental activities	106,029,367	15,906,875	5,248,999	4,894,915
Business-type activities:				
Water	3,643,315	4,159,350	—	1,159,909
Sewer	4,909,885	7,170,533	—	486,010
Parking facilities	2,824,368	1,449,012	—	—
Total business-type activities	11,377,568	12,778,895	—	1,645,919
Total primary government	$117,406,935	$28,685,770	$5,248,999	$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
Unrestricted 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

Exhibit 2

Net (Expense) Revenue and Changes in Net Assets			
Primary Government			
Governmental Activities	Business-type Activities	Total	Component Units
$ (5,532,627)		$ (5,532,627)	
(32,213,296)		(32,213,296)	
(7,029,313)		(7,029,313)	
(594,852)		(594,852)	
(518,408)		(518,408)	
(450,681)		(450,681)	
(5,088,846)		(5,088,846)	
(414,389)		(414,389)	
(21,893,273)		(21,893,273)	
(6,242,893)		(6,242,893)	
(79,978,578)		(79,978,578)	
—	$ 1,675,944	1,675,944	
—	2,746,658	2,746,658	
—	(1,375,356)	(1,375,356)	
—	3,047,246	3,047,246	
(79,978,578)	3,047,246	(76,931,332)	
			$ 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
1,885,455	619,987	2,505,442	884,277
884,907	—	884,907	19,950
2,653,488	—	2,653,488	—
501,409	(501,409)	—	—
76,828,288	118,578	76,946,866	29,259,208
(3,150,290)	3,165,824	15,534	3,202,656
126,092,699	82,531,442	208,624,141	16,025,971
$122,942,409	$85,697,266	$208,639,675	$ 19,228,627

Exhibit A-3
Government-wide Statement of Net Assets Combined With Governmental Fund Balance Sheet
(Adapted from GASB 34 Implementation Guide, Appendix 3, Exhibit 7)

Exhibit 7

Sample County Fire Protection District
Statement of Net Assets and
Governmental Funds Balance Sheet
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
Land	—	—	—	301,507	301,507
Other capital assets, net of accumulated depreciation	—	—	—	5,217,699	5,217,699
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	—	—	—	436,054	436,054
Due after one year	—	—	—	3,597,107	3,597,107
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	6,615,003	—	6,615,003	(6,615,003)	—
Unreserved, reported in:					
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				510,741	510,741
Unrestricted				8,208,670	8,208,670
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 34 Implementation Guide, Appendix 3, Exhibit 9)

Exhibit 9

Sample County Fire Protection District
Statement of Activities and
Governmental Fund Revenues, Expenditures, and
Changes in Fund Balances
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:					
Fire protection:					
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	2,310,734	9,348,822
End of the year	$ 6,812,311	$1,205,754	$ 8,018,065	$2,789,194	$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 activities (Q&A 8)
Measurement focus and basis of accounting	Economic resources/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 infrastructure and other capital assets 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 19)
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 19) 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 19 and 20)
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 21)

Feature	*Description and Q&A Number*
Classifications—statement of activities	Expenses: reported at a minimum by function or different identifiable activities, 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 infrastructure and other capital assets and interest on general long-term liabilities may be reported as direct expenses, indirect expenses, or separate line items. (Q&As 21–24)
	Revenues: reported as one of three categories of program revenues or as general revenues, unless they are contributions to term or permanent endowments, contributions to permanent fund principal, or special or extraordinary items (Q&A 25)
Internal activity and balances	Generally, eliminated or reclassified (Q&A 27)
Other	Activity and balances between the primary government and its discretely presented, nonfiduciary component units: reported like external transactions (Q&A 28)

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 30)
Required financial statements	Governmental funds: balance sheet and statement of revenues, expenditures, and changes in fund balances (Q&A 34) 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 34) Fiduciary funds: statement of fiduciary net assets and statement of changes in fiduciary net assets (Q&A 47)
Measurement focus and basis of accounting	Governmental funds: current financial resources/modified accrual (Q&A 37) Proprietary funds: economic resources/accrual (Q&A 41) Fiduciary funds: generally, economic resources/accrual (Q&A 48)
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 38)

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 35) Proprietary funds: major enterprise funds, aggregate nonmajor enterprise funds, total enterprise funds, and aggregate internal service funds (Q&A 35) Fiduciary funds: fund type (Q&A 47)
"Position statement" format and classifications	Governmental funds: balance sheet format, with fund balances segregated into reserved and unreserved amounts (Q&As 34 and 39) 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 43) Fiduciary funds: net assets format (Q&A 49)
"Operating statement" format and classification	Governmental funds: a specifically sequenced format of revenues, expenditures, other financing sources and uses, and special and extraordinary items. Classify revenues by major source and expenditures at a minimum by function (Q&A 40) Proprietary funds: A specifically sequenced format that distinguishes operating and nonoperating revenues and expenses. Classify revenues by major source and expenses by object or function (Q&A 44) Fiduciary funds: Additions to and deductions from net assets (except for agency funds) (Q&A 49)
Interfund activity	Loans, services provided and used, transfers, and reimbursements (Q&A 50)
Reconciliation	Summaries presented at the bottom of the fund financial statements or in an accompanying schedule to reconcile to the government-wide financial statements (Q&A 51)

Appendix D—Basic Implementation Steps

Following is a listing of the basic steps needed to implement the financial reporting model required by GASB Statement No. 34. The preparer can use this listing as a starting point for an implementation plan.

☐ ***Obtain and study*** GASB Statement No. 34, its related pronouncements, and other appropriate resource materials.

☐ ***Inform*** the governing board, management, and other stakeholders about the new standards and update them as implementation progresses.

☐ ***Develop*** an implementation committee (and perhaps advisory subcommittees) comprising management, finance personnel, personnel from other relevant areas (such as the public works department, the grants accounting office, and information technology), component units personnel, and the independent auditor.

☐ ***Obtain*** training on the new standards for all committee and subcommittee members.

☐ ***Determine*** implementation dates for the basic standards and for retroactive capitalization of general infrastructure assets for both the primary government and for its component units.

☐ ***Identify*** the needed accounting and financial reporting changes.

☐ ***Develop*** an implementation plan and timetable.

☐ ***Obtain*** funding, new personnel, and consultants as needed to accomplish the plan.

☐ ***Develop*** mechanisms (such as policy and procedural changes and software modifications or replacements) to institute the required accounting and financial reporting changes. It is especially important to obtain the independent auditor's concurrence with changes in accounting and financial reporting policies.

☐ ***Prepare*** proforma financial statements, note disclosures, management's discussion and analysis (MD&A), and other required supplementary information (RSI) for the period preceding the implementation period. The ending balances in the proforma government-wide statement of net assets will provide the opening net assets balances for that statement in the implementation period.

☐ ***Modify*** implementation mechanisms, timetable, and resources as appropriate, based on the proforma experience.

☐ ***Develop*** and publish implementation-year financial statements in conformity with GASB Statement No. 34, as amended.

Appendix E—Accounting and Financial Reporting Policies

Governments will need to establish or reconsider various accounting and financial reporting policies while implementing the new financial reporting model. Following is a listing of some of the more-significant policies that a government may need to consider. See the referenced Q&As for additional details.

Policy	*Q&A Number*
General	
If a special-purpose government, the financial statements to present	61–66
Government-wide financial statements	
Classifying activities as governmental or business-type	8
Applying previous GASB pronouncements to governmental activities	10
Net asset versus balance-sheet format	19
Relative liquidity versus current and long-term classification	19
Displaying nondepreciable capital assets, accumulated depreciation, and major classes of capital assets	11
Formatting the statement of activities	21
The functions or programs to report in the statement of activities	21
Defining various revenue elements, including program versus general revenues	21, 25
Reporting direct and indirect expenses	22–24
Internal activity and balances, including internal service fund activity and balances, and inter-entity activity and balances	27–29
Both government-wide and fund financial statements	
Recognizing and reporting specific exchange and nonexchange transactions	9, 37, 41
Applying private-sector pronouncements	10, 42
Special items, extraordinary items, and other significant "one-shot" items	26
Classifying net assets	20
Whether to first spend restricted or unrestricted resources	20, 52
Spending investment income on donor-restricted endowments	52
Level of detail for aggregating receivables and payables	56

Policy	Q&A Number
Fund financial statements	
Fund classifications of various activities	30–33
Major funds	36
Eliminating interfund activity and balances in aggregate nonmajor funds	35
Classifying revenues and expenditures/expenses	40, 44
"Availability" period for revenue recognition purposes	56
Governmental fund balance reserves and designations	39
Formatting the proprietary fund financial position statement	43
Classifying proprietary fund assets and liabilities	43
Reporting revenue discounts and allowances	44
Defining operating and nonoperating revenues and expenses	45
Defining segments	54
Direct method of presenting cash flows	46
Classifying and reporting interfund activity and balances	50
Level of detail for financial statement reconciliations	51
Capital assets	
Capitalizing assets, including capitalization thresholds, ancillary costs, infrastructure assets to report, works of art and historical treasures, and documentation to support recorded amounts	11, 18
Defining asset classes, networks, and subsystems	11
Capitalizing and expensing improvement and maintenance costs	11
Determining the cost of previously unrecorded capital assets	12
Identifying inexhaustible capital assets	13
Depreciation, including estimating salvage (residual) values, estimating useful lives and the frequency for reevaluating those lives, and identifying depreciation method(s) and level of detail at which to apply depreciation	14
Modified approach	
Use of the modified approach	15
Features of the asset-management system, including the intended condition level	15
Condition assessment documentation	15
Capitalizing and expensing improvement, maintenance, and preservation costs	15
Budgetary comparison information	
Formatting, presenting variance columns, and presenting as RSI or as basic financial statements	59

Policy	Q&A Number
Component unit information	
Defining major component units, identifying information to disclose, and selecting the presentation method for required information	52, 57
Supplementary information	
Transmittal letter	4, 6
Combining financial statements	4, 35
Budgetary comparison information	59
Statement of activities (in certain situations relating to enterprise funds)	55, 65
Transition	
When to implement the new model	5
Presenting prior-year comparative data in the MD&A	7
Retroactive reporting of general infrastructure assets	17
Retroactive application of certain APB and GASB pronouncements	67
Documenting beginning net assets	67

Glossary of Selected Terms

Following are brief definitions of selected terms used in the financial reporting model required by GASB Statement No. 34.

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.

Capital assets—Tangible and intangible assets that are used in operations and that have initial useful lives that extend beyond a single reporting period.

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.

Different identifiable activities—The minimum level of detail in the government-wide statement of activities for presenting the activities accounted for in enterprise funds. An enterprise fund activity is "identifiable" if it has a specific revenue stream and related expenses and gains and losses that are accounted for separately. An activity is "different" generally based on the goods, services, or programs provided by an activity.

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).

Enabling legislation—Legislation that (1) authorizes a government to assess, levy, charge, or otherwise mandate payment of resources from external resource providers and (2) includes a legally enforceable requirement that those resources be used only for the specific purposes in the legislation.

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). The minimum level of detail in the government-wide statement of activities for presenting the activities accounted for in governmental funds. Also used to refer to "different identifiable activities," the minimum level of detail in the government-wide statement of activities for presenting the activities accounted for in enterprise funds.

General capital assets—Capital assets associated with and generally arising from governmental activities.

General revenues—All revenues (other than contributions to term and permanent endowments, contributions to permanent fund principal, and special and extraordinary items) 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.

Infrastructure assets—Normally stationary capital assets that can be preserved for a significantly greater number of years than most capital assets, including 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.

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.

Major funds—The government's main operating fund (the general fund or its equivalent), other individual governmental and enterprise funds that meet specific quantitative criteria, and any other governmental or enterprise fund that a government's officials believe is particularly important to financial statement users.

Major general infrastructure assets—Infrastructure assets associated with and generally arising from governmental activities whose actual or estimated cost is expected to be at least a specific percentage of the total cost of all general capital assets reported in the first fiscal year ending after June 15, 1999. For assets accounted for based on networks, the percentage is 10 percent. For assets accounted for based on subsystems of networks, the percentage is 5 percent.

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 a function (or some lower classification level presented in the statement of activities), reduced by program revenues relating to that function. Sometimes referred to as the net cost of a function.

Program revenues—Revenues (other than contributions to term and permanent endowments, contributions to permanent fund principal, and special and extraordinary items) that (1) derive directly 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 constraints 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 (or grouping of activities) that has outstanding bonds or other debt instruments 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. It also has related assets, liabilities, revenues, expenses, gains, and losses that an external party requires to be accounted for separately.

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 current projects include assisting an AICPA task force with a comprehensive revision of the Audit and Accounting Guide *Audits of State and Local Governmental Units.* She also is developing an AICPA practice aid on auditing state and local governments reporting under GASB Statement No. 34. 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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