



TREASURER

State of North Carolina

Department of State Treasurer

*State and Local Government Finance Division
and the Local Government Commission*

Memorandum No. 980

October 11, 2002

TO: Officials of Local Governments and Certified Public Accountants

FROM: Vance Holloman, Director
Fiscal Management Section

SUBJECT: Questions Concerning the Implementation of Governmental Accounting Standards Board (GASB) Statement No. 34

In the process of preparing illustrative financial statements in accordance with GASB Statement No. 34, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments*, a number of questions regarding presentation came to our attention. We have also received questions from many units preparing their financial statements. In this memorandum we will discuss these issues and provide some guidance in dealing with them.

In the fund and government-wide financial statements, changes have occurred in how certain transactions with component units are reported. Transfers to and from discretely presented component units are now recorded as revenues and expenditures/expenses. The revenue would be reported as described in LGC Memorandum No. 964, and the expenses/expenditure should be reported in the appropriate program. This reporting would be similar to the required presentation prior to the implementation of GASB Statement No. 14. Amounts due to and from component units would be separately captioned on the statement of net assets.

Payments in lieu of taxes (PILOTs) to the General Fund from another fund that are based upon the value of property and the unit's tax rate would be reported as transfers. In the past, PILOTs were reported as revenue in the General Fund and an expenditure/expense in the fund making the payment. Most of the transfer policies adopted by units with electric systems call for PILOTs that are based upon the value of assets and the unit's tax rate. These PILOTs would be reported as transfers under GASB Statement No. 34. Although these PILOTs will be reported as transfers, this office will not count PILOTs as transfers for determining compliance with transfer policies. We encourage units to distinguish PILOTs from other transfers in the budget to actual schedules for enterprise funds that are presented in the supplemental schedules.

Units will no longer distinguish operating transfers and residual equity transfers in the financial statements. Previously, most units had reported only changes in retained earnings for proprietary funds on the face of the operating statements. Residual equity transfers were closed to contributed capital and did not appear on the statement of revenues, expense, and changes in retained earnings. Proprietary

funds will now measure the change in net assets. Net assets will include amounts that had previously been reported as contributed capital. Therefore, all transfers must be included in the statement of revenues, expenses, and changes in net assets.

For proprietary funds, there should be few cases where the combined prior year ending retained earnings and contributed capital balances (total equity) do not equal beginning net assets in the year of implementation of GASB Statement No. 34. Although the individual components are calculated and captioned differently, in total both represent the difference between assets and liabilities as determined under the full accrual basis of accounting.

It will be necessary to break out the three elements of net assets – invested in capital assets, net of related debt, restricted net assets, and unrestricted net assets. The same classification will be shown in the proprietary funds, and in the government-wide statements for business-type activities and governmental activities. When calculating invested in capital assets, net of related debt, debt for capital assets not reported by the unit is not included. That debt must be included in calculating unrestricted net assets. The most common example of this is debt for public schools if a county does not report the asset on its books. This could occur for debt issued for community colleges, hospitals and other entities as well. It can occur for units other than counties also. Units that want to explain the impact of this debt on the balance of unrestricted net assets may do so in their Management's Discussion and Analysis and/or the notes to the financial statements. Examples of potential disclosures are attached to this memorandum, but are not included in the illustrative financial statements. This example should be adjusted to reflect the circumstances of the unit.

Restricted net assets are determined by restrictions placed upon the revenue sources that resulted in the net assets. These restrictions are put in place by external parties, or imposed by the unit through enabling legislation or constitutional provisions used to establish the revenue source. Restricted sales taxes, grants, special district taxes, occupancy taxes, and restricted register of deed fees would be examples of revenues that would give rise to restricted assets. Revenues transferred to a capital reserve or revaluation fund and revenues in a capital project fund would not be reported as restricted assets unless the original sources of revenue were restricted. Units that have projects funded with restricted and unrestricted revenue sources will have to make assumptions about which revenues were used first to calculate restricted net assets. These assumptions should be disclosed in the notes.

Investment earnings that are earned on amounts restricted in use to a program should be reported as program revenue rather than general revenue. In order for those earnings to be reported as program income, they must be earned on funds generated from revenue sources that are restricted, as discussed in the preceding paragraph.

In calculating the current portion of accumulated vacation, units may make one of two assumptions about the use of vacation. Units may assume that employees are first using leave earned in prior years (FIFO method). This assumption results in the current portion of accumulated vacation equaling an amount expected to be taken during the year, an estimate that should be based upon the actual vacation taken by employees in recent years. Alternatively, units may assume that employees first take the vacation they have earned in the current year (LIFO method). The current portion would represent leave expected to be taken by employees in excess of what they earn in the current year. That assumption would result in a much lower balance, if not a zero balance, for the current portion of accumulated

vacation. Units may select either method and should disclose their assumption in the notes to the financial statements. The choice has no impact on net assets. In the illustrative financial statements prepared by this office, the statements for Carolina County and Carolina County Schools were prepared assuming that employees first used vacation earned during the current year. The statements for the City of Dogwood were prepared assuming that employees use vacation earned in prior years first.

For units that are changing their capitalization thresholds in the year or years prior to GASB 34 implementation, several items should appear on the financial statements and in the note disclosures to those statements. In the governmental funds, an adjustment will be made to the General Fixed Asset Account Group to reduce the fixed asset total by the amount of assets being removed from that account group. Two additional columns are added to the changes in general fixed assets note to show general fixed assets as originally stated and the amounts being removed as a result of the change in the capitalization threshold. In the proprietary funds, an adjustment will be made to beginning retained earnings to account for those assets previously capitalized but now being expensed. A note disclosure should accompany these adjustments explaining the adjustments.

For units changing their capitalization thresholds in the year of GASB 34 implementation, the presentation for proprietary funds is essentially the same except that the adjustment is to beginning net assets rather than retained earnings. In the governmental funds, no adjustment will appear in the fund statements. In the government-wide statements the adjustment will be made to beginning net assets. All of these changes will be disclosed in the notes – one combined note will be acceptable.

Any you have any questions concerning this memorandum, please contact Sharon Edmundson at 919-807-2394 or Sara Shippee at 919-807-2386.

Unrestricted Net Assets – Sample Disclosure

The County has issued debt for the acquisition and construction of capital assets that are not reported as assets of the County. This debt has been issued for the construction of public school, community college and hospital facilities. The General Statutes do not permit public schools and community colleges to issue debt for the acquisition and construction of facilities. Responsibility for providing these facilities lies with the County. The titles to these assets are held by Carolina County Board of Education and Carolina County Community College and the assets are reported on their financial statements. The County issued debt for hospital facilities that are owned by the County but operated by Carolina County Hospital, Inc. The assets are reported by the Hospital because the assets are leased to the Hospital by the County under a capital lease. That lease does not require the Hospital to make lease payments to the County.

These debt issues were necessary to provide for the education and health of the citizens of the County. The outstanding amount of this debt, \$11,234,000, has been reported as a reduction of unrestricted net assets for governmental activities. Had this debt not been reported as a reduction of unrestricted net assets, the balance of unrestricted net assets for governmental activities would be \$16,513,395.