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GASB STATEMENT 34

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SUMMARY

GASB 34 was a watershed event for state and local governmental accounting and financial reporting. The results of GASB 34 affect the audit report primarily by requiring new disclosures, a new required supplementary data section, a narrative analysis of the audited financial statements and additional financial reports. Most of the new requirements will mean substantial record keeping, documentation and work by the city. The budget and normal fund-based financial statements are not affected.

For the general fund and other governmental funds, GASB 34 brings **long-term** items onto a new additional balance sheet in the audit. Long-term assets are those that will not be a source of cash during the budget year. Long-term liabilities are those that will not be a use of cash during the budget year. The new additional balance sheet is called the “statement of net assets” to differentiate it from the regular fund-based balance sheet. The fund-based balance sheet will continue to show short-term assets only.

The statement of net assets will include long-term assets that have never been reported before, such as city hall, fire trucks and infrastructure. Infrastructure includes roads, bridges, tunnels, curbing, etc. Long-term liabilities will also appear on the new

statement of net assets. The regular balance sheet will continue as before, showing short-term liabilities only. The difference between total assets and total liabilities is called net assets. The difference between current assets and current liabilities is still called fund balance.

In addition to the current income statement, called the “statement of revenues, expenditures and changes in fund balance,” a new income statement is created called the “statement of activities.” It looks very different, beginning with **expenses**, not expenditures, at the top and general revenues at the bottom of the statement. Also, any revenues associated with a specific city department, such as police ticket revenues, are offset against that department’s expenses. Note that depreciation expense is calculated and reported by department.

There are changes to the proprietary funds (enterprise and internal service) from GASB 34. The income statement gets a new name, “statement of revenues, expenses and changes to fund net assets.” The balance sheet is called the “balance sheet.” Contributions and grants are considered revenues. The old NCGA Statement 2 add-back of depreciation from grant acquired assets is gone.

The new government-wide financial statements create a new accounting picture similar to that in corporate America. For people familiar with normal accrual accounting, this could help them analyze and understand a city audit.

GASB 34 took effect over three consecutive years beginning in FY02. This phasing began with cities with revenues of over \$100 million in FY99, the base year. Phase 2 cities had revenues in FY99 of less than \$100 million but more than \$10 million and began in FY03. Phase 3 cities began in FY04.

DETAILS OF GASB 34 ACCOUNTING

A city's fund-based balance sheet includes **short-term** assets and liabilities only. That is, only assets that can turn into cash during the budget year are included on the balance sheet. Cities track only short-term liabilities that can use cash during the budget year. Fund balance appears on the balance sheet as the difference between the "current" assets and liabilities. In theory, fund balance represents cash available for additional appropriations. This modification of accrual accounting was tailored to the annual budgeting process.

Fund accounting modifies regular accrual accounting methods to ease financial review of the budget to actual spending comparisons. Cities track expenditures or all cash outflows. All cash received, or cash inflows, are simply revenue. All cash spent, or cash outflows, are expenditures. The budget forces a balancing of anticipated revenues and expenditures.

Fund balance is used when expenditures exceed revenues. This does not change with GASB 34. Instead, cities will keep two sets of books.

NEW FINANCIAL STATEMENTS

GASB 34 requires additional financial statements in the audit "the government-wide financial statements" while keeping the existing fund-based financial statements. The new government-wide balance sheet is called the "statement of net assets" to differentiate it from the regular fund-based balance sheet. In addition to current assets, the statement of net assets will include long-term assets that have never been reported before, such as capital assets, city hall and fire trucks. Liabilities on the new statement of net assets will include short-term liabilities and all other liabilities such as the total bonded debt. The difference between total assets and liabilities is certainly not fund balance — it is net assets.

The new government-wide balance sheet combines all major, or primary, governmental funds into one column. All the business-type funds (proprietary) are combined into another column. Any other component units, or non-major funds, are combined and shown in a third column but off to the side and clearly marked as "non-major." The focus of the new government-wide financial statements is supposed to be a broad overview of the government's finances, greater than the general fund, and considers the whole city.

This concept of major funds is new, and the presentation combines the general fund with

other major governmental funds. There are two tests to meet the qualification of a major fund. Any fund with 10 percent or more of the total governmental fund expenditures, total governmental fund revenues, total governmental fund assets, or total governmental fund liabilities meet the first test to be classified a major fund. But to be considered a major fund, a second test must be applied. Any fund meeting the 10 percent test must then meet a five percent test to be classified as a major fund. This criterion uses the aggregate of the governmental funds and business-type funds. The five percent of the larger total is applied to the same four criteria.

The new additional government-wide income statement in the audit is very different from the current statement of revenues, expenditures and changes in fund balance. It is called the “statement of activities.” Like the government-wide balance sheet, this income statement combines all the major governmental fund activities and separately shows all the business-type activities. Component units not shown elsewhere are also separately listed on the government-wide income statement.

Expenses rather than expenditures are reported in the statement of activities. Expenditures track cash outflows, which is ideal for budgeting. Expenses track the use or consumption of resources. This is the method used in accrual accounting, which is the accounting method used by most corporations.

Long-term assets are newly measured by cities in the government-wide financial statements. Recognition of the use or consumption of any long-term asset is through depreciation expense. Long used by utilities, this is new for governments. Depreciation is calculated by dividing the historical cost of a depreciable asset by its expected useful life.

Not every expense is an expenditure. Depreciation expense is added to every department using depreciable capital assets. However, there is no cash outflow or expenditure from depreciation expenses. Principal repayments are cash expenditures and are properly reported in the fund income statement. But principal repayment is not an expense and is not reported in the statement of activities.

Another new concept is program revenue. Program revenues stem from activities of a specific city department. Typical program revenues come from recreation fees, police fines and code violations. As such, these specific revenues offset the programs, thus creating the net departmental expense.

INFRASTRUCTURE

A new capital asset called infrastructure was created by GASB 34. Infrastructure includes roads, bridges, tunnels, curbing, etc. Reporting infrastructure assets is phased in annually, beginning with Phase 1 cities in FY06. Phase 1 and Phase 2 cities go back to 1980 to pick up infrastructure assets. Infrastructure assets are reported at their historical cost and will appear only

on the new government-wide statement of assets. Phase 3 cities begin reporting new infrastructure in FY08 but do not go back to pick up existing infrastructure assets. MTAS has a separate publication called "Capital Asset Accounting System" with more information regarding infrastructure and other capital assets.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Another large element of GASB 34 is a new financial narrative: The Management's Discussion and Analysis (MD&A). This is a multipage written analysis of the audited financial statements. It is included in the audit report, but it is not audited as it is supposed to be prepared by the city. Although GASB 34 limits the MD&A to eight areas, it is very detailed and tailored to the city's current conditions, facts and decisions. This is an in-depth financial analysis requiring substantial knowledge of the budget, financial statements and governmental accounting.

MTAS offers another publication with sample MD&A called "GASB Statement 34 Management's Discussion and Analysis."

REQUIRED SUPPLEMENTARY INFORMATION

In addition to the other changes previously mentioned, the audit report is expanded by GASB 34 to add a new section called Required Supplementary Information (RSI). This is an attempt to further standardize supporting presentation and documentation, especially for the MD&A, which is technically part of the RSI. Previous audits had a section called "Supplementary Information" where cities could include ancillary data. That section still exists, but the new RSI is mandated. A new required inclusion in the RSI is a comparison, by fund, with the original budget, final budget and actual revenues/expenditures. This aids in analyzing whether resources were obtained and used according to the budget.

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