

***Kansas GFOA***  
***GASB Update***  
Annual Fall Conference  
October 13, 2010

**Shelly Hammond**  
Vice President,  
Assurance Services

**Mike Lowry**  
Manager,  
Assurance Services

# Objectives

Overview and practical guidance on:

- GASB 54
- GASB 51 (effective 6.30.10)
- Other recent GASB releases

# **GASB Statement No. 54**

## ***Fund Balance Reporting and Governmental Fund Type Definitions***

# Overview

- Fund type definitions have been clarified
- Fund balance classifications based on hierarchy of relative strength of constraints

# Overview

- Stabilization funds or “rainy day” funds
- Stabilization-like or minimum fund balance policies
- Reporting the balances
- Policies and Note Disclosures
- Transfers
- Encumbrances

# Overview

## Why the change?

The overall objective of fund balance reporting is to isolate that portion of fund balance that is unavailable to support the following period's budget

- Lack of consistency among governments in the reporting components of fund balance
- Within the current methodology it is often unclear if any of the reserved or designated fund balances are available to help balance a government's budget.

# Current practice – general fund

**Example: assume general fund has capital projects, grants activity**

	<u>General fund</u>	<u>Special revenue fund</u>	<u>Capital projects fund</u>
<b>Reserved for:</b>			
<b>Capital projects</b>	\$100		
<b>Grants</b>	\$100		
<b>Unreserved</b>	\$100		

# Current practice – general fund

**Example: assume capital projects and grants activity occur in other funds**

	<u>General fund</u>	<u>Special revenue fund</u>	<u>Capital projects fund</u>
<b>Reserved for:</b>			
<b>Capital projects</b>			
<b>Grants</b>			
<b>Unreserved</b>	\$100	\$100	\$100

# Fund Balance – New Approach

What has happened with fund balance?

Classification hierarchy based on the extent to which a government is bound to honor constraints on the specific purposes for which amounts in those funds can be spent.

- 1) What are the limits? How resources can be spent.
- 2) Who says so? Identify sources of constraints.

# New classifications

- Nonspendable
  - Restricted
  - Committed
- } essentially now  
***reserved***
- Assigned
  - Unassigned
- } essentially now  
***unreserved***

# Nonspendable fund balance

- Not in spendable form
  - Inventory
  - Long-term receivables not expected to be converted to cash in the near term
- Legally or contractually required to be maintained intact
  - Corpus of a permanent fund (endowment)
  - Revolving loan fund – core funds to remain

# Restricted fund balance

- Essentially the same definition as for net assets under GASB 34 (as amended by 46)
  - External parties
  - Constitutional provisions
  - Enabling legislation

\* Externally Enforceable\*

# Committed fund balance

- Constraint on use imposed by the government itself, using its highest level of decision-making authority
- Constraint can be removed or changed only by taking the same action
- Action to constrain resources should occur before the end of the year, though the exact amount may be determined later

# Assigned fund balance

- Amounts intended to be used for specific purposes – similar to current “designated, unreserved fund balance”
- Intent expressed by
  - The governing body
  - A body (budget or finance committee.) or official authorized by the governing body
- Residual amounts in governmental funds other than the general fund are assigned
- Appropriation of existing fund balance

# Unassigned fund balance

- Available for any purpose
- Reported only in the general fund, except in cases of negative fund balance
  - Negative balances in other governmental funds are reported as unassigned (cannot “assign” a negative balance)

# New practice – general funds

**Example: assume capital projects and debt service activities occur in the general fund**

	<u>General fund</u>	<u>Debt service fund</u>	<u>Capital projects fund</u>
<b>Restricted for debt service</b>	\$100		
<b>Committed for capital projects</b>	\$100		
<b>Unassigned</b>	\$100		

# New practice – all funds

**Example: assume capital projects and debt service activities occur in other funds**

	<u>General fund</u>	<u>Debt service fund</u>	<u>Capital projects fund</u>
<b>Restricted for debt service</b>		\$100	
<b>Committed for capital projects</b>			\$100
<b>Unassigned</b>	\$100		

# Encumbrances

- Encumbrances should not be displayed separately within the restricted, committed and assigned categories.
- Amounts are classified as restricted, committed, and assigned based on the source and strength of the constraints placed on them – encumbering those amounts does not further affect them.

# Note

- Not all governments will have all five classifications of fund balance – in fact, with the exception of the General fund, this will be rare!
- Special Revenue Funds – classifications generally will follow the character and nature of the revenue source.

# Encumbrances

- The concept of an encumbrance is based on budgetary availability – reserving resources that can't be used for next year's budget.
- GASB 54 focus is on distinguishing the extent to which purpose limitations have been established regarding use of amounts.

# Encumbrances

- For example, an amount could be classified as Restricted for a specific purpose, some or all of which may be encumbered.
- Encumbering the amount does nothing to further restrict the amount, so it should not be shown on the face of the statements.

# Encumbrances

- If you have encumbrance accounting, encumbrances will be reported as either:
- Committed – if approved by action of the highest decision-making authority
    - Board votes to allocate \$300,000 of fund balance for purchase of a new fire truck.
  - Assigned – resulting from the issuance of purchase orders as a result of normal purchasing activity approved by appropriate officials
    - This will be the most common classification.

# Example – next year's budget

- In order to balance the next year's budget, the city budgets the use of \$1.5 million of carryover fund balance.
- Does this have an impact on fund balance reporting at the end of the current year?

# Example – construction contract

- The capital projects fund has a \$10 million in outstanding construction contract.
- The project is funded by:
  - \$5 million in bond proceeds, which have been received
  - \$3 million in local funds that are in the capital project fund for the project
  - \$2 million to come from a general fund transfer next year

# Fund definitions

What has happened with Fund Type Definitions?

Impacted –

- General Fund
- Debt Service Funds
- Capital Project Funds
- Special Revenue Funds

# Fund definitions

The good news!

Changes to the general fund, debt service fund and capital project fund definitions are minor and in most cases, just reflect the new terms of restricted, committed and assigned.

# Fund definitions

Capital projects fund definition has been broadened to allow for more practical application and to include the capital reserve methodology.

# Special Revenue Funds

Used to account and report the proceeds of specific revenue sources that are restricted or committed to expenditures for specific purposes other than debt service or capital projects

# Special Revenue Funds

- Foundation for the fund should be from a revenue source that is either restricted or committed.
- The restricted or committed revenue source should be expected to continue to represent a substantial portion of the inflows reported in that fund.
- Other restricted, committed, or assigned may be reported in that fund.
- At any point the government does not expect that a substantial portion of the inflows will be from restricted or committed resources, stop using a special revenue fund and move remaining resources to the general fund.

# Special Revenue Funds

## Transfers

- If revenues are initially received in another fund, they should NOT be reported as revenues in the fund receiving them; instead, they should be recognized in the special revenue fund where they will be spent.
- Meaning – if a special revenue fund's substantial revenue source is a transfer, determine the nature of the revenue being transferred. If it is restricted or committed in nature then it is a reduction of the revenue in the fund it is originally flowing into and an increase in revenue to the fund receiving it. Example – school districts.
- Reminder – a special revenue fund where the substantial portion of revenue is a transfer no longer qualifies unless meeting the above.

# Special revenue funds - example

	Special District	School Reserve	Economic Development	Major Projects	Science Center
Revenues:					
Property taxes	\$1,500,000	\$0	\$0	\$0	\$0
Charges for svcs	0	0	475,000	0	6,000,000
Investment inc.	45,000	0	50,000	1,500,000	22,000
Expenditures	950,000	0	9,900,000	300,000	7,000,000
Transfers In (Out)	0	0	9,100,000	(1,300,000)	1,000,000
Fund balance, BOY	1,100,000	4,000,000	900,000	28,000,000	125,000
Fund balance, EOY	\$1,695,000	\$4,000,000	\$625,000	\$27,900,000	\$147,000

# Special revenue funds: disclosure

- Disclose purpose of each major special revenue fund, and each revenue source or other resources authorized to be reported in each.

# Special revenue funds

## Implementation – Start Now!

- Important to know where certain resources will be reported at the start of the budget cycle.
- Review special revenue funds to determine if they meet the revised definition
- Some funds may not meet the additional guidance requiring that a substantial portion of the future inflow come from a restricted or committed resource.

# Special revenue funds

## Journal of Accountancy

*“In one test case, nearly one-third of a government’s special revenue funds did not appear to meet the revised special revenue fund definition”!*

# Example: Stabilization (rainy-day) amounts

- Stabilization was not previously considered a specific purpose.
- If constraints on stabilization amounts meet criteria to be reported as restricted or committed, then stabilization can be considered a specific purpose.
- Stabilization amounts should NOT be reported as assigned.

# Stabilization amounts - other

- Stabilization is regarded as a specified purpose only if the circumstances that signal the need for stabilization:
  - Are identified in sufficient detail, and
  - Are not expected to occur routinely

# Presentation & disclosure

- May present details on face of the financial statements, or in the footnotes
- Disclose:
  - Nonspendable by type
  - Restrictions by purpose
  - Commitments and assignments in sufficient detail that major purposes are evident to the reader

# Note disclosures

- Description of authority and actions that lead to committed and assigned fund balance
- Encumbrances, if significant, are disclosed in conjunction with other disclosures of significant commitments
- Spending prioritization policies
  - Use of restricted vs. unrestricted
  - Committed, assigned, unassigned

# Note disclosures

- Stabilization arrangements
  - Authority for establishing
  - Requirements for additions
  - Conditions under which amounts may be used
- Minimum fund balance policies

# Fund balance policies

- Generally applies to the General Fund
- The following should be addressed:
  - The appropriate level of unrestricted fund balance to be maintained in the general fund
    - Can be expressed as a minimum amount or a range between amounts
  - The circumstances in which unrestricted fund balances can be “spent down”
  - The policy for replenishing deficiencies
    - Should indicate source of funding and time period for replenishment to occur

# Fund balance policies

- Authority and actions that lead to committed and assigned fund balances
  - Need to be specific
    - Committed = resolution, ordinance, etc.
    - Assigned = Board, Dir. of Finance, City or County Manager, Purchasing, etc.
    - Be careful not to get too general – will cause challenges in tracking controls and documenting balances.
- The order of spending
  - Overall goal should lead to a policy that provides the most flexibility
- Creation of governmental funds
- Properly documented
- Properly disclosed in the notes to the financial statements

# Effective date

- Effective for periods beginning after June 15, 2010
- Consider implications now, as changes to fund definitions and other actions may need to be taken during the next budget cycle.

# GASB 54 steps to take

- Review fund structure (definitions).
- Review / establish fund balance policy.
- Be sure that appropriate Board action is taken to ensure funds can be shown as committed.
- Establish / strengthen control processes to track changes in committed and assigned funds.

# **GASB Statement No. 51**

## ***Accounting and Financial Reporting for Intangible Assets***

# GASB 51: Accounting and Financial Reporting for Intangible Assets

An intangible asset must have ALL of the following:

- Lack of physical substance
- Non-financial in nature
- Initial useful life extending beyond a single reporting period

# Common intangible assets

Right-of-way easements

Other easements

Patents, copyrights, trademarks

Land use rights

Licenses and permits

Computer software

- purchased or licensed
- internally generated

# Accounting for intangible assets

- All intangible assets should be classified as capital assets.
- Means that other authoritative guidance related to capital assets also applies (recognition, measurement, depreciation, impairment, presentation, etc.)
  - Therefore not reported as assets in the governmental funds

# Recognition of intangible assets

An intangible asset should be recognized only if it is identifiable:

- Asset is separable (capable of being separated or divided from the gov't and sold, transferred, licensed, rented, etc.)

OR

- Asset arises from contractual or other legal rights, regardless of whether those rights are transferable or separable

# Measurement

Follow same guidance as for capital assets:

- Historical cost
- If donated, estimated fair value at date of donation

# Donated right-of-way easements for roadways

Fair value = amount for which the asset could be exchanged in a current transaction between willing parties

Easements: generally the only willing buyer is the government. Therefore, the amount which the gov't would have incurred to acquire the easement can be used for fair value.

- can use the fair value of the associated land

# Internally generated intangible assets

Considered an internally generated asset (IGA) if:

- Created or produced by the government or an entity contracted by the government
- Acquired from a third party, but requires more than minimal incremental effort on the part of the government to achieve expected service capacity

# IGAs – when to capitalize

Only if ALL of the following occur:

- 1) Determination of the specific objective of the project and service capacity expected
- 2) Demonstration of the technical or technological feasibility for completing the project
- 3) Demonstration of the current intention, ability, and presence of effort to complete or continue development

# Internally generated computer software

Either:

Developed in-house by the government's personnel, or

Commercially available software modified using more than minimal incremental effort before being put into operation

# Software development stages

- 1) Preliminary project stage
- 2) Application development stage
- 3) Post-implementation / operation stage

# Preliminary project stage

- Conceptual formulation and evaluation of alternatives
- Determination of the existence of needed technology
- Final selection of alternatives

# Application development stage

- Design of the chosen path
- Coding
- Software configuration and interfaces
- Installation to hardware
- Testing, including parallel processing
- Data conversion, if necessary to make operational

# Post-implementation / operation stage

- Application training
- Software maintenance
- Data conversion, if not necessary to make operational

# Software – reporting activities

- Preliminary project stage – expense as incurred
- Application development stage – capitalize once criteria on slide 14 are met
- Post-implementation / operation stage – expense as incurred

# Modifications to software

Outlays associated with modifications to software already in operation should be capitalized according to the previous guidance if it results in:

- 1) An increase in the functionality
- 2) An increase in the efficiency
- 3) An extension of the estimated useful life

# Amortization

- Useful life taken from the term of contractual or other legal rights
- Indefinite useful life: no factors limiting the useful life
  - Example: permanent right-of-way easements

# Impairment

Impairment analysis would be the same as under GASB 42, with one new additional item added:

- Development stoppage

# Note disclosures

- No note disclosure requirements specific to intangible assets
- Intangible assets should be incorporated into the capital asset note disclosures

# Effective date / transition

- Effective for periods beginning after June 15, 2009
- Generally applied retroactively (restating prior financial statements)
- Exceptions to retroactive reporting:
  - Not required for intangible assets with indefinite lives
  - Not required for internally generated assets (including those already under development)
  - Phase 1 & 2 gov'ts: only have to report assets acquired in fiscal years ending after June 30, 1980
  - Phase 3 gov'ts: retroactive reporting not required

# Practical considerations

- Capitalization policies established?
  - Thresholds
  - Lives
  - Software activities – classification
  - Accumulation of costs
  - Evaluation / assessment of modifications to software – consider materiality – expense unspecified upgrades?

# Other examples

- 1) Land use rights: for those associated with property already owned, should not report as a separate intangible asset
- 2) Water rights: if acquired by a utility enterprise fund with the intent they be used in operations as the main source for water sold by the utility, they are a separable intangible asset
- 3) Websites: considered computer software

# Other examples

- 4) Maintenance contracts: annual fixed fees for maintenance and upgrades – for upgrades, follow guidance on slide 21. Also may have an internal capitalization threshold policy which these may fall under.
- 5) Licensing agreement for computer software: for use of the software, routine systems maintenance, rights to future upgrades, etc. Allocate costs – i.e., if related to use of the software, capitalize; if for maintenance, expense

# Other GASBs

## **Statement No. 55**

*The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*

- Issued March 2009
- Effective upon issuance
- Incorporate the hierarchy of GAAP for State and Local Governments into the GASBs

## **Statement No. 56**

*Codification of Accounting and Financial Reporting Guidance Contained in the AICPA Statements on Auditing Standards*

- Issued March 2009
- Effective upon issuance
- Incorporate authoritative literature for certain accounting and financial reporting guidance presented in the AICPA audit standards.

# Other GASBs

## **Statement No. 57**

*OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*

- Issued December 2009
- Effective immediately
- Addresses issues related to the use of alternative measurement method and the frequency and timing of measurements by employers that participate in agent multiple-employer OPEB plans

# Other GASBs

## **Statement No. 58**

*Accounting and Financial Reporting for Chapter 9 Bankruptcies*

- December 2009
- Effective for periods beginning after June 15, 2009
- The objective of this Statement is to provide accounting and financial reporting guidance for governments that have petitioned for protection from creditors by filing for bankruptcy under Chapter 9 of the United States Bankruptcy Code. It requires governments to re-measure liabilities that are adjusted in bankruptcy when the bankruptcy court confirms (that is, approves) a new payment plan.

# Other GASBs

## **Statement No. 59**

### *Financial Instruments Omnibus*

- Issued June 2010
- Effective for periods beginning after June 15, 2010
- The objective of this Statement is to update and improve existing standards regarding financial reporting and disclosure requirements of certain financial instruments and external investment pools for which significant issues have been identified in practice.