STATE OF CALIFORNIA

CALIFORNIA COMMUNITY COLLEGES
CHANCELLOR'S OFFICE
1102 Q STREET
SACRAMENTO, CA 95814-6511
(916) 445-8752
HTTP://WWW.CCCCO.EDU

ACCOUNTING ADVISORY NO. 2001-01
June 18, 2001

TO: District Chief Business Officers

FROM: Frederick E. Harris, Director
College Finance and Facilities Planning

SUBJECT: Implementation of GASB 34/35
Raised Threshold for Inventory of Capital Assets

Synopsis: The Governmental Accounting Standards Board has issued new financial reporting standards that apply to state and local governments and to public colleges and universities. In June of 1999 the Governmental Accounting Standards Board (GASB) issued Statement No. 34, "Basic Financial Statements — and Management's Discussion and Analysis — for State and Local Governments." This new statement makes significant changes in the format and focus of financial statements of state and local governments. In November of 1999, GASB issued Statement No. 35, "Basic Financial Statements — and Management's Discussion and Analysis — for Public Colleges and Universities, an Amendment of GASB Statement No. 34." Statement No. 35 permits public colleges and universities to adopt a reporting model based on the provisions of Statement No. 34 that apply to special-purpose governments engaged only in business-type activities (BTA), engaged only in governmental activities, or engaged in both governmental and business-type activities.

It appears that all or nearly all public colleges and universities nationwide have selected to implement the provisions of the BTA reporting model. Based on this and other factors discussed below, the consensus of district representatives and the Chancellor's Office is that the California Community Colleges will best benefit from and will therefore implement the BTA reporting model. To this end, the Chancellor's Office through consultation is examining the *Budget and Accounting Manual* (BAM) in order to bring it into compliance with the BTA reporting model and to maintain the integrity of the information provided by community college districts.

In a separate but related effort to update the accounting standards on capital equipment acquisitions, this Accounting Advisory also raises the minimum capitalization threshold for district property and equipment to $5,000. This change is discussed more fully under the Capital Assets heading on page 4.

BTA, Combined Governmental and BTA, or Governmental Reporting Model?

In a teleconference on May 17, 2001, the Fiscal Standards and Accountability Committee consulted with Joseph Blythe, Project Manager for GASB, and with community college leaders from two other states that had already begun implementation of GASB 35 using the BTA reporting model.

According to Joseph Blythe, the guidance contained in GASB Statements 34 and 35 is set up in such a way that there are absolutely no overriding criteria that are defined in the standards to guide an organization to any one of the specified reporting models. Each college and university system is free to choose whether to follow the governmental reporting model, the combined governmental and BTA reporting model, or the BTA reporting model. BTA is an option so long as nominal amounts of enrollment fees are collected. Based on information from Joseph Blythe and other teleconference participants, it appears that all or nearly all public colleges and universities nationwide will be implementing the BTA reporting model and it will be easier to display comparable data if we follow the college and university industry standards.

The Fiscal Standards and Accountability Committee's unanimous recommendation to the Chancellor's Office to adopt the BTA model was based on the following considerations:

- It appears that virtually all of the public colleges and universities in the country will use the BTA reporting model. This presentation will help differentiate us from cities, counties and local school districts; and it will improve comparability with colleges and universities nationwide.

- The new reports will be presented in a format similar to private sector reports, and are easier for outside entities to understand.

- The necessary implementation training for business and fiscal staff will be more readily available for colleges and universities that follow the BTA model.

<u>What Will Continue</u>

- Traditionally, the annual district audit includes fund-based financial statements and supplemental information required to fulfill reporting requirements of Generally Accepted Accounting Principles (GAAP) and outside entities. These statements, schedules and information are presented for the purposes of additional analyses and to ensure compliance with legal requirements. However, these items are not part of the basic financial statements under the BTA model. It is therefore anticipated that these items will become part of the supplemental information section of the annual district audit. As GASB 34/35 is implemented, the information included in the supplemental information section may change through consultation.

- A change in the fund structure will not be necessitated by the implementation of GASB 34/35.

- At this point, fund information included in the CCFS-311 (Annual Financial and Budget Report) and CCFS-311Q (Quarterly Financial Status Report) will continue. It is anticipated that the Fiscal Standards and Accountability Committee and other consultative groups will have the opportunity to review and provide input on the conversion from modified accrual to full accrual basis, and consideration of any necessary revisions to the BAM, CCFS-311, and CCFS-311Q as a result of the new financial reporting standards.

What Will Change

New District Financial Statements:

Management's Discussion and Analysis (MD&A)
[GASB 34, paragraph 8-11]

- Is required supplementary information (RSI);

- Precedes the basic financial statements;

- Provides an objective and easily readable analysis of the institution's financial activities based on currently known facts, decisions, and conditions;

- Discusses positive and negative aspects of the comparison with the prior year;

- May use charts, graphs, and tables to enhance understandability of the information.

Statement of Net Assets
[GASB 34, paragraphs 97-98]

- Uses classified format (current vs. noncurrent [long term] classifications);

- Requires separation of restricted assets (e.g., cash and cash equivalents restricted for repayment of debt);

- Three net asset categories: unrestricted; restricted (distinguishing between major categories of restrictions); and invested in capital assets, net of related debt;

- Can use net assets format (assets less liabilities equal net assets) or a balance sheet format (assets equal liabilities plus net assets), (the process for coming to consensus on our system's selection is not yet complete); and

- Does not display internal designations of unrestricted net assets on the face of the statement of net assets (but may disclose them in the notes to the financial statements). [GASB Statement 34, Paragraph 37]

Statement of Revenues, Expenses, and Changes in Net Assets
[GASB 34, paragraphs 100-101]

- Distinguishes between operating/nonoperating revenues and expenses;

- Considers state appropriations as nonoperating revenues;

- Has an optional natural or functional expense classification (the process for coming to consensus on our system's selection is not yet complete); and

- Provides for separate reporting of revenues from capital contributions, additions to the principal of permanent and term endowments, special and extraordinary items, and transfers.

Statement of Cash Flows
[GASB 34, paragraph 105 and GASB 9]

- Requires the direct method;

- Has four categories:
  - Operating
  - Noncapital financing (e.g., state appropriations and gifts);
  - Capital and related financing, and
  - Investing.

- Requires reconciliation of operating income (loss) to net cash flows from (used In) operating activities; and

- Requires that information concerning significant noncash activities be reported separately.

Capital Assets
[GASB 34, paragraphs 18-22]

Includes land, improvements to land, easements, buildings, building improvements, vehicles, machinery, equipment, works of art and historical treasures, infrastructure, and all other tangible or intangible assets that are used in operations and that have initial useful lives extending beyond a single reporting period.

- Must be reported at historical cost or, if donated, at the estimated fair value at the time of acquisition;

- Are depreciated over their estimated useful life—except for—
  - Noncapitalized collections of works of art, historical treasures, and similar assets
  - Inexhaustible assets (e.g., land); and
  - Infrastructure assets reported using the modified approach.
- Include ancillary costs and capitalized interest;
- Use the same depreciation methods to calculate the depreciation amounts for facilities and administrative rate purposes as are used by the institution for its financial statements [OMB Circular A-21, paragraphs 12.b.(2); and
- Are recorded at net book value as of the date of implementation--
  - Prior periods restated, and
  - Net assets cumulatively adjusted.

Raised Capitalization Threshold (*Budget and Accounting Manual*)

Based on federal guidelines, the State of California has recently adopted a $5,000 capitalization threshold for capital assets (formerly called fixed assets). The Fiscal Standards and Accountability Committee unanimously recommended raising the threshold for community colleges to the same level. Districts retain authority to inventory assets at a lower level if there is local need to do so, but the $5,000 level is the uniform system level for capitalization and depreciation. The committee also unanimously recommended tying the capitalization threshold for community colleges to the federal guidelines.

In further support of this position, the committee noted that raising the threshold will usually eliminate about 80% of the inventory line items, while retaining about 80% of the total value of the inventory.

This Accounting Advisory supersedes the Budget and Accounting Manual, pages 2.47, 2.48, 4.64, 4.65, and 5.12 as it relates to inventory, capitalization, and depreciation.

Infrastructure Assets (i.e., long-lived capital assets)
[GASB 34, paragraphs 148-166]

- Must be implemented at the same time as GASB 35 for public institutions that report as BTA;
- Are long-lived capital assets that normally are stationary in nature and normally can be preserved for a significantly greater number of years than most capital assets, (e.g., roads, bridges, tunnels, drainage systems, water and sewer systems, lighting systems, etc.); and

- Parking lots and fencing may be treated as land improvements because they are typically adjacent to the buildings that they service and have a much shorter life than long-lived infrastructure assets as defined by GASB. Furthermore, these assets serve different functions than infrastructure assets and are considered part of the adjacent building. [Questions 25 and 46 of the GASB34/35 Implementation Guide address this issue.]

Note Disclosures about Capital Assets and Long-Term Liabilities [GASB 34, paragraphs 116-120]:

- Should provide detail in the notes to the financial statements about capital assets and long-term liabilities reported in the statement of net assets. The information disclosed should be divided into major classes of capital assets and long-term liabilities. Capital assets that are not being depreciated should be disclosed separately from those that are being depreciated; and

- Should provide disclosures about capital assets and long-term liabilities of discretely presented component units if deemed necessary for fair presentation.

IMPLEMENTATION ISSUES:

The effective date of implementation is based on total revenues as of the 1998-99 Fiscal Year:

Phase I:	**7-1-2001**	**Districts with total revenues ≥ $100,000,000**
Phase II:	**7-1-2002**	**Districts with total revenues ≥ $10,000,000 < $100,000,000**
Phase III:	**7-1-2003**	**Districts with total revenues < $10,000,000**

Obtaining Fixed Asset Information:

Districts will need to restate the beginning fund balances during the year of implementation to properly present the ending net asset balance. This means that districts will need to establish the original cost basis (or fair market value at the time of donation, if donated), for land, building, furniture, equipment, etc. These capital assets will then need to be depreciated from the date purchased or placed into service through the end of the year prior to implementation.

Depreciation can be calculated using various generally accepted methods such as straight-line or an accelerated calculation. Assets can be depreciated on an individual basis or like items can be grouped and depreciated on a composite basis. GASB 34 also provides guidance for calculating depreciation.

In addition, please note that GASB 34 makes a distinction about which capital assets are infrastructure assets such as roads, bridges, water system, etc. Most districts will have few, if any, infrastructure assets. Capital assets, that are not infrastructure assets, must be capitalized and depreciated as of the date of implementation of GASB 34.

Converting Modified Accrual Accounting Basis to Full Accrual Accounting Basis:

Individual funds under the modified accrual basis of accounting will need to generate journal entries to convert the financial statements to the full accrual basis of accounting in order to complete the BTA model financial statements. An example of such entries would be:

- Reduce capital outlay expense for fixed assets purchased and to be capitalized under GASB 34
- Increase expenses by reporting depreciation expense on capital assets
- Reduce proceeds from long-term debt for new debt entered into during the fiscal year, such as capital leases, COPs, GO Bonds, etc.
- Record long-term debt as a liability on the Statement of Net Assets (Balance Sheet)
- Reduce long-term debt expense for principal payments on debt and apply this against the long-term debt reported on the Statement of Net Assets
- Record accounts receivable as outlined in GASB 33 – criteria for revenue recognition
- Record liabilities for obligations incurred during the reporting period but not paid within the standard 60 to 90 day period. Such obligations would include those covered under GASB 16 – Accounting for Compensated Absences and debt service interest.

In order to properly complete the financial statements under the BTA model, districts will need to restate their beginning fund and net asset balances for the year of implementation using the full accrual method.

Resources Available for Districts

The Fiscal Standards and Accountability Committee has named a subcommittee to coordinate the implementation activities and to arrange for training for district staff on all the aspects of implementing this nationwide change. The subcommittee is composed of district representatives from the first phase and second phase of implementation.

The Chancellor's Office will conduct workshops in the north and the south this calendar year. The Chancellor’s Office will co-host a workshop at the Foothill-DeAnza district this

September, and one in the south at a later date. There will also be audit workshops conducted in the Spring of 2002.

The Chancellor's Office will issue further accounting advisories on various facets of the implementation process as the need arises.

OTHER RECOMMENDATIONS:

- Contact your auditors and discuss GASB 34/35 prior to implementation
- Attend workshops on the topic
- Prepare a GASB 34/35 implementation timeline
- Districts may want to begin drafting a sample MD&A to know what types of information should be included, methods to gather data, how to produce graphs, etc.
- Districts may want to go through a trial run prior to the beginning of their implementation year in order to prepare for the actual implementation

As the implementation date draws closer, and as Phase I districts begin to implement their plans, more and more information will become available. The Chancellor's Office is planning to issue sample financial statements in the revised Contracted District Audit Manual.

Contact: If you have any questions related to the financial statements and audit aspects of GASB 34/35 please contact Steve Nakamura at (916) 327-6818/E-mail snakamur@cccco.edu. For questions related to the Budget and Accounting Manual and the CCFS-311 please contact Patrick Ryan at (916) 327-6223/E-mail pryan@cccco.edu.

CC: District Superintendent/President
Thomas J. Nussbaum
Patrick J. Lenz
Steve Nakamura
Patrick Ryan
Debbie Copple

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