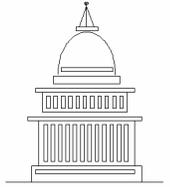




Local Governmental Auditing and Accounting

Newsletter



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Questions or Concerns?

If any entity has questions or concerns regarding budgeting, financial reporting, or compliance with state law or policy, please feel free to call any of the individuals listed above. If we don't have the answer, we can research the question or refer you to the office or individual that can help you! Outside the Salt Lake City area, feel free to use our toll-free telephone number: 1-800-622-1243. You can also e-mail us at the addresses shown above.

GASB STATEMENT No. 34

AND NEW AUDIT GUIDE

Auston G. Johnson, CPA

State Auditor

In June of 1999, we met as an AICPA task force to rewrite the AICPA audit guide "Audits of State and Local Government Units" (ASLGU). Since GASB Statement 34 (the new reporting model) had just been adopted, we needed a new audit guide that would address the very significant changes caused by its implementation.

One year later, the new audit guide is drafted and in the process of being reviewed by the task force members. Following the task force review, the draft guide will be reviewed by "outsiders" and will hopefully be available in the spring of 2001. Since the new guide addresses the world after Statement 34, the AICPA will continue to support the current ASLGU for a few more years. With the transition to Statement 34 occurring over several years, there will need to be two guides during the transition period.

A number of areas in the new guide have been expanded including: infrastructure, depreciation, required supplementary information, auditing of estimates, revenue recognition, and materiality, just to name a few. Materiality has been a heavily discussed item, not just because of Statement 34, but because the way we have worded the auditor's report does not match up with the way we have planned the audit. The current auditor's report opines on the financial statements taken as a whole, but the audit has been planned at the fund type level or, in practice, by columns.

Under the new reporting model, financial statements are presented using different formats, there are entity-wide statements, and there are fund level statements. Auditing by columns will no longer work the way it has in the past. For instance, there are no fiduciary funds shown in the entity wide statements, and the entity wide statements will include all governmental fund types in one column including all capital assets. All proprietary fund types will be shown in a second column, and component units will be shown in a third. The total column in this presentation will be a true total column and not "memorandum only".

Because of these reasons (and others), the expanded discussion in the new audit guide will deal more with qualitative factors in establishing materiality. Misstatements of relatively small amounts that come to the auditor's attention could have a material effect on the financial statements. Governments as well as auditors will want to consider the qualitative factors as well as quantitative measures in establishing materiality.

We realize that these changes will be stressful to local governments as well as auditors. The State Auditor's Office plans to have extensive training for financial statement preparers and auditors beginning next year. The training, as currently envisioned, will be full day sessions getting down to the nitty-gritty of putting statements together, and performing the audits. The training will be regional and will probably be during the summer months. As we are able to finalize our plans for next year, we will provide you more information. _

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REPORTING INFRASTRUCTURE IN THE NEW REPORTING MODEL

As we have reported in prior issues of the Newsletter, local governments will be implementing a new reporting model for their financial statements within the next four years. We have previously discussed some of the new reporting requirements and the implementation schedule.

In this issue, we will discuss the new reporting requirements for infrastructure.

Local governments are not currently required to report infrastructure assets on their financial statements. However, under the new model, local government financial statements will be required to report both capital assets and infrastructure assets on their balance sheets.

Infrastructure assets 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. Examples of infrastructure assets include roads, bridges, tunnels, drainage systems, water and sewer systems, dams, sidewalks, and lighting systems.

There are three major issues related to reporting infrastructure. These include identifying the infrastructure assets, placing a value on the infrastructure, and determining how to depreciate the infrastructure assets.

Identifying Infrastructure Assets

Local governments should begin immediately identifying infrastructure assets owned by the entity. For many smaller local governments this may be a relatively easy task. A municipality may have a limited number of roads, bridges, sidewalks, and lighting systems owned and maintained by the municipality. On the other hand, larger municipalities and counties may have extensive infrastructure that will require significant resources to

In 1998, a government has sixty-five lane miles of roads in a secondary road subsystem, and the current construction cost of similar roads is \$1 million per lane-mile. The estimated total current replacement cost of the secondary road subsystem of a highway network, therefore, is \$65 million (\$1 million x 65). The roads have an estimated weighted-average age of fifteen years; therefore, 1983 is considered to be the acquisition year. Based on the U.S. DOT, FHWA's *Price Trend Information for Federal-Aid Highway Construction* for 1983 and 1998, 1983 construction costs were 69.03 percent of 1998 costs. The estimated historical cost of the subsystem,

identify.

It may be necessary for some entities to classify certain types of infrastructure into several subclassifications for placing values on, and depreciating those assets. For example, roads can have several subclasses such as main arterial, arterial, secondary, and dirt roads, etc. On the other hand the classification called "roads" may include curb and gutter, lighting systems, and sidewalks. The way an entity classifies its infrastructure will depend upon its needs and situation.

The new standard requires that most local governments retroactively identify infrastructure assets that were acquired or significantly reconstructed, or that received significant improvements in fiscal years ending after June 30, 1980. However, local governments with total revenues less than \$10,000,000 for the first fiscal year ending after June 15, 1999 are not required to retroactively report infrastructure. But all entities *are* required to record and report additions to infrastructure after they implement the new reporting model.

Placing a Value on Infrastructure Assets

A much more difficult task than identifying infrastructure assets is placing a value on those assets. Ideally, local governments will have records that go back 25 or 30 years that document the cost of infrastructure assets. In reality, few local governments will have records that go back that far. The Governmental Accounting Standards Board (GASB) recognizes the difficulty that may be encountered in placing values on infrastructure assets. Therefore, the transition provisions have been designed to minimize the costs of implementing the new model while nevertheless requiring infrastructure assets to be reported.

Governments may use any approach at valuing infrastructure assets that complies with the intent of GASB Statement 34. One suggested approach is to estimate historical cost using current replacement cost. This is done by calculating the current replacement cost of a similar asset and deflating this cost through the use of price-level indexes to the acquisition year or estimated acquisition year if the actual year is unknown. GASB provides the following example:

therefore, is \$44,869,500 (\$65 million x 0.6903). In 1998, the government would have reported the subsystem in its financial statements at an estimated historical cost of \$44,869,500 less accumulated depreciation for fifteen years based on that deflated amount.

Determining How to Depreciate Infrastructure Assets

Another significant challenge will be determining how to depreciate infrastructure assets once they have been identified and valued. Again, GASB states that governments may use any established depreciation

method. Depreciation may be based on the estimated useful life of a class of assets, a network of assets, a subsystem of a network, or individual assets. In determining useful lives of assets, governments may use (a) general guidelines obtained from professional or industry organizations, (b) information for comparable assets of other governments, or (c) internal information. A government should also consider an asset's present condition and how long it is expected to meet service demands.

Continuing the example from above, assume that in 1998 the road subsystem had a total estimated useful life of twenty-five years from 1983 and therefore has an estimated remaining useful life of ten years. Assuming no residual value at the end of that time, straight-line depreciation expense would be \$1,794,780 per year ($\$44,869,500 \div 25$) and accumulated depreciation in 1998 would be \$26,921,700 ($\$1,794,780 \times 15$).

Composite methods may also be used to calculate depreciation expense. Composite methods refer to depreciating a group of similar assets or dissimilar assets of the same class using the same depreciation rate. Initially a depreciation rate for the composite is determined. Annually, the determined rate is multiplied by the cost of the grouping of assets to calculate depreciation expense.

As an alternative to depreciation of infrastructure assets, governments may use the "modified approach" for reporting these assets. There are two requirements that must be met to avoid the requirement to depreciate infrastructure assets. First, the government must manage the infrastructure assets using an asset management system that has certain characteristics. And second, the government must be able to document that the infrastructure assets are being preserved approximately at (or above) a condition level established and disclosed by the government. We will discuss the modified approach for reporting infrastructure assets in more detail in our next edition of the Newsletter.

The good news is that only those governmental entities with revenues in excess of \$10,000,000 for fiscal years. The fund balance of a capital projects fund has no restrictions making it possible to save enough in the fund to allow for the purchase of expensive items. That is the purpose of the capital projects fund. The fund also allows the government to account separately for such capital activities. However, a capital projects fund is not required in Utah, except that it's the only realistic and legal way to save for major capital facilities, equipment, and vehicles. A capital projects fund should never be used as a "slush fund," a place to put funds to remain under the legal limit in the general fund. All monies put into and saved in a capital projects fund must be earmarked by the governing board (commission, council, trustees) for the future purchase of specific acquisitions. It is not required, however, that all savings for a capital

ending June 30, 1999 or December 31, 1999 must retroactively report infrastructure. That includes approximately the 19 largest cities, the 19 largest counties, 27 school districts, and about 10 special districts. However, all entities are required to record and report additions to infrastructure following the implementation date for that entity. _

FUND ACCOUNTING

In this issue we continue with the third article in a series on fund accounting. This series should be helpful for all sizes of government entities. Our reason for writing this series is to help government accountants and bookkeepers understand the accounting environment and requirements for local governmental units. This article will discuss the capital projects fund.

Before discussing the capital projects fund it must be pointed out that government accounting standards set forth that governmental units can have any number of funds, but that the least number possible should be used. Governments should establish and maintain those funds required by law and sound financial administration. Unnecessary funds will only result in undue complexity and inefficient financial administration.

The Capital Projects Fund

A capital projects fund is mostly an optional fund. When a state or local government undertakes significant capital acquisitions or construction, it may want to use a capital projects fund. Significant capital acquisitions might include the purchase of land, buildings, equipment, and vehicles. It would also include the construction of buildings. The purchase of something which is expensive and lasts over one year is usually considered a capital asset. It is difficult, if not impossible, to save enough money in the general fund for such a purchase, because the size of a general fund's fund balance is limited by law.

acquisition be included in this fund, for example, routine acquisitions like office furniture may be saved for and reported in the general fund. Once the government is ready to make the purchase, the payment may be made right out of the capital projects fund, or the payment may be made out of the general fund after the money has been transferred from the capital projects fund into the general fund.

GASB's *Codification, G60.105* states that capital grants or shared revenues from other governments restricted for capital acquisitions or construction, other than those associated with enterprise and internal service funds, should be accounted for in a capital projects fund. In this case "should" means must. _

GASB Rescinds Year 2000 Disclosure Requirements

The Governmental Accounting Standards Board has rescinded the requirements for local governments to report on Y2K preparedness in their financial statements.

As it turned out, most local governments either took adequate measures to prevent Y2K problems, or their systems were not as vulnerable as some feared they might be.

During 1998 and 1999 GASB issued Technical Bulletins requiring state and local governments to include disclosures in their financial reporting regarding steps they were taking to prepare themselves to ensure that they could continue operating when computer clocks turned over to the year 2000. This was a concern since many computers and computer programs were designed using only two digits to indicate the year. Many programs, it was feared, would interpret the digits 00 to mean the year 1900, resulting in chaos.

However, the transition from 1999 to 2000 resulted in very few system breakdowns and some very minor headaches. Therefore, since this has become a nonissue, GASB has rescinded Technical Bulletins 98-1 and 99-1, and Y2K preparedness disclosures will no longer be required for financial statements issued after February 22, 2000. _

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