GASB STATEMENT 34 IMPLEMENTATION TASKS

Determining How to Arrive at Restricted Net Assets in the Statement of Net Assets

Task

As part of the conversion from the fund financial statements to the government-wide statements, the total net assets must be broken down into invested in capital assets net of related debt, restricted and unrestricted. We must determine how to arrive at the Restricted Net Assets balance in the Statement of Net Assets.

Background, Definitions & Examples

As stated in paragraph 34 of Statement 34, restricted net assets can be defined as those net assets where constraints are placed on them either externally by creditors (such as through debt covenants), grantors, contributors, or laws and regulations of other governments; or by law through constitutional provisions or enabling legislation of the government itself. The term “enabling legislation” is defined in paragraph 34 as legislation that authorizes the government to assess, levy, charge, or otherwise mandate payment of resources (from external providers) including a legally enforceable requirement that those resources be used only for the specific purposes stipulated in the legislation.

In contrast to the definition above, constraints arising from any management designations or restrictions of net assets are internal as opposed to external, and thus would not be included as restricted net assets. The distinction between internal and external is important in the determination of restricted net assets. In addition to management constraints, a law “earmarking” existing revenue would be considered internal and would therefore not be restricting resources. The distinction is that for the specific resource to be restricted, the law committing that resource to a specific purpose would have to have been created in the same legislation that authorized the mandated payment of resources. In other words, the government has to obtain the funds under the conditions that would define it as restricted for those resources to be part of restricted net assets.

The balance of restricted net assets represents restricted assets reduced by the liabilities related to those assets. A liability is related to a restricted asset when the asset results from incurring that liability or if the liability will be liquidated with the restricted asset. A good example of this can be found in the GASB 34 Implementation Guide exercise for calculating net asset balances for governmental activities. The debt service fund balances are shown as a category of restricted net assets titled “Restricted for Debt Service”. The fund balances of the debt service funds are reduced by the accrued interest liability to be paid from the debt service funds.
Generally, restricted net assets for governmental activities will be different from the reserved fund balances in the governmental fund balance sheet. In the answer to Question # 200 in the GASB 34 Implementation Guide, there are several reasons for the differences. The first reason is that different measurement focuses and bases of accounting are used in the Statement of Net Assets than in the governmental fund statements. Secondly, the definition of reserved as it relates to resources that are part of fund balances includes more than resources that are restricted as net assets. The answer elaborates further by pointing out that resources that are reserved in governmental fund balances generally are those that are not available for appropriation in the budgetary process or is legally segregated for a specific use, and that those legally segregated for a specific purpose would be restricted net assets and those that are otherwise unavailable for appropriation are not restricted net assets. For example, as explained in the answer to Question # 96 of the Implementation Guide, it would appear that all special revenue funds would fit the definition of restricted. However, since the use of a special revenue fund is not limited to legally restricted resources, all of the resources of special revenue funds would not necessarily meet the definition of restricted for net assets reporting.

Generally, resources such as grants, contributions, donations, or bond proceeds that were received or earned in the governmental funds with an explicit understanding with the resource providers that those funds be used for a specific purpose would be considered restricted net assets. Unspent proceeds of capital related debt and the portion of the debt attributable to the unspent proceeds is also be included in restricted net assets. This restriction category would be considered restricted for capital projects. The answer to Question 200 of the Implementation Guide gives several specific examples of revenue sources that meet the definition of restricted in Paragraph 34, and those that do not. First, examples of revenue sources that meet the definition of restricted federal grants that are restricted for specific purposes by the grant agreements, taxes that are restricted to certain specified purposes pursuant to state statute or voter referendums, and impact fees that are restricted to certain purposes by contract. In contrast, resources that may be reserved in governmental fund balances because they are unavailable for appropriation, such as reserves for inventories, are not restricted net assets.

**Presentation Requirements**

According to GASB 34, net assets should be displayed in three components in the government-wide Statement of Activities – invested in capital assets net of related debt, restricted net assets, and unrestricted net assets. The same is required in the enterprise fund financial statements, which amounts will generally be the same as those shown in the government-wide statement as business-type activities.

The restricted net assets should be shown with separate line items distinguishing between major categories of restrictions. When permanent endowments or permanent fund principal amounts are included in restricted net assets, two subcomponents of
restricted net assets – expendable and nonexpendable (net assets required to be retained in perpetuity) - should be displayed.

Restricted net assets represents restricted assets reduced by the liabilities related to those assets. A liability is related to a restricted asset when the asset results from incurring that liability or if the liability will be liquidated with the restricted asset. It is possible that the liabilities related to the restricted asset could be greater than the restricted asset itself. However, a category of restricted net assets on the Statement of Net Assets cannot be negative. According to the discussion in the GASB 34 Implementation Guide exercise for calculating net asset balances for governmental activities, if the liabilities relating to the restricted assets are greater than those assets, then no balance would be reported as restricted net assets. The negative amount would be reported as a reduction to unrestricted net assets.

**Recommendations**

Based on the requirements and definitions above, procedures will need to be developed to identify and categorize restricted net assets for presentation in the government-wide Statement of Net Assets. The fund financial statements balances will have to be analyzed as part of the conversion to the government-wide financial statements to aid in this process. The enterprise fund financial statements will have the same required components of net assets, therefore these same amounts will generally be presented in the government-wide statements for business-type activities with no adjustments needed. Therefore, the procedures needed are those to identify resources such as grants, contributions, donations, or bond proceeds that were received or earned in the governmental funds with an explicit understanding with the resource providers that those funds be used for a specific purpose.

It is recommended that in the conversion of the fiscal year 2000 CAFR, these procedures be developed as the governmental fund balances of the governmental funds are converted to net assets in the government-wide Statement of Net Assets. It would be more efficient to develop these procedures during this process, since at this time the exact overall process in not defined. Also, it will be more efficient to determine the other categories of net assets within the same process.

**Procedures**

There is limited guidance available from GASB or other organizations on specifically how this process of determining restricted net assets will be done. The Implementation Guide does include an exercise for calculating net asset balances for governmental activities which includes all three components of net assets. This can be used as a guide to begin the process, but this exercise provides only limited details. A summary of the guidance given is as follows:

First, determine the major categories of restrictions that will be reported separately, i.e. capital projects, debt service, education, transportation, and so on. Using a
spreadsheet format, list these categories of net assets including the major restricted categories across the top of the spreadsheet as column headings. Next, the fund balances of the governmental funds are spread across the restricted categories as they are determined. The items in the reconciliation of the governmental funds balance sheet to the statement of net assets must then be allocated to the appropriate categories of restrictions. Finally, any categories of restricted net assets that are negative must be reclassified to unrestricted net assets. The result is that the total of the categories of restricted net assets, plus the unrestricted net assets and invested in capital assets net of related debt will equal the total net asset balances on the Statement of Activities and the previously mentioned reconciliation.

Specific procedures and methods will have to be developed when the CAFR conversion process begins, and when more specific guidance is available from GASB or other organizations.