

Primer: GASB 34



U.S. Department
of Transportation

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An FHWA Primer on the Governmental Accounting Standards Board's Statement 34: Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments



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November 2000

U.S. Department of Transportation
Federal Highway Administration
Office of Asset Management

ACKNOWLEDGMENT

The Office of Asset Management gratefully acknowledges the cooperation of the Governmental Accounting Standards Board (GASB) for permission to reprint from its publications and for assistance during the development of the Primer. We particularly thank James R. Fountain, Assistant Director of Research, and his staff, who graciously provided valuable review and comments.

NOTE TO THE READER

Appendices 1 and 2 contain sections from both GASB Statement No. 34, “Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments,” and the GASB Implementation Guide for Statement No. 34, copyright by Governmental Accounting Standards Board, 401 Merritt 7, Norwalk, CT 06856. This material is included by permission. Complete copies of both GASB documents can be obtained from the GASB.

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NOTE FROM THE DIRECTOR

Office of Asset Management, Infrastructure Core Business Unit, Federal Highway Administration

I am pleased to offer this Primer on the Governmental Accounting Standards Board (GASB) Statement 34 (GASB 34), “Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments,” which was promulgated by GASB on June 15, 1999. Statement 34 calls for state, local, and municipal governments to calculate the original cost of infrastructure constructed or improved during the 20-year period prior to the Statement’s issuance date in their annual financial reports. Governments may choose to report how much of the estimated original cost has been “used up” (i.e., depreciated) in the intervening years, or they can, if they meet certain requirements, report as expense the cost to maintain and renew that infrastructure on an annual basis. All new infrastructure must also either be depreciated or have its maintenance requirements accounted for.

The changes spurred by GASB Statement 34 are not only significant for public accounting, and therefore the financial markets, but are also important because they alter the way state and local governments offer financial information to the public. Finally, and importantly for the transportation community, the Statement encourages a mechanism by which the traveling public can be kept informed about the infrastructure issues of concern to them.

With GASB’s issuance of Statement 34, the Office of Asset Management has received a myriad of questions regarding the new standard. To fill this void in information, I determined that a primer on GASB 34 was in order. A previous primer issued by the Office, the “Asset Management Primer,” was received with enthusiasm and has proved helpful in explaining Transportation Asset Management concepts to a wide audience. This Primer is the second of what is anticipated to be a comprehensive series of documents exploring various issues related to Transportation Asset Management.

Since Transportation Asset Management is a business approach that transportation agencies are exploring and adopting as a way to make effective resource allocation decisions, this new Primer looks at Statement 34 from the perspective of transportation officials. It is intended to explain the Statement, set out what is required for compliance with the infrastructure provisions, and delineate how Asset Management can be of assistance. This Primer also provides a discussion of what GASB 34 may provide in terms of benefits to transportation agencies and is timely because of upcoming implementation deadlines. Large governments, those with over \$100 million in total annual revenues (which includes all states), must prospectively report on new infrastructure assets starting in the fiscal year beginning after June 15, 2001, with reporting of previously acquired infrastructure assets 4 years later.

Clearly GASB Statement 34 presents transportation agencies with an unparalleled opportunity to make other government officials and citizens aware of the value of the significant transportation assets that governments own and operate and the maintenance they require. Statement 34 will heighten awareness of the importance of investment in these assets and pinpoint the need to preserve their condition. State transportation officials, therefore, will continue to be interested in the Statement to the degree that it impacts their accountability for these same transportation assets.



Madeleine Bloom
Director, Office of Asset Management

INTRODUCTION

In June 1999, the Governmental Accounting Standards Board (GASB) established new financial reporting standards that will fundamentally change the way State and local governments report their financial results. Among other provisions, GASB Statement 34 (GASB 34), “Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments,” requires that major infrastructure assets acquired or having major additions or improvements in fiscal years beginning after June 15, 1980, be capitalized in financial statements. In addition, the cost of using the assets must be reflected.

HISTORY

The GASB, a private, nonprofit organization, was established in 1984 by the Financial Accounting Foundation. The Foundation oversees GASB, provides funding, and appoints the members of GASB’s board. The Foundation has a similar relationship with GASB’s sister organization, the private-sector, standard-setting Financial Accounting Standards Board.

GASB’s span of influence covers over 84,000 state, county, and other local governmental units. Also impacted by GASB’s financial reporting standards are organizations such as public utilities, municipal hospitals, and state universities. GASB, which does not impact the Federal government, establishes concepts and standards that guide the preparation of external financial reports. GASB establishes generally accepted accounting principles that are utilized by auditors charged with evaluating state and local government financial statements.

GASB has been working toward a revised governmental reporting model since being organized in 1984. This initiative responded to a belief that the financial reports of state and local governments were not providing information sufficient to assess financial position and cost of services. Fund information, while useful, did not meet many user needs (see “Basic Financial Statements sidebar,” pages 10-11.)

GASB’s approach to developing Statement 34 was characterized by a comprehensive outreach effort. First, the permanent Governmental Accounting Standards Advisory Council contributed significant input as the standard was being developed. The Council is comprised of individuals representing financial statement users from the government; the financial community; public interest groups; accountants, auditors, preparers; and others.

In addition, GASB established a special task force to focus on Statement 34. The task force included, among others, infrastructure experts from the American Association of State Highway and Transportation Officials (AASHTO) and the Federal Highway Administration (FHWA). Further, the outreach and review process included comments from interested individuals and organizations as well as GASB-sponsored public hearings and focus groups.

GASB listened to the input from its broad constituency. As a result, the Board altered its initial position to be more flexible on issues such as the magnitude of assets to be retroactively reported, procedures for capitalization, the implementation schedule, and the requirement that smaller governments report their assets retroactively. In addition, it is this dialogue that generated the “modified approach” as an alternative to depreciation. (The alternative approach is discussed in detail beginning on page 14.)

OVERVIEW OF THE NEW GOVERNMENTAL REPORTING MODEL

GASB Statement 34 specifies that full accrual accounting principles will be used for the government-wide statements. In other words, revenues and costs will be accounted for as they occur; costs may not be shifted to a future year by delaying payment. Therefore, Statement 34 calls for all long-lived capital assets—including infrastructure such as roads and bridges—to be reported in state and local government financial statements.

Also important is the requirement for a Management's Discussion and Analysis (MD&A) section. The MD&A is intended as a nontechnical presentation—suitable for a knowledgeable lay audience—of the government's financial performance over the year, including a comparison with the previous year's performance. The discussion will offer insights on the government's overall financial standing, provide an assessment of the change in financial position relative to the last reporting period, and identify current factors with the potential to influence the government's future financial position. This requirement follows the private-sector model, which requires similar information for publicly traded companies.

To meet the specifications of this new standard, governments will need to determine the cost associated with their transportation infrastructure assets. This includes initial construction costs and the cost of subsequent capital improvements as well as the associated expense of using the assets.

In terms of determining the cost of using the assets, GASB will allow governments to report a depreciation expense or apply an alternative modified/preservation approach. Governments may use the modified

approach in lieu of depreciating their assets if they have a systematic approach to managing those assets that, at a minimum, meets the following four requirements:

- Having a current inventory of eligible assets
- Documenting the condition of those assets via a reproducible assessment procedure
- Demonstrating that assets are being preserved at a level predetermined by the government
- Estimating the actual cost to maintain and preserve the assets.

The new infrastructure-related reporting features in Statement 34 provide for snapshots of long- and short-term financial performance and condition. For the first time, governments will account for all of the capital resources they use in delivering services. In other words, they will provide the full cost of serving the public. Previously only short-term resources were addressed, and infrastructure and associated usage costs were not considered by governmental funds. The governmental fund's balance sheets included only financial resources, or, basically, "cash on hand." Statement 34 more closely aligns government financial reporting practices with those that are presently used by proprietary funds and for corporate-style accounting because governments are now required to accrue costs in the same way businesses do.



SIGNIFICANCE

Statement 34 establishes methods for governments to be more accountable to bond market analysts and underwriters, citizens, and other financial users. The Statement provides for a comprehensive understanding of a government's financial position, making transparent the ability to repay long-term debt and deal with infrastructure maintenance obligations. The implications for issuance of bonds appear highly significant.

However, the potential impact of GASB 34 extends beyond financial reporting statements and may influence the manner in which infrastructure is thought of by citizens, the media, legislators, and others interested in public finance and infrastructure performance. State and local governments accounted for over \$75 billion in expenditures on highways and bridges in 1997. These expenditures are significant by any standard, and there is enormous concern regarding how this money is being spent. It is notable that literally trillions of dollars in public infrastructure have not, until now, been included in the financial statements of state and local governments.

In a general sense, implementation of Statement 34 may highlight the fact that considerable resources are spent on transportation infrastructure assets and that the benefits from these facilities extend many years beyond the initial investment. Infrastructure expenditures may be viewed more as investments.

For transportation agencies, Statement 34 is an opportunity to demonstrate that they are properly caring for the assets with which they have been entrusted. Indeed, by making the total cost of providing infrastruc-

ture-based transportation services explicit, an agency could anticipate a heightened interest in transportation issues. Specifically, questions such as the following could be raised:

- Does the agency allocate its resources in an efficient manner?
- Are citizen needs and wants being adequately addressed?
- What is the prognosis for the future condition of the system?
- How does the performance of one transportation agency compare to other similar agencies?
- Are the government's maintenance strategies resulting in the renewal of infrastructure assets?

Finally, Statement 34 has the potential to reinforce a transportation agency's choice to preserve a given asset instead of deferring maintenance. Because an increased emphasis is placed on reducing life-cycle costs, the preservation choice may be demonstrated as more reasonable than deferring maintenance. Deferred maintenance may result in prematurely replacing the asset, potentially at higher cost.

It is not an overstatement to say that Statement 34 will shape the environment in which transportation decisions are made. Asset Management, while independent of this GASB Statement, offers a means of enhancing the positive implications of Statement 34 and also of establishing more effective interactions with the public who utilize or are impacted by the assets.

BASIC FINANCIAL STATEMENTS

With GASB Statement 34, the following statements are required as part of the state and local financial reports and are audited.

GOVERNMENT-WIDE FINANCIAL STATEMENTS

The government-wide statements are a new requirement and include a statement of net assets and a statement of activities. The subject statements focus on the government as a whole and report all assets (including infrastructure), liabilities, revenues, and expenses of the government. These statements follow the flow of economic resources method (see the Financial versus Economic Measures sidebar, page 11), using full accrual basis accounting. Accrual accounting means that transactions are recorded when they occur, rather than when cash is disbursed or received.

These methods are similar to those used in the private sector and for enterprise funds of State and local governments (for example, tollways). GASB believes that this approach will provide better information about (1) operating results, (2) the government's financial position as a whole, (3) how and when expenses to provide government services are incurred, and (4) how one government compares to another.

Statement of Net Assets

The statement of net assets accounts for the entity's assets and liabilities at a given point in time. Net assets are simply the difference between assets and liabilities. All financial and capital resources are reported. Infrastructure assets that are being or have been depreciated are reported at historical cost (or estimated historical cost, at transition), less accumulated depreciation. Infrastructure assets that are reported using the "modified approach" are presented separately, capitalized at historical cost. Because preservation costs are expensed, there is no accumulated depreciation. In either case, additions and improvements to infrastructure are capitalized at historical or estimated historical cost.

Statement of Activities

The statement of activities reports government operating revenues and expenses. Expenses are reported by function and program, such as transportation, and any revenue (except taxes) attributable to that function or program is reported with the function or program and net expense or revenue presented. A review of this statement will indicate which programs contribute to and which draw from general revenues. Annual depreciation expense is generally reported with each program or function. For those assets reported via the modified approach, preservation expenditures are expensed; no depreciation expense is reported.

FUND FINANCIAL STATEMENTS

Fund accounting is used only by governments. A self-balancing set of accounts is maintained for various categories—or funds—for the organization. With GASB 34, the presentation, measurement focus, and basis of accounting of funds did not change. Fund accounting will continue alongside the new government-wide statements. Reconciliation of the fund statements with the government-wide statements will be required.

The funds reported by governments are organized into three categories: governmental, proprietary, and fiduciary. Each of these broad categories includes a number of different funds. The three broad categories are described below:

Governmental Funds

The entity's basic activities are reported in the "governmental fund" statements. These funds are prepared using the current financial resources measurement focus (see the Financial versus Economic Measures sidebar, page 11) and a modified, as opposed to full, accrual basis of accounting. This means that governmental funds do not report fixed assets, and therefore do not have depreciation expense. Further, they do not show long-term debt.

An example of a fund included in the broad governmental fund subdivision is the general fund. Departments generally funded with unrestricted income

sources (e.g., general sales tax) are reported in this area. Another example of a governmental fund is the capital-project fund, which includes funds earmarked for building and/or acquiring major capital assets such as infrastructure.

Governmental funds will continue to be reported on a flow of current financial resources measurement focus and modified accrual basis of accounting. The required financial statements are a balance sheet and a statement of revenues, expenditures, and changes in fund balances.

Proprietary Funds

Proprietary fund statements are used to report on activities financed and operated in a fashion similar to the private sector. Included in this major category are enterprise funds and internal service funds. Enterprise funds account for services where cost recovery is via user fees. Examples of enterprise fund activities include electrical and water utilities. Internal service funds report on departments that provide services to other governmental activities (e.g., a motor pool).

Proprietary fund statements will continue to record transactions using the economic resources measurement focus and accrual basis of accounting (with depreciation). Required proprietary fund statements are as follows: statement of net assets; a statement of revenues, expenses, and changes in fund net assets; and cash flow statements.

Fiduciary Funds

Fiduciary funds account for assets held and administered by a government for others. In other words, the government is acting as the trustee, and the funds may not be used by the government to support its own programs. An example of such an activity is a pension trust fund. Like proprietary fund statements, fiduciary statements are prepared using the economic resources focus and the accrual basis of accounting. According to GASB, required fiduciary fund statements include a statement of net assets and a statement of changes in net assets.

FINANCIAL VERSUS ECONOMIC MEASURES

Within governmental financial reporting, one of two different measurement focuses is employed. The choice depends on accounting assumptions regarding what the transaction represents in terms of how the resources will be used.

The *financial resources measurement focus* is similar to a cash basis and measures outlays in terms of cash expended (e.g., short-term payments). This means that even disbursements to secure a capital investment item are classified as expenditures.

The *economic resources measurement focus* accounts for all assets and liabilities. This is the focus used in proprietary funds of governments, government-wide financial statements, and for-profit accounting. Under this approach, an expenditure for a capital asset is noted on the balance sheet as an asset; the purchase is not reflected on the operations statement. The asset is depreciated over its useful life with its cost being allocated to the years for which it is used.

STATEMENT 34 INFRASTRUCTURE REQUIREMENTS

The following discussion highlights the key infrastructure features of GASB Statement 34. A summary of the actual Statement, from the transportation community’s perspective, is included at [Appendix 1](#). The reader is referred to [Appendix 2](#) for GASB’s answers to commonly asked questions.

INFRASTRUCTURE WILL BE INCLUDED IN THE ASSET BASE

The asset base will include all long-lived capital assets that are employed in a government’s operations. The term “long-lived” refers to assets that have initial useful lives that go beyond one reporting period. Examples of such assets include land, improvements to land, buildings, equipment, and infrastructure.

Infrastructure assets such as roads, bridges, and tunnels represent a somewhat special case among capital assets in that they are stationary and can generally be preserved for an indefinite period of time.

INFRASTRUCTURE WILL BE REPORTED AT HISTORICAL COST

GASB 34 calls for capital assets to be capitalized at historical cost. To “capitalize” means to record the amount expended to acquire a capital resource as an asset, rather than as an expense. The capitalized amount includes all charges for establishing the subject asset in a condition and location where it is available for its intended use.

GASB’s preference is that the initial capitalization amount represent historical cost. However, if reporting entities have difficulty securing historical cost amounts at the time of transition to Statement 34, either prospectively or retrospectively, the use of “estimated historical cost” and “deflated current replacement cost” methods will be allowed for infrastructure assets.

INFRASTRUCTURE WILL BE REPORTED AT THE NETWORK, SUBSYSTEM, OR INDIVIDUAL ASSET LEVEL

Statement 34 provides entities with the option of reporting at the network, subsystem, or individual asset level. This provision is particularly helpful in the case of infrastructure where it is less burdensome to report on a major subsystem, such as the Interstate system, rather than each numbered highway.

GASB defines a “network” as a group of assets where the individual members either provide similar services or work together to provide one service. Thus, a network can range from one asset that is made up of many components to a collection of assets that are roughly the same. For example, an entire roadway system, including all types of highways, signages, and rest areas, can be considered a transportation network. Similarly, a “subsystem” is a part of a network of assets. Components of the subsystem together perform a unique function, related to but distinct from the network. For example, a municipality’s road system constitutes a network, whereas residential streets could be a considered a subsystem of the network.

GASB has established the concept of major networks and major subsystems. A government, at a minimum, must identify and report on major networks where, according to Statement 34, “the cost or estimated cost of the network is expected to be at least 10 percent of the total cost of all general capital assets reported in the first fiscal year after June 15, 1999,” or on subsystems where estimated costs are expected to be at least 5 percent of the entity’s capital assets. Governments organizing their assets in this manner may choose not to report on non-major networks and still be consistent with the generally accepted accounting standards under Statement 34.



INFRASTRUCTURE WILL BE DEPRECIATED OR REPORTED USING A MODIFIED APPROACH

To be in compliance with Statement 34, governments must report capital assets—including infrastructure—at historical cost and then depreciate those assets over their useful lives. However, if infrastructure assets are maintained so as to preserve remaining service potential, the “modified approach” may be employed instead of reporting depreciation for the assets. GASB recognizes that when assets are consistently maintained and renewed so as to ensure essentially an indefinite life, they are not being “used up” as is assumed under traditional depreciation rules.

Under the modified approach, governments must inventory and assess the condition of the assets comprising a network (or subsystem), decide on a minimum level of acceptable condition, estimate the amount necessary to maintain and renew the assets, and then demonstrate that investment has been sufficient to maintain the target condition level established by the government. If these requirements are met, the government may report as expense the cost of maintaining and preserving or renewing the asset network as opposed to reporting depreciation.

The traditional and modified approaches are explained in greater detail in the following sections.

REPORTING INFRASTRUCTURE COST OF USE

THE TRADITIONAL APPROACH (DEPRECIATION)

The traditional accounting approach to reporting the annual cost of using capital assets involves two components: (1) operating maintenance and repairs, and (2) depreciation. Depreciation is a method of accounting for the “using up” of long-lived assets due to use or obsolescence. It is not intended as a measure of actual deterioration. In fact, deterioration may not actually occur in any given year, and, further the “real world” value of the asset may increase.

For each year of the asset’s useful life, expenses associated with routine maintenance and repairs and depreciation are reported in the statement of activities. Capital assets are reported net of accumulated depreciation, if any, in the statement of assets. (See Basic Financial Statements sidebar, pages 10-11.)

Depreciation expense is the share of the net acquisition cost of an asset allocated to the current period. To calculate the net acquisition cost, the initial cost of the capital asset is determined and then adjusted to reflect the salvage value, or that portion of the initial cost that will remain when the asset is taken out of use. To determine depreciation expense, the net acquisition cost is allocated to each year over the total years of its useful life, usually by dividing net acquisition cost by the estimated years of useful life (e.g., straight line depreciation).

“Useful life” is an estimate of how long the asset will be in use. The useful life estimate assumes a given maintenance and repair schedule. Thus, the costs associated with such maintenance and repair activities are reported as expenses when incurred because they do not extend the life of the asset. For example, maintenance only helps ensure that the asset will reach its useful life and provide acceptable service during that period.

Depreciation expense also includes an allocation of the costs of any additions or improvements that occur after initial acquisition and that benefit more than one period. In other words, the “net acquisition cost” (i.e., the amount that is depreciated) will be adjusted over time if the asset is materially improved in terms of quantity or quality or if its service life is expected to increase beyond the prior reported estimate. This is because the benefits associated with such improvements will be received over an extended period. Consistent with this approach, the cost of preservation/renewal activities will be capitalized and assigned to future periods through depreciation. Alternatively, amounts that benefit only the current period, such as routine operating maintenance and repair, are shown in the financial statements as expenses and are not capitalized.

There are many ways to allocate the net cost of depreciable assets. In the case of Statement 34, any established depreciation method may be used. Further, reporting entities may use composite methods.

THE MODIFIED APPROACH (PRESERVATION)

The modified approach recognizes that transportation agencies typically strive to maintain their assets at a specified level in perpetuity. Transportation agencies are constantly renewing their assets and thereby extending their useful lives. Therefore, preservation costs may reasonably be considered an appropriate measure for the cost of use because the expenditures necessary to preserve the system at its current condition are reported as period costs. Like the cost of routine operating maintenance—which benefits only one period—preservation costs would be reported as an expense in the financial statements. The reader will recall that in the case of depreciation, preservation/renewal expenditures are capitalized and then, over time, depreciated. Similarly, under the modified approach, improvements and additions that increase capacity or efficiency are capitalized, however, they are not depreciated.

A government using the modified approach will not have to depreciate infrastructure assets as long as certain requirements are met. First, the reporting entity must establish, and make public, condition goals for the subject assets on which they are reporting. Second, the government must estimate the spending levels necessary to achieve or maintain the condition target. Third, the amount required to maintain the pre-determined condition level must be compared to actual spending. Fourth, the government must document that the assets are being preserved approximately at or above the condition goal it pre-selected.

To comply with the requirements of the modified reporting approach, the government must have in place a system of managing assets that will produce a current inventory, assess the condition of that inventory, calculate the maintenance and preservation levels associated with alternative condition targets and estimate the spending levels necessary to achieve those targets. This information will provide a basis from which to establish attainable condition goals. Further, Statement 34 requires that governments be able to demonstrate these capabilities.

GASB also requires that governments address the following questions for assets reported using the modified approach in the “Required Supplementary Information” section of the financial statements:

- What is the “current” condition of the assets? (Assessments are required at least every 3 years, with the past three assessments being reported.)
- At what condition level does the government intend to maintain its assets?
- How is the government doing in terms of maintaining and preserving the assets relative to the government’s stated goal?
- How do actual maintenance and preservation expenditures compare with the amount estimated as being required to approximately meet or exceed the target condition level?
- What is the basis for tracking condition (e.g., the International Roughness Index might be used for pavements)?
- Has the reporting entity done anything that might impact the reported trends (e.g., changes in the basis for tracking and reporting condition)?

If a government is not able to maintain the pre-specified condition level for a given category of assets, then the entity will no longer be eligible to report using the modified approach and will need to depreciate those assets; alternatively the government may lower their pre-established condition level. It is important to note that the condition target specified for Statement 34 purposes may be less ambitious than the management target. For example, the management target could be that 85 percent of roads are in good or better condition while the target for GASB 34 compliance purposes could be that 75 percent of roads are in good or better condition.

IMPLICATIONS

In summary, under the depreciation option, infrastructure assets are capitalized based on historical cost and reported (net of accumulated depreciation) in the statement of net assets. Also capitalized are improvements, additions, and preservation activities. Depreciation expense is reported in the statement of activities.

In the case of the modified approach, infrastructure assets are capitalized based on historical cost. These costs are recorded in the statement of net assets. However, they are not depreciated. Instead, preservation costs are recorded as expenses in the statement of activities. As with depreciation, expenditures that materially improve the quantity or quality of the subject asset are to be capitalized.

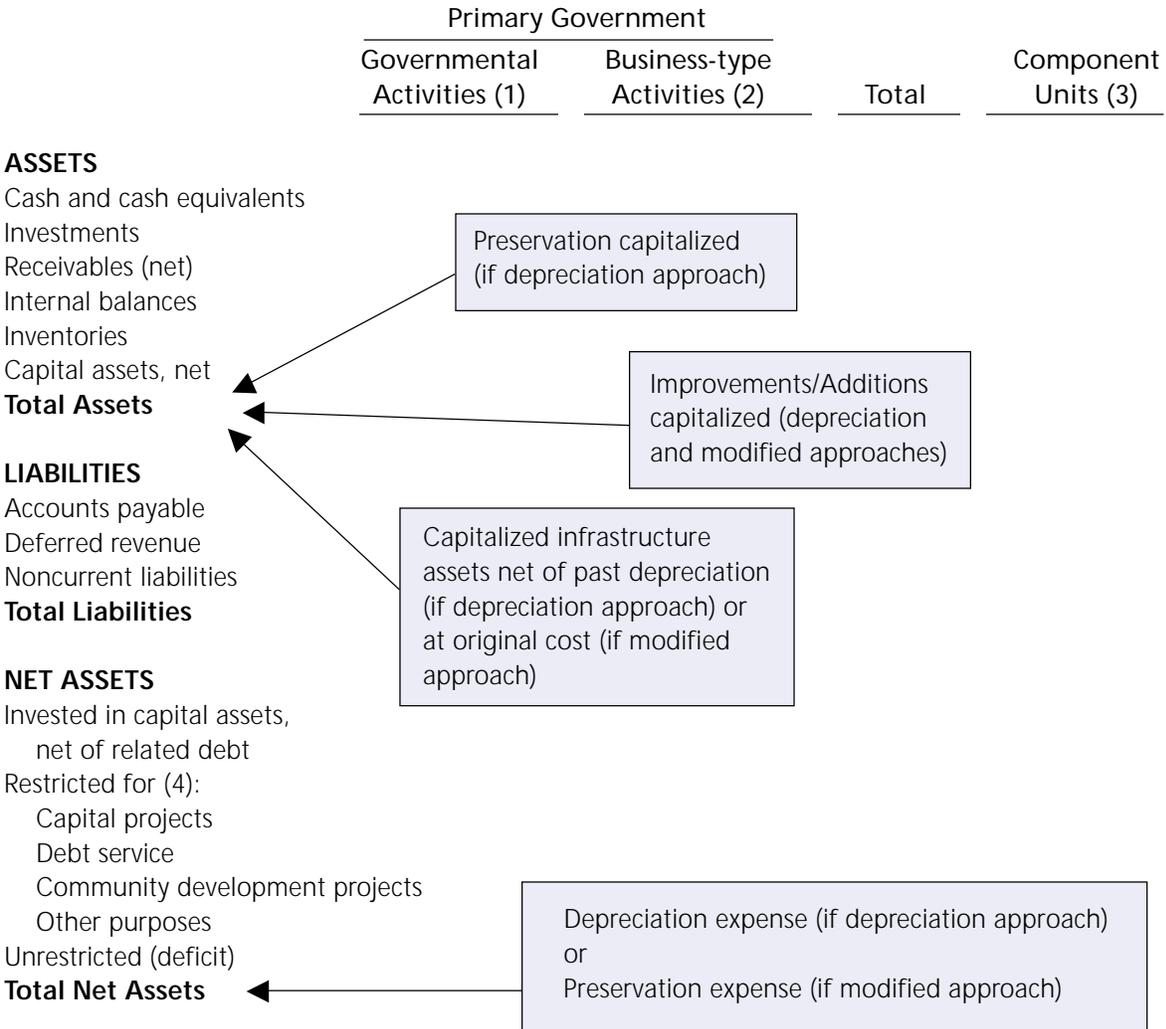
Figure 1, Depreciation and Preservation on the Financial Statements, pages 16-17, illustrates the treatment of expenses associated with depreciation, preservation, improvements, and additions for the traditional and preservation approaches to reflecting the cost of use of capital assets under Statement 34.

DEPRECIATION AND PRESERVATION ON THE FINANCIAL STATEMENTS

Depreciation and Modified Approaches

The reader should note that examples of completed statements, provided as schematics in this figure, may be found in Appendix 1.

Statement of Net Assets



(1) Examples: Public safety, health and sanitation, transportation

(2) Examples: Water, sewer

(3) Examples: Landfill, public schools

(4) Assets whose use is constrained by law or externally

Note: See also Question No. 57, Appendix 2.

FIGURE 1. Depreciation and Preservation on the Financial Statements

DEPRECIATION AND PRESERVATION ON THE FINANCIAL STATEMENTS

Depreciation and Modified Approaches (continued)

Statement of Activities

	<u>Expenses</u>	<u>Program Revenues</u>	<u>Net Revenue and Changes in Net Assets</u>	
			<u>Primary Government</u>	<u>Component Units</u>
<i>Functions/Programs</i>				
Primary Government				
Governmental activities				
General government				
Public safety				
Public works				
Engineering services				
Health and sanitation				
Cemetery				
Culture and recreation				
Community development				
Education				
Interest on long-term debt				
Total governmental activities				
Business-type activities				
Water				
Sewer				
Parking facilities				
Total business-type activities				
Total primary government				
Component units				
Landfill				
Public school system				
Total component units				
			General revenues: Taxes: Property Franchise Public service Investment Earnings Miscellaneous Special Items Transfers Changes in net assets Net assets – beginning Net assets – ending	

Maintenance and depreciation expenses are recorded as expenses if the depreciation approach is used.
or
Maintenance and preservation/renewal expenses are recorded as expenses if the modified approach is used.

FIGURE 1. Depreciation and Preservation on the Financial Statements continued

Technical Application

There are significant technical hurdles to overcome in applying depreciation to long-lived transportation infrastructure assets. First, transportation agencies attempt to maintain such assets at a constant condition level indefinitely. This makes it difficult to estimate the number of years constituting useful life. In fact, depreciation expense would be marginal if the estimated useful life of an asset reflected the agency's efforts to continually renew the asset's life. Nonetheless, agencies implementing the depreciation approach will have to determine useful life given a set of assumptions regarding the level of future preservation and maintenance activity. Such assumptions will need to be documented and validated for the auditors of the financial reports.

Another issue that arises is determining which expenditures should be capitalized and depreciated and which should be expensed. Also, it is difficult to ascertain when remaining useful life should be revised given changes in

maintenance and preservation activities or in the use of the asset relative to assumptions made when useful life was initially determined. As an illustration, if a government does not perform maintenance and preservation activities as planned—or if wear and tear on the road increases to the point where it is expected to reduce useful life, useful service life should be reduced, thereby increasing the depreciation expense.

There are difficulties with the modified approach as well. One is that it may be viewed as subjective since decisions regarding condition targets and assessments are made by individuals with the potential to be directly impacted by the outcome. Further, some believe it is difficult for accountants to audit the processes and procedures used by the transportation agency in complying with the requirements of the modified approach. It should be noted, however, that accounting involves estimation and application of judgment whether the modified or the depreciation approach is used.



Public Interpretation

Depreciation is a systematic allocation of the cost of an asset over its estimated useful life; it is not meant to indicate the cost of actually using the asset in any particular time frame. Further, the net cost of an asset, as reported in the statement of assets, reports the undepreciated or remaining cost of the asset, not its physical condition or its replacement cost. As a result, the depreciation approach does not provide information to the public regarding the actual cost of use of infrastructure assets.

Further, depreciation expense could be viewed by the public as evidence that the asset is being allowed to deteriorate over time when most agencies continuously maintain these assets to a given level of condition. In fact, these same agencies would view a decline in condition as a problem to be corrected. Finally, the depreciation approach does not capture the effect of preservation or renewal efforts and therefore does not provide information for assessing deferred maintenance.

In contrast, the modified approach provides a venue to document asset management efforts in general and preservation or renewal activities in particular. Governments will have a platform from which to discuss the merits of highway preservation compared to deferred maintenance.

Another potential advantage of the modified approach is its requirement for documentation, which may provide trend information indicating changes in condition over time. This material may be a useful avenue for transportation agencies to outline the effectiveness of their stewardship activities and to demonstrate the requirement for and use of future resources.



IMPLEMENTATION

TIMING

In the fiscal year beginning after June 15, 2001, large governments with annual revenues of \$100 million or more must prospectively report all major infrastructure assets built, restored, or improved after the effective date of GASB Statement 34. And, they must report on those assets in subsequent years, using either the depreciation or the modified approach. Medium and small size governments have later effective dates (see Timeline sidebar, below).

While all governments are encouraged to report all infrastructure assets as of the effective date of Statement 34, large governments are only required to begin reporting all major infrastructure acquired, renovated, or improved in terms of quantity or quality after June 30, 1980, for years following June 15, 2005. Medium governments have until 2006 before they must satisfy the retroactive reporting requirements. This requirement is optional for small governments.

Statement 34 allows for transition to the new requirement. For example, governments may begin using the modified approach as long as at least one condition assessment has been completed and the results of the assessment show that the infrastructure assets are being preserved at approximately the condition level selected by the government. Eventually the prior three condition assessments will be required to be disclosed.

CHALLENGES

State and local governments are grappling with questions such as those listed in the sidebar on page 21. The answers will determine the cost, difficulty and time frame of complying with GASB's Statement 34. For example, to the extent that transportation agencies are able to build on existing information and capabilities, cost will be minimized. Difficulty will be determined by how easy or hard it is to secure the necessary information. And the time frame that a government requires for compliance will depend on how long it takes to set up the necessary mechanisms.

TIMELINE	Phase 1	Phase 2	Phase 3
	Governments	Governments	Governments
	Annual Revenues >= \$100 million in FY99	Annual Revenues \$10 million up to \$100 million in FY99	Annual Revenues < \$10 million in FY99
PROSPECTIVE REPORTING Report on all infrastructure built or improved after the effective date of GASB	Fiscal year beginning after June 15, 2001	Fiscal year beginning after June 15, 2002	Fiscal year beginning after June 15, 2003
RETROACTIVE REPORTING Report on all infrastructure built or improved on or after June 15, 1980	Fiscal year beginning after June 15, 2005	Fiscal year beginning after June 15, 2006	Optional

IMPLEMENTATION QUESTIONS

As state and local transportation agencies begin to investigate the requirements for complying with GASB Statement 34, they will need to address questions such as those presented below:

How will we define our networks/subsystems for reporting purposes? For example, the highway infrastructure could be reported, in its entirety, as a network. Alternatively, it could be broken down into subsystems such as pavements and bridges, or it could be reported by functional class. How should asset classes such as signs be treated?

Is it better to depreciate or apply the modified approach? How concerned should we be about the information we provide to readers of the financial statements? How much effort will one approach require, versus the other? What will be the relative cost?

Do we have management systems in place that will support the modified approach?

- Do we know our inventory?
- Are we able to assess the current condition of our inventory? Are we using a reproducible approach?
- Do we have the ability to set minimum condition targets that we can defend and achieve?
- Can we estimate future system condition given alternative investment levels?
- Can we estimate investment requirements to achieve a given system condition level?
- Can we determine the level of funding associated with a particular network or subsystem?

How concerned should we be about our reporting practices being consistent with those of other governmental units?

What method should we use to arrive at the historical cost of our infrastructure, especially if our historical records are inadequate?

How should we define “maintenance” versus “preservation” versus “additions” versus “improvements” for reporting purposes? Depending on the assumptions, these activities will be capitalized and depreciated or expensed.

If we choose to implement the depreciation approach, what method will we use? Also, what should be depreciated, what should be the useful life of the asset, and what should be the capitalization dollar threshold?

Do we have a sufficient understanding of GASB Statement 34 to effectively communicate with our Comptroller’s Office?

Do we have the ability to explain, to external groups, how we arrived at our spending/investment decisions?

Do we have available the information necessary to provide for an informed resource allocation process as it takes place outside our agency as well as at the highest levels within our organizations? For example, can we demonstrate the merits of preserving assets as opposed to deferring maintenance?

However governments choose to respond to Statement 34, they will want to be sensitive to the issue of citizen concerns. From a public perspective, the new financial statements will be similar to a report card that can be used to assess government performance with regard to the effect of infrastructure decisions on financial position and cost of services.

STATUS

As this Primer went to publication, it was not totally clear how states would initially respond to Statement 34. That is, would they report their infrastructure assets using the depreciation or modified approach? Preliminary evidence suggested that perhaps a majority of states would use depreciation; however, a significant number, it appeared,

would use the modified approach. In many states, the comptroller will make the decision, and may be particularly concerned with the technical application issues for the modified approach. Also, it is noted that state comptrollers must consider infrastructure assets other than those related to transportation, and they may have concerns with consistency.

It is important to remember that states may change their reporting approach at any time in the future, i.e., they could move from depreciation to the modified approach. Of course, if a state is not able to meet its condition targets, it will have to depreciate the assets or lower its acceptable condition target. What was clear as the first implementation date approached was that virtually all states planned to comply with Statement 34.

ASSET MANAGEMENT AND GASB STATEMENT 34

ASSET MANAGEMENT OVERVIEW

Asset Management is a framework for making cost-effective resource allocation decisions. The decisions are strategic rather than tactical. That is, they are based on a wide, systems view of all the assets under the transportation agency's umbrella, and they reflect an extended time horizon. An Asset Management approach has at its foundation technical, fact-based, information for decision-making and is driven by goals, policies, and budgets.

The technical information supporting the framework is derived from engineering, economic, performance, and behavioral models. Raw data such as inventory statistics are also required to make Asset Management work. The ability to gather timely and useful technical information, critical to Asset Management, has been made possible by the technological revolution that has brought about faster and more capable computers.

Obtaining the necessary information and appropriately applying the tools require horizontal and vertical communication. Vertical communication means that everyone involved in the process—from elected officials to front-line practitioners—has access to reliable, overarching information. Successful Asset Management also requires information that flows horizontally, across functions, asset classes, and modes.

Customer-based performance targets and organizational goals, policies, and budget levels establish the guiding principles for making decisions using an Asset Management framework. Knowing these factors is critical when applying the analytical tools. Performance goals reflect input from citizens, legislators, and policy makers, and they provide a focal point from which transportation officials may explain their programs and performance to the public. In addition, they assist transportation executives in identifying and focusing on critical system requirements.

Implementing an Asset Management framework provides not only the means to identify optimal investment strategies but also a way to articulate them. These capabilities arise from the transportation agency having the ability to weigh one alternative over another—in other words, to conduct “what if” analysis. For example, an agency faced with the possibility of a decrease in funding can readily demonstrate the resulting impact on system condition and performance.

Figure 2 includes a flow diagram characterizing a generic Asset Management framework and an overview of the process. It should be noted that, in application, Asset Management will vary significantly from organization to organization.

DRIVING FORCES

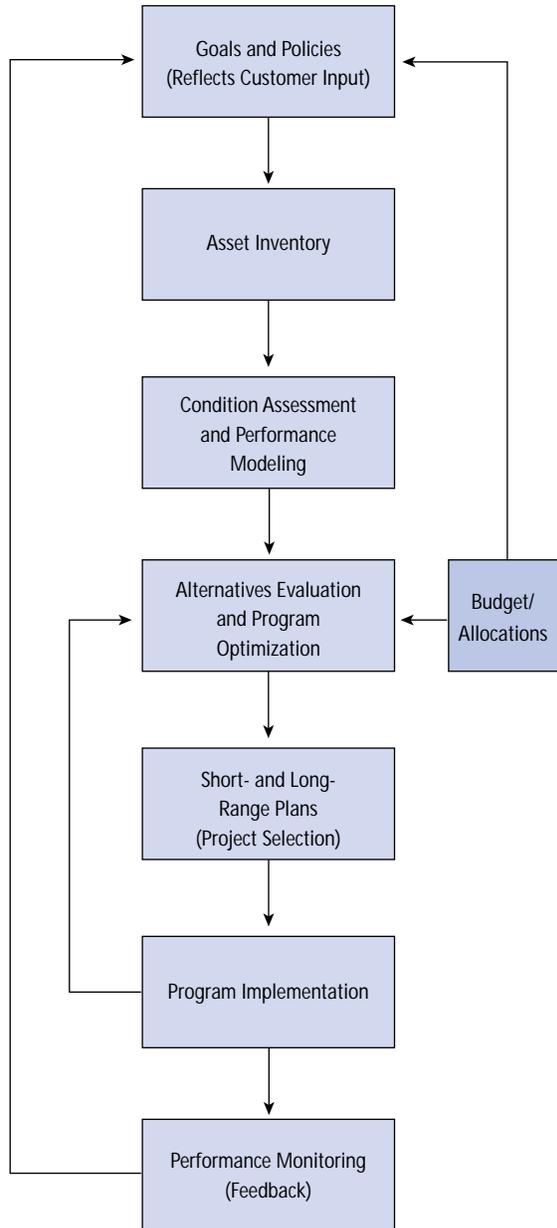
Those charged with managing highway assets are faced with a mature system that is experiencing high and growing demand as well as the ongoing deterioration associated with an aging asset. At the same time, system users expect high quality service.

Transportation officials are being asked to deal with this challenge in an era of increasingly constrained funding. The transportation sector faces difficult competition from other components of a State's budget. In addition, legislative provisions directing transportation funds to activities other than traditional infrastructure projects have become more common.

Further complicating the new transportation environment is the changing transportation agency workplace. First, staffing is down as the result of the recent downsizing initiatives associated with government reinvention as well as a robust economy that has made it difficult to attract and retain capable staff. Second, a dramatic increase in outsourcing and a move toward public/private ventures has brought more players into the process of managing the system.

A GENERIC ASSET MANAGEMENT FRAMEWORK

SYSTEM COMPONENTS



OVERVIEW

First, performance expectations, consistent with goals, available budgets, and organization policies, are established and used to guide the analytical processes, as well as the decision-making framework. Second, inventory and performance information are collected and analyzed. This information provides input on future system requirements (also called “needs”). Third, the use of analytical tools and reproducible methods produces viable cost-effective strategies for allocating budgets to satisfy agency needs and user requirements, using performance expectations as critical inputs. Alternative choices are then evaluated, consistent with long-range plans, policies, and goals. Fourth, projects are selected and programs are implemented. The entire process is periodically evaluated through performance monitoring and systematic processes.

Source: Adapted from *Asset Management Primer*, Federal Highway Administration, 1999

FIGURE 2. Generic Asset Management System Components and Overview

Just a few decades ago “accountability” was a relatively unfamiliar term in the transportation community. This has changed dramatically. Now these agencies understand that citizens expect them to be responsible stewards of their investment. Therefore, transportation agencies are increasingly sensitive to the probability that they will be called upon to communicate and explain their management approach and results.

Because GASB Statement 34 will make public the impact of transportation decisions, public demands for accountability are likely to intensify. Statement 34 will clearly help to move Asset Management forward. However, even if Statement 34 had never been formalized, Asset Management would still be viewed as a valuable way of doing business. In fact, in response to the above indicated driving forces, the interest in Transportation Asset Management was here well before Statement 34.

IMPLEMENTING ASSET MANAGEMENT

For decades, all transportation agencies have actively managed their assets. In response to the driving forces discussed above, some have explored sophisticated engineering, economic, data integration, and business practices. These practices have made it possible to begin the move from decision-making styles that result in tactical solutions to ones that provide more strategic options.

In the past, many transportation agencies made investment and maintenance decisions based on the counsel of high-level staff. These individuals typically had extensive experience and a broad knowledge base. However, both the experience and the knowledge were often specialized, and decisions tended to be based on information pertaining to a specific asset class, such as pavements. In fact, the management systems supporting the decision-making process were developed along the silo pattern, with, for example, separate systems for bridges and pavements.

Not surprisingly, program development decisions were based more on historical spending patterns, political considerations, and intuition. Success was measured as the extent to which backlog was reduced, and decisions were often made using “worst first” criteria.

Transportation agencies are interested in moving from asset management (e.g., managing their assets individually) to Asset Management (with a capital “A” and a capital “M,” that is, managing their assets under a comprehensive framework). To assist in this process, AASHTO and FHWA have underway initiatives to develop and enhance the building blocks of Asset Management. In addition, a number of transportation agencies have contracted with subject-matter experts to evaluate their particular situations and recommend future action.

In 1999, FHWA established the Office of Asset Management. Its research agenda is intended to bring state-of-the-art management system technology and best practice to state and local practitioners. Work is ongoing to enhance and encourage the application of existing management systems and to integrate these systems. New management systems, such as for tunnels and roadway hardware, are under development or are being explored.



HIGHWAY ECONOMIC REQUIREMENTS SYSTEM

A major new initiative being sponsored by FHWA's Office of Asset Management is a program to provide an economic/engineering programming tool called the Highway Economic Requirements System (HERS) model to interested states. HERS is currently used by FHWA at the national level to identify the costs, benefits, and national economic implications associated with highway investment options.

FHWA believes that HERS may also be useful for state-level highway investment planning. A pilot program is planned where a number of states will evaluate the applicability of the model for their use. If the model is found to be appropriate, FHWA is committed to bringing the HERS capability to all interested states.

HERS uses incremental benefits-versus-cost analysis to optimize highway investment. The model addresses highway deficiencies by quantifying the agency and user costs of various types and combinations of improvements, each subjected to a rigorous benefits-versus-cost analysis that considers travel time, safety, and vehicle operating and emissions costs.

Within the HERS process, state travel forecasts are analyzed, using a set of user-defined standards based on accepted engineering practice, to predict future pavement and capacity deficiencies. HERS selects the "best" set of highway improvements to satisfy economically sound highway performance objectives. When funding is not available to achieve "optimal" spending levels, HERS prioritizes economically worthwhile potential improvement options according to relative merit (that is, benefit-to-cost ratios) and selects the "best" set of projects. Given funding constraints or user-specified performance objectives, HERS minimizes the expenditure of public funds while simultaneously maximizing highway user benefits.

The state version of HERS (HERS/ST) has the potential to help state-level policy makers address resource allocation questions because it is able to perform "what if" analyses. For example, HERS/ST would allow users to examine the economic and system impacts of a 20 percent reduction in investment levels. In this way, HERS could provide an objective platform from which state DOTs could communicate with other state officials. In addition, HERS/ST may assist state DOTs in meeting the new Governmental Accounting Standards Board provisions.

Source: *Asset Management Primer*, Federal Highway Administration, 1999

The Office also provides technical assistance to transportation agencies interested in developing or improving maintenance and construction and system preservation programs. Recent activities have focused on the development of training courses and a national specifications database.

Developing, recommending, and advancing engineering/economic analysis (EEA) tools for use by state transportation agencies is another Office priority area. Activities are currently focused on development of a generic life cycle cost analysis (LCCA) model to support pavement design decisions and evaluating the applicability, at the state level, of the Highway Economic Requirements System (HERS) (see sidebar page 26). The HERS is able to predict future investment requirements necessary to correct pavement and/or capacity deficiencies given specific performance goals. Alternatively, HERS can predict future user cost as well as system condition and performance levels given alternative investment levels. This model may be of use for states reporting the cost of infrastructure use using GASB 34's modified approach.

Integrated data systems are an essential component of an Asset Management framework. The Office is developing a Data Integration Primer that will present state-of-the-art data integration procedures and provide information on best practices.

AASHTO, through the National Cooperative Highway Research Program, is sponsoring development of a first generation Guide to Asset Management. This document will provide the states with assistance, guidance, and tools as they incorporate Asset Management principles and procedures into their organizations.

ASSET MANAGEMENT AND GASB IMPLEMENTATION

Regardless of which approach—depreciation or modified—is selected to report on the use of capital assets over time, an Asset Management framework can be helpful in responding to Statement 34 requirements as well as in explaining to the public the transportation material included in financial reports. In addition, an Asset Management framework that operates as presented in [Figure 3, page 28](#), will assist transportation agencies in complying with the requirements of the modified approach.

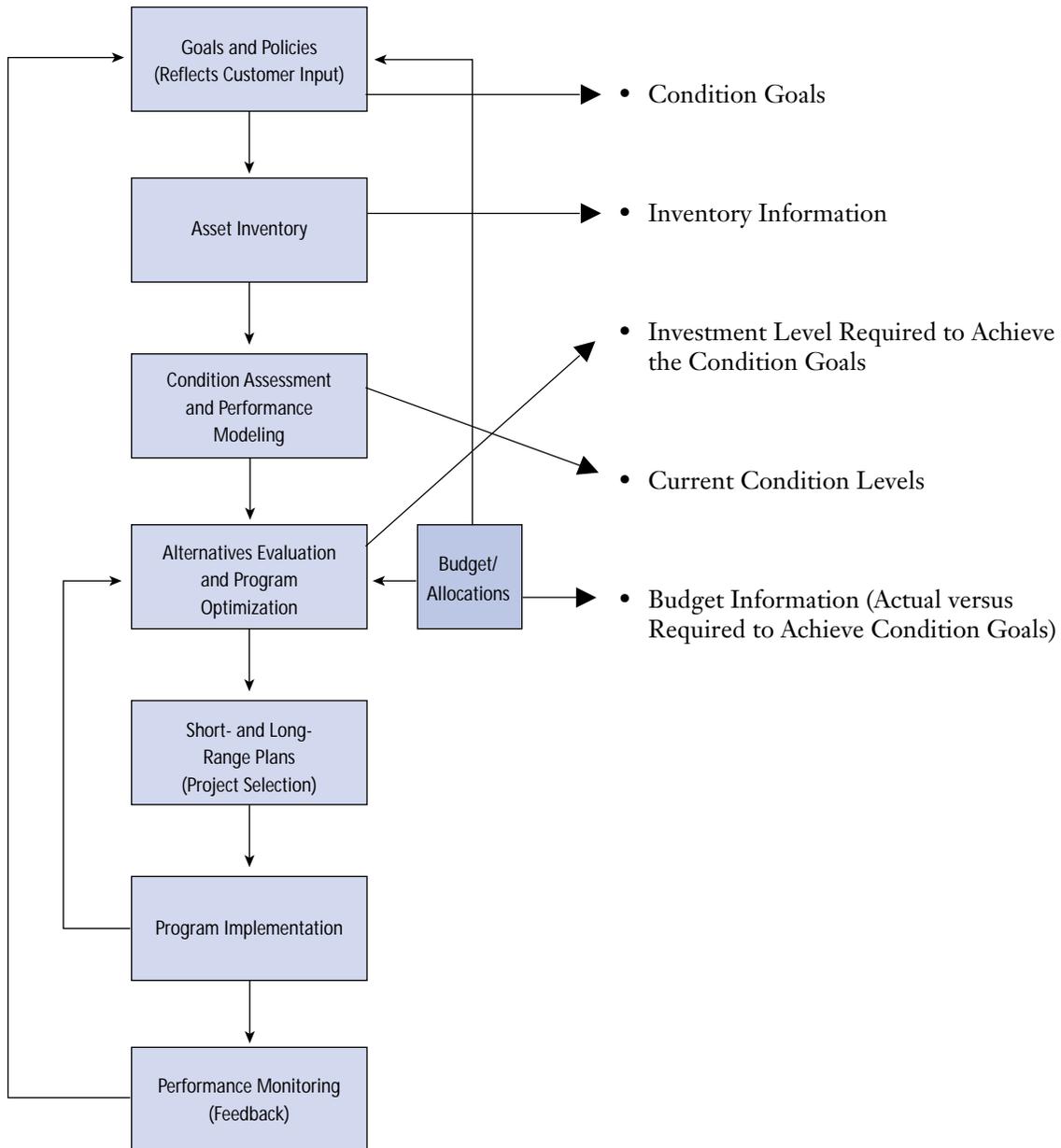
Also, Asset Management will result in better, more cost-effective decisions—thereby improving a state's ability to set system condition and performance targets and to meet them through effective decisions.

It should be noted that Statement 34, in its presentation of the modified approach, calls for “an asset management system” to be in place. However, the requirement is not so much for an Asset Management framework (with a capital “A” and capital “M”) but rather any comprehensive, fully employed management system, such as a pavement or bridge management system.

THE ASSET MANAGEMENT FRAMEWORK AND THE MODIFIED APPROACH

GENERIC ASSET MANAGEMENT FRAMEWORK*

INFORMATION REQUIRED FOR THE MODIFIED APPROACH



*Source: *Asset Management Primer*, Federal Highway Administration, 1999

FIGURE 3. Asset Management and the Modified Approach

CONCLUSION



Clearly, GASB Statement 34 is a major step toward greater accountability to the public regarding transportation services. By keeping track of transportation assets and efforts to preserve them, governments will be able to demonstrate prudent stewardship of their infrastructure. Also, the Statement’s provisions help to highlight the significance of infrastructure as an investment and the importance of maintenance activities.

It appears that an Asset Management decision-making framework will not only help transportation agencies comply with Statement 34, but will also assist them in realizing its potential benefits. The Statement is one more reason why transportation agencies are becoming more enthusiastic about moving from managing assets to Asset Management—that is, with a capital “A” and a capital “M.”

GLOSSARY

Accrual Basis of Accounting

Revenue, expenses, and other changes in the financial condition of an organization are accounted for when they occur, without consideration of the timing of actual cash received or expenditures made.

Capital Asset

A long-term, productive asset, such as a building or a road.

Capitalize

To record an expenditure as capital asset (long-term) rather than an expense. If the benefits from an expenditure will be realized over several future periods, the expenditure is capitalized and the cost is allocated to future periods through depreciation, that is, if it has a definite life and the modified approach is not used.

Composite Depreciation Expense

Refers to grouping similar assets or dissimilar assets within the same class together for the purpose of computing a single depreciation rate to be applied to all assets in the group. (Source: GASB)

Depreciation

A systematic allocation to current operating cost, over the asset's estimated useful life, of the original cost of the asset. (See *useful life*.)

Expense

To record an expenditure as an expense to current operations (as opposed to capitalizing the expenditure). (See *capitalize*.)

Fund Accounting

A system of accounting used by governments that presents an array of self-balancing accounts representing governmental categories, or funds.

Generally Accepted Accounting Principles (GAAP)

The standards and conventions recognized by certified public accountants as required in the preparation of financial statements.

Governmental Accounting Standards Board (GASB)

An organization established in 1984 to establish generally accepted accounting standards for state and local governments. GASB operates with oversight from the Financial Accounting Foundation.

Infrastructure Assets (GASB Statement 34 Context)

Infrastructure assets are long-lived capital assets that normally can be preserved for a significantly greater number of years than most capital assets and that normally are stationary in nature. Examples of infrastructure assets include roads, bridges, tunnels, drainage systems, water and sewer systems, dams, and lighting systems. Buildings, except those that are an ancillary part of a network of infrastructure assets, are not considered infrastructure assets. (Source: GASB)

Modified Approach (GASB Statement 34 Context)

An alternative to depreciating infrastructure assets. The modified approach recognizes that such assets are routinely preserved (or renewed) so as to indefinitely extend useful life. Under this approach, preservation (or renewal) expenditures are expensed rather than being capitalized and the original cost and improvements and additions to the asset are not depreciated. (See *capitalize, expense*.)

Prospective Reporting (GASB Statement 34 Context)

Reporting on long-lived capital assets that were acquired or materially improved after Statement 34's effective date.

Retroactive Reporting (GASB Statement 34 Context)

Reporting on long-lived capital assets that were acquired or materially improved after June 15, 1980.

Useful Life

An estimate of how long the asset will be in use assuming a given maintenance and repair schedule.

OTHER RESOURCES

American Institute of Certified Public Accounts

<http://www.aicpa.org>

AICPA is currently working on new audit guidance for Audits of State and Local Governments.

Federal Highway Administration

Office of Asset Management

Economic Evaluation and Investment Team

<http://www.fhwa.dot.gov/infrastructure/asstmgt>

Provides miscellaneous information on Transportation Asset Management and GASB Statement 34.

FinanceNet

<http://financenet.gov>

Provides general information.

Governmental Accounting Standards Board

<http://gasb.org>

Provides the latest on GASB Statement 34 implementation.

Government Finance Officers Association

<http://www.gfoa.org>

Provides a forum for GASB Statement 34 questions and answers.

National Association of State Comptrollers

<http://sso.org/nasact/nasact.htm>

Sponsors a web site and educational materials directed at GASB Statement 34 implementation.

APPENDIX 1:

SUMMARY OF CAPITAL ASSET AND INFRASTRUCTURE REQUIREMENTS: GASB STATEMENT NO. 34, BASIC FINANCIAL STATEMENTS—AND MANAGEMENT’S DISCUSSION AND ANALYSIS—FOR STATE AND LOCAL GOVERNMENTS*

Statement 34 establishes new requirements for the annual financial reports of state and local governments. Financial statements for the funds are similar to current requirements. The principal change to fund statements is that only major funds and non-major funds in aggregate are required to be reported. The greatest changes are to the government-wide financial statements. The focus of these statements is on the government as a whole, with governmental and business-type activities presented separately. The government-wide statements, consisting of a *statement of net assets* and a *statement of activities* that presents revenues and expenses by function or program in a net expense format, use the economic resources measurement focus and accrual basis of accounting for both governmental and business-type activities. The change in measurement focus and basis of accounting for governmental activities requires that all capital assets, including infrastructure, be recorded and depreciated. Additionally, management’s discussion and analysis, that gives readers an objective and easily readable analysis of the government’s financial performance for the year, should be presented as required supplementary information.

Capital Assets Include Infrastructure

All capital assets are required to be reported at historical cost and should be depreciated over their estimated useful lives unless they are either inexhaustible or are infrastructure assets reported using the modified approach. Infrastructure assets are included as capital assets in the statement of net assets. (§§ 18, 19, 21)**

Required Note Disclosures about Capital Assets

The notes to the financial statements should provide the following detail for historical cost and accumulated depreciation for each major class of capital asset:

1. Beginning- and end-of-year balances
2. Capital acquisitions
3. Sales or other dispositions
4. Depreciation expense.

* This is an incomplete document. The material in this appendix is excerpted from Governmental Accounting Standards Series, Statement No. 34, Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments, June 1999, copyright by Governmental Accounting Standards Board, 401 Merritt 7, Norwalk, Connecticut 06856. Reprinted by permission. The complete document should be read for a full understanding of infrastructure issues, including the Board’s Basis for Conclusions. For information, see www.rutgers.edu/Accounting/raw/gasb/gasb34.html.

Endnotes appear on page 43.

**Specific paragraphs mentioned refer to the Governmental Accounting Standards Series, Statement No. 34, Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments, June 1999.

Capital assets that are not being depreciated should be disclosed separately from those that are being depreciated. Additionally, the amounts of depreciation charged to each of the functions in the statement of activities should be disclosed. (§§ 117)

Modified Approach for Infrastructure

Infrastructure assets are not required to be depreciated if the assets are:

1. Managed using an asset management system
2. Preserved at an established condition level.

The asset management system should include an inventory of infrastructure assets, perform condition assessments of the infrastructure and estimate the annual level established by the government. (§§ 23)

The government should perform condition assessments at least every three years, and the results of the three most recent assessments should show that the infrastructure assets are being preserved at or above the established condition level. (§§ 24)

Disclosures for Modified Approach for Reporting Infrastructure

For infrastructure assets reported using the modified approach, the following disclosures should be presented as *required supplementary information*:

1. The assessed condition from the three most recent condition assessments
2. Annual maintenance and preservation cost, both estimated and actual, for the past five years
3. The basis and scale for the condition measurement
4. The condition level established by the government as acceptable
5. Factors that significantly affect trends in the information in 1. and 2. (§§ 132, 133)

Effective Date and Transition

The provisions of Statement 34, except for retroactive recording of infrastructure, are effective for fiscal years beginning after:

1. June 15, 2001 for governments with revenues of \$100 million and greater
2. June 15, 2002 for governments with revenues between \$10 and \$100 million
3. June 15, 2003 for governments with revenues less than \$10 million. (§§ 143)

Depreciation of capital assets and prospective capitalization of infrastructure assets are two of the requirements that must be adopted according to the schedule above.

Reporting General Infrastructure Assets at Transition

The requirement for retroactive recording of general infrastructure is effective for fiscal years beginning after:

1. June 15, 2005 for governments with revenues of \$100 million and greater
2. June 15, 2006 for governments with revenues between \$10 and \$100 million

For governments with revenues less than \$10 million, retroactive recording of infrastructure is not required. (§ 148)

Modified Approach for Reporting Infrastructure Assets at Transition

Governments may begin using the modified approach as long as at least one condition assessment has been completed and the results of the assessment show that the infrastructure assets are being preserved at the established condition level. (§ 152)

Initial Capitalization of General Infrastructure Assets

Only *major* general infrastructure assets that were acquired in fiscal years ending after June 30, 1980 are required to be capitalized. The threshold for a major asset is set at a percentage of the cost of all general capital assets reported for the year ended June 30, 1999. If the asset to be capitalized is a subsystem, the threshold is 5% of capital assets; if the asset is a network, the threshold is 10%. (§ 156)

The initial capitalization amount should be based upon historical cost or estimated historical cost. One method of estimating historical cost is deflating the current replacement cost of a similar asset using price-level indexes to the acquisition year. Bond documents, capital outlay expenditures in prior financial statements or engineering document may also be used for estimating historical cost. (§ 158, 160)

Methods for Calculating Depreciation

Any established depreciation method may be used. Depreciation may be calculated for a class of assets, a network of assets, a subsystem of a network, or individual assets. (§ 161)

Governments may use composite methods to calculate depreciation expense. Composite methods refer to grouping similar assets or dissimilar assets within the same class together for the purpose of computing a single depreciation rate to be applied to all assets in the group. (§ 163)

INFRASTRUCTURE OUTTAKES

Reporting Capital Assets

18. Capital assets should be reported at historical cost. The cost of a capital asset should include capitalized interest and ancillary charges necessary to place the asset into its intended location and condition for use. Ancillary charges include costs that are directly attributable to asset acquisition—such as freight and transportation charges, site preparation costs, and professional fees. Donated capital assets should be reported at their estimated fair value at the time of acquisition plus ancillary charges, if any.
19. As used in this Statement, the term *capital assets* 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. *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, and lighting systems. Buildings, except those that are an ancillary part of a network of infrastructure assets, should not be considered infrastructure assets for purposes of this Statement.
20. Capital assets that are being or have been depreciated (paragraph 22) should be reported net of accumulated depreciation in the statement of net assets. (Accumulated depreciation may be reported on the face of the statement or disclosed in the notes.) Capital assets that are not being depreciated, such as land or infrastructure assets reported using the modified approach (paragraphs 23 through 25), should be reported separately if the government has a significant amount of these assets. Capital assets also may be reported in greater detail, such as by major class of asset (for example, infrastructure, buildings and improvements, vehicles, machinery and equipment). Required disclosures are discussed in paragraphs 116 and 117.
21. Capital assets should be depreciated over their estimated useful lives unless they are either inexhaustible or are in-

infrastructure assets reported using the modified approach in paragraphs 23 through 25. Inexhaustible capital assets such as land and land improvements should not be depreciated.

22. Depreciation expense should be reported in the statement of activities as discussed in paragraphs 44 and 45. Depreciation expense should be measured by allocating the net cost of depreciable assets (historical cost less estimated salvage value) over their estimated useful lives in a systematic and rational manner. It may be calculated for (a) a class of assets, (b) a network of assets,¹ (c) a subsystem of a network,² or (d) individual assets. (Composite methods may be used to calculate depreciation expense. See paragraphs 161 through 166 for a more complete discussion of depreciation.)

Modified approach

23. Infrastructure assets that are part of a network or subsystem of a network³ (hereafter, eligible infrastructure assets) are not required to be depreciated as long as two requirements are met. First, the government manages the eligible infrastructure assets using an asset management system that has the characteristics set forth below; second, the government documents that the eligible infrastructure assets are being preserved approximately at (or above) a condition level established and disclosed by the government.⁴ To meet the first requirement, the asset management system should:
 - a. Have an up-to-date inventory of eligible infrastructure assets
 - b. Perform condition assessments⁵ of the eligible infrastructure assets and summarize the results using a measurement scale
 - c. Estimate each year the annual amount to maintain and preserve the eligible infrastructure assets at the condition level established and disclosed by the government.
24. Determining what constitutes adequate documentary evidence to meet the second requirement in paragraph 23 for using the modified approach requires professional judgment because of variations among governments' asset management systems and condition assessment methods. These factors also may vary within governments for different eligible infrastructure assets. However, governments should document that:
 - a. Complete condition assessments of eligible infrastructure assets are performed in a consistent manner at least every three years.⁶

- b. The results of the three most recent complete condition assessments provide reasonable assurance that the eligible infrastructure assets are being preserved approximately at (or above) the condition level⁷ established and disclosed by the government.

25. If eligible infrastructure assets meet the requirements of paragraphs 23 and 24 and are not depreciated, all expenditures made for those assets (except for additions and improvements) should be expensed in the period incurred. Additions and improvements to eligible infrastructure assets should be capitalized. Additions or improvements increase the capacity or efficiency of infrastructure assets rather than preserve the useful life of the assets.
26. If the requirements of paragraphs 23 and 24 are no longer met, the depreciation requirements of paragraphs 21 and 22 should be applied for subsequent reporting periods.⁸

[SECTION ON Reporting works of art and historical treasures (paragraphs 27, 28, 29) OMITTED HERE]

Required Financial Statements—Statement of Net Assets

30. The statement of net assets should report all financial and capital resources. Governments are encouraged to present the statement in a format that displays *assets less liabilities equal net assets*, although the traditional balance sheet format (assets equal liabilities plus net assets) may be used. Regardless of the format used, however, the statement of net assets should report the difference between assets and liabilities as *net assets*, not fund balances or equity.
31. Governments are encouraged to present assets and liabilities in order of their relative liquidity.¹⁰ An asset's liquidity should be determined by how readily it is expected to be converted to cash and whether restrictions limit the government's ability to use the resources. A liability's liquidity is based on its maturity, or when cash is expected to be used to liquidate it. The liquidity of an asset or liability may be determined by assessing the average liquidity of the class of assets or liabilities to which it belongs, even though individual balances may be significantly more or less liquid than others in the same class and some items may have both current and long-term elements. Liabilities whose average maturities are greater than one year should be reported in two components—the amount due within one year and the amount due in more than one year. Additional disclosures concerning long-term liabilities are discussed in paragraph 119.

32. The difference between a government's assets and its liabilities is its *net assets*. Net assets should be displayed in three components—*invested in capital assets, net of related debt; restricted* (distinguishing between major categories of restrictions); and *unrestricted*.

Invested in Capital Assets, Net of Related Debt

33. This component of net assets consists of capital assets (see paragraph 19), including *restricted* capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. If there are significant unspent related debt proceeds at year-end, the portion of the debt attributable to the unspent proceeds should *not* be included in the calculation of *invested in capital assets, net of related debt*. Rather, that portion of the debt should be included in the same net assets component as the unspent proceeds—for example, *restricted for capital projects*.

* * * * *

Required Note Disclosures about Capital Assets and Long-term Liabilities

116. Governments should provide detail in the notes to the financial statements about capital assets and long-term liabilities of the primary government reported in the statement of net assets. The information disclosed should be divided into major classes of capital assets and long-term liabilities as well as between those associated with governmental activities and those associated with business-type activities. Capital assets that are not being depreciated should be disclosed separately from those that are being depreciated. (See paragraph 20.)

117. Information presented about major classes of capital assets should include:

- Beginning- and end-of-year balances (regardless of whether beginning-of-year balances are presented on the face of the government-wide financial statements), with accumulated depreciation presented separately from historical cost
- Capital acquisitions
- Sales or other dispositions
- Current-period depreciation expense, with disclosure of the amounts charged to each of the functions in the statement of activities.

118. For collections not capitalized (see paragraphs 27-29), disclosures should provide a description of the collection and the reasons these assets are not capitalized. For collections that are capitalized, governments should make the disclosures required by paragraphs 116 and 117.

119. Information about long-term liabilities should include both long-term debt (such as bonds, notes, loans, and leases payable) and other long-term liabilities¹¹ (such as compensated absences, and claims and judgments). Information presented about long-term liabilities should include:

- Beginning- and end-of-year balances (regardless of whether prior-year data are presented on the face of the government-wide financial statements)
- Increases and decreases (separately presented)
- The portions of each item that are due within one year of the statement date
- Which governmental funds typically have been used to liquidate other long-term liabilities (such as compensated absences and pension liabilities) in prior years.

120. Determining whether to provide similar disclosures about capital assets and long-term liabilities of discretely presented component units is a matter of professional judgment. The decision to disclose should be based on the individual component unit's significance to the total of all discretely presented component units and that component unit's relationship with the primary government.

* * * * *

Modified Approach for Reporting Infrastructure

132. Governments should present the following schedules, derived from asset management systems, as RSI for all eligible infrastructure assets¹² that are reported using the modified approach:

- The assessed condition, performed at least every three years, for at least the three most recent complete condition assessments, indicating the dates of the assessments
- The estimated annual amount calculated at the beginning of the fiscal year to maintain and preserve at (or above) the condition level established and disclosed by the government compared with the amounts actually expensed (as discussed in paragraph 25) for each of the past five reporting periods.

133. The following disclosures¹³ should accompany the schedules required by paragraph 132:

- a. The basis for the condition measurement and the measurement scale used to assess and report condition. For example, a basis for *condition measurement* could be distresses found in pavement surfaces. A *scale* used to assess and report condition could range from zero for a failed pavement to 100 for a pavement in perfect condition.
- b. The condition level at which the government intends to preserve its eligible infrastructure assets reported using the modified approach.
- c. Factors that significantly affect trends in the information reported in the required schedules, including any changes in the measurement scale, the basis for the condition measurement, or the condition assessment methods used during the periods covered by the schedules. If there is a change in the condition level at which the government intends to preserve eligible infrastructure assets, an estimate of the effect of the change on the estimated annual amount to maintain and preserve those assets for the current period also should be disclosed.

* * * * *

EFFECTIVE DATE AND TRANSITION

142. The requirements of this Statement are effective in three phases based on total annual revenues, as discussed in paragraph 143, below. Earlier application is encouraged. Governments that elect early implementation of this Statement for periods beginning before June 15, 2000, also should implement Statement 33 at the same time. If a primary government chooses early implementation of this Statement, all of its component units also should implement this standard early to provide the financial information required for the government-wide financial statements.

143. The requirements of this Statement are effective in three phases based on a government's total annual revenues in the first fiscal year ending after June 15, 1999:

- Phase 1 governments—with total annual revenues of \$100 million or more—should apply the requirements of this Statement in financial statements for periods beginning after June 15, 2001.
- Phase 2 governments—with total annual revenues of \$10 million or more but less than \$100 million—should apply the requirements of this Statement in financial statements for periods beginning after June 15, 2002.

- Phase 3 governments—with total annual revenues of less than \$10 million—should apply the requirements of this Statement in financial statements for periods beginning after June 15, 2003.

For purposes of identifying the appropriate implementation phase, *revenues* includes all revenues (not other financing sources) of the primary government's governmental and enterprise funds, except for extraordinary items as defined in paragraph 55. Special-purpose governments engaged only in fiduciary activities should use total annual *additions*, rather than *revenues*, to determine the appropriate implementation phase. All component units should implement the requirements of this Statement no later than the same year as their primary government, regardless of the amount of each component unit's total revenues. Paragraphs 148 through 153 provide additional phase-in provisions for reporting general infrastructure assets.

144. Adjustments to governmental, proprietary, and fiduciary funds resulting from a change to comply with this Statement should be treated as adjustments of prior periods, and financial statements presented for the periods affected should be restated. If restatement of the financial statements for prior periods is not practical, the cumulative effect of applying this Statement should be reported as a restatement of beginning fund balance or fund net assets, as appropriate, for the earliest period restated (generally, the current period). In the first period that this Statement is applied, the financial statements should disclose the nature of the restatement and its effect.

145. In the first period that this Statement is applied, governments are not required to restate prior periods for purposes of providing the comparative data for MD&A as required in paragraph 11. However, governments are encouraged to provide comparative analyses of key elements of total governmental funds and total enterprise funds in MD&A for that period. Also, in the first year of implementation, MD&A should include a statement that, in future years, when prior-year information is available, a comparative analysis of government-wide data will be presented.

146. The requirements of APB Opinions No. 12, *Omnibus Opinion—1967*, and No. 21, *Interest on Receivables and Payables*, as amended, require deferral and amortization of debt issue premium or discount. These Opinions may be applied prospectively to governmental activities in the statement of net assets and the statement of activities, except for governmental activity debt that is deep-discount or zero-coupon debt.¹⁴ Similarly, FASB Statement No. 34, *Capitalization of Interest Cost*, as amended, which requires capitalization of interest cost as a component of the historical

cost of capital assets, also may be applied prospectively by governmental activities. Finally, Statement 23, which requires deferral and amortization of the difference between the reacquisition price and the net carrying amount of old debt in debt-refunding transactions, may be applied prospectively by governmental activities. The retroactive effect of applying those standards is not required to be considered in determining beginning net assets for governmental activities.

Governmental Entities That Use the AICPA Not-for-Profit Model

147. Governmental entities that report as of the date of this Statement using the AICPA Not-for-Profit model, as defined in Statement 29, but that do not meet the criteria in paragraph 67 may use enterprise fund accounting and financial reporting.

Reporting General Infrastructure Assets at Transition

148. Prospective reporting of general infrastructure assets in the statement of net assets is required beginning at the effective dates of this Statement. Retroactive reporting of all *major* general infrastructure assets¹⁵ is encouraged at that date. Phase 1 governments as described in paragraph 143 should retroactively report all major general infrastructure assets for fiscal years beginning after June 15, 2005. Phase 2 governments should retroactively report all major general infrastructure assets for fiscal years beginning after June 15, 2006. Phase 3 governments are encouraged but are not required to report major general infrastructure assets retroactively.

149. If determining the actual historical cost of general infrastructure assets is not practical because of inadequate records, governments should report the estimated historical cost for major general infrastructure assets that were acquired or significantly reconstructed, or that received significant improvements, in fiscal years ending after June 30, 1980. (See paragraphs 155 through 166 for a more complete discussion of methods of estimating the cost of infrastructure assets and, if appropriate, accumulated depreciation on infrastructure assets.)

150. If, during the transition period, information is not available for all networks of infrastructure assets, those networks for which information is available may be reported.

151. While governments are applying the transition provisions, they should make these disclosures:

- a. A description of the infrastructure assets being reported and of those that are not
- b. A description of any eligible infrastructure assets that the government has decided to report using the modified approach (paragraphs 23-25).

Modified Approach for Reporting Infrastructure Assets

152. Governments may begin to use the modified approach for reporting eligible infrastructure assets (as described in paragraphs 23-25) as long as at least one complete condition assessment is available and the government documents that the eligible infrastructure assets are being preserved approximately at (or above) the condition level the government has established and disclosed.

153. The three most recent complete condition assessments and the estimated and actual amounts to maintain and preserve the infrastructure assets for the previous five reporting periods required by paragraph 132 may not be available initially. In these cases, the information required by that paragraph should be presented for as many complete condition assessments and years of estimated and actual expenses as are available.

INITIAL CAPITALIZATION OF GENERAL INFRASTRUCTURE ASSETS

Determining Major General Infrastructure Assets

154. At the applicable general infrastructure transition date, phase 1 and 2 governments are required to capitalize and report major general infrastructure assets that were acquired (purchased, constructed, or donated)¹⁶ in fiscal years ending after June 30, 1980, or that received major renovations, restorations, or improvements during that period.

155. The approaches in paragraphs 158 through 160 may be used to estimate the costs of existing general infrastructure assets when actual historical cost data are not available. These approaches are examples only; governments may use any approach that complies with the intent of this Statement. General infrastructure assets acquired after the effective dates of this Statement should be reported using historical costs.

156. The determination of major general infrastructure assets should be at the network or subsystem level and should be based on these criteria:
- The cost or estimated cost of the subsystem is expected to be at least 5 percent of the total cost of all general capital assets reported in the first fiscal year ending after June 15, 1999, *or*
 - The cost or estimated cost of the network is expected to be at least 10 percent of the total cost of all general capital assets reported in the first fiscal year ending after June 15, 1999.

Reporting of nonmajor networks is encouraged but not required.

Establishing Capitalization at Transition

157. The initial capitalization amount should be based on historical cost. If determining historical cost is not practical because of inadequate records, estimated historical cost may be used.

Estimated Historical Cost—Current Replacement Cost

158. A government may estimate the historical cost of general infrastructure assets 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). There are a number of price-level indexes that may be used, both private- and public-sector, to remove the effects of price-level changes from current prices. Accumulated depreciation would be calculated based on the deflated amount, except for general infrastructure assets reported according to the modified approach.
159. The following example illustrates the calculation of estimated historical cost. 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. Department of Transportation, Federal Highway Administration's *Price Trend Information for Federal-Aid Highway Construction* (publication number FHWA-IF-99-001) for 1983 and 1998, 1983 construction costs were 69.03 percent of 1998 costs. The estimated historical cost of the subsystem, 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.

Estimated Historical Cost from Existing Information

160. Other information may provide sufficient support for establishing initial capitalization. This information includes bond documents used to obtain financing for construction or acquisition of infrastructure assets, expenditures reported in capital project funds or capital outlays in governmental funds, and engineering documents.

Methods for Calculating Depreciation

161. 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. For estimated useful lives, governments can use (a) general guidelines obtained from professional or industry organizations, (b) information for comparable assets of other governments, or (c) internal information. In determining estimated useful life, a government also should consider an asset's present condition and how long it is expected to meet service demands.
162. Continuing the example from paragraph 159, 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 ($\$44,869,500/25$), and accumulated depreciation in 1998 would be \$26,921,700 ($\$1,794,780 \times 15$).

Composite Methods

163. Governments also may use composite methods to calculate depreciation expense. Composite methods refer to depreciating a grouping of similar assets (for example, interstate highways in a state) or dissimilar assets of the same class (for example, all the roads and bridges of a state) 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.
164. A composite depreciation rate can be calculated in different ways. The rate could be calculated based on a weighted average or on an unweighted-average estimate of useful lives of assets in the composite. For example, the compos-

ite depreciation rate of three interstate highways with estimated remaining useful lives of sixteen, twenty, and twenty-four years could be calculated using an unweighted average estimated as follows:

$$\frac{1}{(16 + 20 + 24)/3} = 5\% \text{ annual depreciation rate}$$

A composite depreciation rate may also be calculated based on an assessment of the useful lives of the grouping of assets. This assessment could be based on condition assessments or experience with the useful lives of the grouping of assets. For example, based on experience, engineers may determine that interstate highways generally have estimated remaining useful lives of approximately twenty years. In this case, the annual depreciation rate would be 5 percent.

165. The composite depreciation rate is generally used throughout the life of the grouping of assets. However, it should be recalculated if the composition of the assets or the estimate of average useful lives changes significantly. The average useful lives of assets may change as assets are capitalized or taken out of service.

166. The annual depreciation expense is calculated by multiplying the annual depreciation rate by the cost of the assets. For example, if the interstate highway subsystem cost \$100 million and the annual depreciation rate was 10 percent, then the annual depreciation charge would be \$10 million. Accumulated depreciation should not exceed the reported cost of the assets.

ILLUSTRATIONS

MANAGEMENT'S DISCUSSION AND ANALYSIS

Our discussion and analysis of Sample City's financial performance provides an overview of the City's financial activities for the fiscal year ended December 31, 2002. Please read it in conjunction with the transmittal letter on pages 38-42 and the City's financial statements, which begin on page XXX. (Note: The preparer would cite the page numbers of the transmittal letter if one is provided.)

CAPITAL ASSETS

At the end of 2002, the City had \$321 million invested in a broad range of capital assets, including police and fire equipment, buildings, park facilities, roads, bridges, and water and sewer lines. (See Table 4 below.) This amount represents a net increase (including additions and deductions) of just under \$12 million, or 3.8 percent, over last year.

TABLE 4

***Capital Assets at Year-end
(Net of Depreciation, in Millions)***

	Governmental Activities		Business-type Activities		Totals	
	2002	2001	2002	2001	2002	2001
Land	\$27.1	\$29.4	\$3.8	\$3.7	\$30.9	\$33.1
Buildings and improvements	30.2	30.5	115.5	113.6	145.7	144.1
Equipment	21.2	22.9	1.2	1.0	22.4	23.9
Infrastructure	91.5	79.3	30.9	29.3	122.4	108.6
Totals	\$170.0	\$162.1	\$151.4	\$147.6	\$321.4	\$309.7

This year's major additions included (in millions):

- Route 7 reconstruction project, paid for with proceeds of general obligation bonds issued last year \$11.3
- Replacement of older segments of the wastewater collection system and treatment facilities, paid for with proceeds from a revenue note issued last year 3.2
- Redevelopment housing construction, paid for with revenue bonds issued this year 2.2
- Land acquired through the City's power of eminent domain, paid for with General Fund resources 2.0
- Water distribution mains, hydrants, and meters, paid for with water and sewer revenue bonds issued this year 1.6
- \$20.3**

The City's fiscal-year 2003 capital budget calls for it to spend another \$16 million for capital projects, principally for the completion of its Route 7 reconstruction project and to create housing units in the City's new community redevelopment housing program. The City has no plans to issue additional debt to finance these projects. Rather, we will use bond proceeds from the community redevelopment bonds issued this year and resources on hand in the City's Gas Tax Fund. More detailed information about the City's capital assets is presented in Note 1 to the financial statements.

ILLUSTRATIONS CONTINUED

STATEMENT OF NET ASSETS

	Primary Government			Component Units
	Governmental Activities	Business-type Activities	Total	
ASSETS				
Cash and cash equivalents	\$ 13,597,899	\$ 10,279,143	\$ 23,877,042	\$ 303,935
Investments	27,365,221	–	27,365,221	7,428,952
Receivables (net)	12,833,132	3,609,615	16,442,747	4,042,290
Internal balances	175,000	(175,000)	–	–
Inventories	322,149	126,674	448,823	83,697
Capital assets, net (Note 1)	170,022,760	151,388,751	321,411,511	37,744,786
Total assets	<u>224,316,161</u>	<u>165,229,183</u>	<u>389,545,344</u>	<u>49,603,660</u>
LIABILITIES				
Accounts payable	6,783,310	751,430	7,534,740	1,803,332
Deferred revenue	1,435,599	–	1,435,599	38,911
Noncurrent liabilities (Note 2):				
Due within one year	9,236,000	4,426,286	13,662,286	1,426,639
Due in more than one year	83,302,378	74,482,273	157,784,651	27,106,151
Total liabilities	<u>100,757,287</u>	<u>79,659,989</u>	<u>180,417,276</u>	<u>30,375,033</u>
NET ASSETS				
Invested in capital assets, net of related debt	103,711,386	73,088,574	176,799,960	15,906,392
Restricted for:				
Capital projects	11,705,864	–	11,705,864	492,445
Debt service	3,020,708	1,451,996	4,472,704	–
Community development projects	4,811,043	–	4,811,043	–
Other purposes	3,214,302	–	3,214,302	–
Unrestricted (deficit)	(2,904,429)	11,028,624	8,124,195	2,829,790
Total net assets	<u>\$123,558,874</u>	<u>\$ 85,569,194</u>	<u>\$ 209,128,068</u>	<u>\$ 19,228,627</u>

ILLUSTRATIONS CONTINUED

STATEMENT OF CHANGES IN NET ASSETS

Functions/Program	Expenses	Program Revenues			Net (Expense) Revenue and Changes in Net Assets			Component Units
		Charges for Service	Operating Grants and Contributions	Capital Grants and Contributions	Primary Government			
					Governmental Activities	Business-type Activities	Total	
Primary government:								
Governmental activities:								
General government	\$ 9,571,410	\$ 3,146,915	\$ 843,617	\$ –	\$ (5,580,878)	\$ –	\$ (5,580,878)	\$ –
Public safety	34,844,749	1,198,855	1,307,693	62,300	(32,275,901)	–	(32,275,901)	–
Public works	10,128,538	850,000	–	2,252,615	(7,025,923)	–	(7,025,923)	–
Engineering services	1,299,645	704,793	–	–	(594,852)	–	(594,852)	–
Health and sanitation	6,738,672	5,612,267	575,000	–	(551,405)	–	(551,405)	–
Cemetery	735,866	212,496	–	–	(523,370)	–	(523,370)	–
Culture and recreation	11,532,350	3,995,199	2,450,000	–	(5,087,151)	–	(5,087,151)	–
Community development	2,994,389	–	–	2,580,000	(414,389)	–	(414,389)	–
Education	21,893,273	–	–	–	(21,893,273)	–	(21,893,273)	–
(payment to school district)								
Interest on long-term debt	6,068,121	–	–	–	(6,068,121)	–	(6,068,121)	–
Total governmental activities	105,807,103	15,720,525	5,176,310	4,894,915	(80,015,263)	–	(80,015,263)	–
Business-type activities:								
Water	3,595,733	4,159,350	–	1,159,909	–	1,723,526	1,723,526	–
Sewer	4,912,853	7,170,533	–	486,010	–	2,743,690	2,743,690	–
Parking facilities	2,796,283	1,344,087	–	–	–	(1,452,196)	(1,452,196)	–
Total business-type activities	11,304,869	12,673,970	–	1,645,919	–	3,015,020	3,015,020	–
Total primary government	\$117,111,882	\$28,394,495	\$ 5,176,310	\$ 6,540,834	(80,015,263)	3,015,020	(77,000,243)	–
Component units:								
Landfill	\$ 3,382,157	\$ 3,857,858	\$ –	\$ 11,397	–	–	–	487,098
Public school system	31,186,498	705,765	3,937,083	–	–	–	–	(26,543,650)
Total component units	\$ 34,568,655	\$ 4,563,623	\$ 3,937,083	\$ 11,397	–	–	–	(26,056,552)
General revenues:								
Taxes:								
Property taxes, levied for general purposes					51,693,573	–	51,693,573	–
Property taxes, levied for debt service					4,726,244	–	4,726,244	–
Franchise taxes					4,055,505	–	4,055,505	–
Public service taxes					8,969,887	–	8,969,887	–
Payment from Sample City					–	–	–	21,893,273
Grants and contributions not restricted to specific programs					1,457,820	–	1,457,820	6,461,708
Investment earnings					1,958,144	601,349	2,559,493	881,763
Miscellaneous					884,907	104,925	989,832	22,464
<i>Special item</i> – gain on sale of park land					2,653,488	–	2,653,488	–
Transfers					501,409	(501,409)	–	–
Total general revenues, special items, and transfers					76,900,977	204,865	77,105,842	29,259,208
Change in net assets					(3,114,286)	3,219,885	105,599	3,202,656
Net assets—beginning					126,673,160	82,349,309	209,022,469	16,025,971
Net assets—ending					\$ 123,558,874	\$85,569,194	\$209,128,068	\$19,228,627

ILLUSTRATIONS CONTINUED

CAPITAL ASSETS NOTE DISCLOSURES

Note 1—Illustrative Disclosure of Information about Capital Assets

Capital asset activity for the year ended December 31, 2002 was as follow (in thousands):

	Primary Government			Ending Balance
	Beginning Balance	Additions	Retirements	
Governmental activities:				
Land	\$ 29,484	\$ 2,020	\$ (4,358)	\$ 27,146
Buildings and improvements	40,861	334	—	41,195
Equipment	32,110	1,544	(1,514)	32,140
Infrastructure	94,575	13,220	—	107,795
Totals at historical cost	<u>197,030</u>	<u>17,118</u>	<u>(5,872)</u>	<u>208,276</u>
Less accumulated depreciation for:				
Buildings and improvements	(10,358)	(691)	—	(11,049)
Equipment	(9,247)	(2,676)	1,040	(10,883)
Infrastructure	(15,301)	(1,020)	—	(16,321)
Total accumulated depreciation for:	<u>(34,906)</u>	<u>(4,387)</u>	<u>1,040</u>	<u>(38,253)</u>
Governmental activities capital assets, net	<u>\$162,124</u>	<u>\$ 12,731</u>	<u>\$ (4,832)</u>	<u>\$170,023</u>
Business-type activities:				
Land	\$ 3,691	\$ 145	\$ —	\$ 3,836
Distribution and collection systems	36,977	2,527	—	39,504
Buildings and equipment	126,370	2,827	(32)	129,165
Totals at historical cost	<u>167,038</u>	<u>5,499</u>	<u>(32)</u>	<u>172,505</u>
Less accumulated depreciation for:				
Distribution and collection systems	(7,654)	(897)	—	(8,551)
Buildings and equipment	(11,789)	(808)	32	(12,565)
Business-type activities capital assets, net	<u>\$147,595</u>	<u>\$ 3,794</u>	<u>\$ 0</u>	<u>\$151,389</u>

*Depreciation expense was charged to governmental functions as follows:

General government	\$ 275
Public safety	330
Public works, which includes the depreciation of general infrastructure assets	1,315
Health and sanitation	625
Cemetery	29
Culture and recreation	65
Community development	40
In addition, depreciation on capital assets held by the City's internal service funds (see D-3) is charged to the various functions based on their usage of the assets	<u>1,708</u>
Total depreciation expense	<u>\$ 4,387</u>

ILLUSTRATIONS CONTINUED

REQUIRED SUPPLEMENTARY INFORMATION FOR GOVERNMENTS USING THE MODIFIED APPROACH

Condition Rating of the City's Street System

	Percentage of Lane-Miles in Good or Better Condition		
	2002	2001	2000
Main arterial	93.2%	91.5%	92.0%
Arterial	85.2%	81.6%	84.3%
Secondary	87.2%	84.5%	86.8%
Overall system	87.0%	85.5%	87.3%

	Percentage of Lane-Miles in Substandard Condition		
	2002	2001	2000
Main arterial	1.7%	2.6%	3.1%
Arterial	3.5%	6.4%	5.9%
Secondary	2.1%	3.4%	3.8%
Overall system	2.2%	3.6%	3.9%

Comparison of Needed-to-Actual Maintenance/Preservation (in Thousands)

	2002	2001	2000	1999	1998
Main arterial:					
Needed	\$ 2,476	\$ 2,342	\$ 2,558	\$ 2,401	\$ 2,145
Actual	2,601	2,552	2,432	2,279	2,271
Arterial:					
Needed	1,485	1,405	1,535	1,441	1,287
Actual	1,560	1,531	1,459	1,367	1,362
Secondary:					
Needed	990	937	1,023	960	858
Actual	1,040	1,021	972	911	908
Overall system:					
Needed	4,951	4,684	5,116	4,802	4,290
Actual	5,201	5,104	4,863	4,557	4,541
Difference	250	420	(253)	(245)	251

Note: The condition of road pavement is measured using the XYZ pavement management system, which is based on a weighted average of six distress factors found in pavement surfaces. The XYZ pavement management system uses a measurement scale that is based on a condition index ranging from zero for a failed pavement to 100 for a pavement in perfect condition. The condition index is used to classify roads in good or better condition (70-100), fair condition (50-69), and substandard condition (less than 50). It is the City's policy to maintain at least 85 percent of its street system at a good or better condition level. No more than 10 percent should be in a substandard condition. Condition assessments are determined every year.

ENDNOTES TO APPENDIX 1

- 1 A network of assets is composed of all assets that provide a particular type of service for a government. A network of infrastructure *assets* may be only one infrastructure *asset* that is composed of many *components*. For example, a network of infrastructure assets may be a dam composed of a concrete dam, a concrete spillway, and a series of locks.
- 2 A subsystem of a network of assets is composed of all assets that make up a similar portion or segment of a network of assets. For example, all the roads of a government could be considered a network of infrastructure assets. Interstate highways, state highways, and rural roads could each be considered a subsystem of that network.
- 3 If a government chooses not to depreciate a subsystem of infrastructure assets based on the provisions of this paragraph, the characteristics of the asset management system required by this paragraph and the documentary evidence required by paragraph 24 should be for that *subsystem* of infrastructure assets.
- 4 The condition level should be established and documented by administrative or executive policy, or by legislative action.
- 5 Condition assessments should be documented in such a manner that they can be replicated. Replicable condition assessments are those that are based on sufficiently understandable and complete measurement methods such that different measurers using the same methods would reach substantially similar results. Condition assessments may be performed by the government itself or by contract.
- 6 Condition assessments may be performed using statistical samples that are representative of the eligible infrastructure assets being preserved. Governments may choose to assess their eligible infrastructure assets on a cyclical basis. For example, one-third may be assessed each year. If a cyclical basis is used, a condition assessment is considered *complete* for a network or subsystem only when condition assessments have been performed for all (or statistical samples of) eligible infrastructure assets in that network or subsystem.
- 7 For example, condition could be measured either by a condition index or as the percentage of a network of infrastructure assets in good or poor condition.
- 8 This change should be reported as a change in accounting estimate.
[Footnote 9 intentionally omitted.]
- 10 Use of a *classified* statement of net assets, which distinguishes between all current and long-term assets and liabilities, is also acceptable. (Paragraphs 97 through 99 provide guidance on presenting classified balance sheets, including reporting on restricted assets.)
- 11 Information about net pension obligations should be reported in a separate pension note, as required by Statement 27.
- 12 If a government applies the provisions of paragraphs 23 and 24 to a subsystem of infrastructure assets (for example, interstate highways), then the RSI disclosures required by this paragraph should be for that *subsystem*.
- 13 Governments with asset management systems for infrastructure assets that gather the information required by paragraphs 132 and 133 and that do not use the modified approach are encouraged to provide the information as supplementary information.
- 14 For purposes of this Statement, deep-discount debt is debt that is sold at a discount of 20 percent or more from its face or par value at the time it is issued. Zero-coupon debt is originally sold at far below par value and pays no interest until it matures.
- 15 *Major* general infrastructure assets are assets that (a) meet the definition of a major asset as described in paragraph 156, (b) are associated with and generally arise from governmental activities, and (c) 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, as described in paragraph 19. The transition period does not apply to proprietary funds and special-purpose governments engaged in business-type activities.
- 16 For purposes of this Statement, governments that have the primary responsibility for managing an infrastructure asset should report the asset. A government should report an asset even if it has contracted with a third party to maintain the asset.

APPENDIX 2:

SELECTED QUESTIONS AND ANSWERS FROM

GUIDE TO IMPLEMENTATION OF GASB STATEMENT 34 ON BASIC FINANCIAL STATEMENTS—AND MANAGEMENT’S DISCUSSION AND ANALYSIS—FOR STATE AND LOCAL GOVERNMENTS

*Selected Questions and Answers**

29. Q—Does Statement 34 prescribe a minimum level for the capitalization of assets?

A—No. However, subparagraph 115e** requires disclosure of the capitalization policy—the dollar value above which asset acquisitions are added to the capital asset accounts. Different types of assets, subsystems, or networks may have different capitalization policies. Additionally, different thresholds may be set for management control purposes or for compliance with laws and regulations. [p. 8]

53. Q—What is the modified approach for reporting infrastructure assets?

A—The modified approach is an alternative to depreciation that may be applied for eligible infrastructure capital assets (see Q54) that meet two requirements. First, the assets should be managed using an asset management system that meets the criteria in paragraph 23. Second, the government should document that the assets are being preserved at or above a condition level established by the government as required by paragraph 24. Under the modified approach, depreciation expense is not recorded for these assets. Rather, costs for both maintenance and preservation of these assets should be expensed in the period incurred. Additions and improvements, on the other hand, are capitalized. (See Exhibit 14 in Appendix 3 for an illustration of the information required to be presented as RSI for eligible infrastructure assets reported using the modified approach.) [p. 13]

57. Q—Under the modified approach, costs for both maintenance and preservation of an asset should be expensed in the period incurred. Is this treatment different from traditional depreciation?

A—Yes. Maintenance costs allow an asset to continue to be used during its originally established useful life. Maintenance costs are expensed in the period incurred, regardless of the method of accounting for the asset. Preservation costs extend the useful life of an asset beyond its previously established useful life. Preservation costs are capitalized and depreciated if the asset is accounted for

using traditional depreciation, but are expensed in the period incurred if the asset is accounted for using the modified approach. [p. 14]

	Modified Approach	Depreciation
Maintenance costs	Expense	Expense
Preservation costs (see Q58)	Expense	Capitalize
Additions and improvements	Capitalize	Capitalize

58. Q—What are “preservation” costs?

A—Although the term is not defined in Statement 34, “preservation” costs generally are considered to be those outlays that extend the useful life of an asset beyond its original estimated useful life, but do not increase the capacity or efficiency of the asset. (See Q57 for discussion of accounting for preservation costs.) [p. 14]

61. Q—What constitutes a change in capacity or efficiency?

A—A change in capacity increases the level of service provided by an asset. For example, additional lanes could be added to a road or the weight capacity could be increased. A change in efficiency maintains the same service level, but at a lower cost. For example, an electric generating plant could be reengineered so that it produces the same megawatts per day using less fuel. [p. 14]

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**Specific paragraphs mentioned in the questions and answers refer to the Governmental Accounting Standards Series, Statement No. 34, Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments, June 1999. (See Appendix 1.)

62. Q—When is a government no longer permitted to use the modified approach for its infrastructure assets?

A—The determination of whether the modified approach may be used is made on a network-by-network or subsystem-by-subsystem basis. A government may no longer use the modified approach for the eligible infrastructure asset if it fails to meet the requirements of paragraphs 23 and 24 for that asset. Reasons could include failure to perform a replicable condition assessment at least every three years, failure to document the condition assessment, a condition assessment that demonstrates that the asset was not maintained approximately at or above the condition level established by the government, and failure to estimate the annual amount needed to maintain and preserve the asset. [p. 15]

63. Q—If a government is not permitted to continue to use the modified approach because the infrastructure assets no longer meet the requirements of paragraphs 23 and 24, in what year is the change to the traditional depreciation approach reported? How is the change reported?

A—Depreciation of the infrastructure assets would begin in the year subsequent to the year that the requirements to use the modified approach are not met. This change would be accounted for prospectively as a change in accounting estimate, as provided for in footnote 21 to paragraph 26. Application of the modified approach essentially equates to the estimation of a useful life of such length that the amount of annual depreciation is insignificant. Therefore, a change in the estimated useful life from almost infinite to a shorter, finite life over which depreciation will be recorded should be reported as a change in estimate. The useful life and residual value of the asset would be estimated and a depreciation method selected at the conversion date. The historical cost of the asset would be depreciated over the period from the cessation of the modified approach through the end of the remaining life of the asset. [p. 15]

64. Q—A government performs condition assessments on a three-year cyclical basis and the condition assessment from the second year shows that the condition is significantly below the level established by the government. Is the government required to stop reporting based on the modified approach and begin depreciating the assets?

A—No. The determination of whether the requirements to use the modified approach have been met is made at the conclusion of a condition assessment cycle (footnote 19). [p. 15]

67. Q—An asset management system should include an up-to-date inventory. Would that require each road sign, light pole, and traffic signal to be tagged and inventoried annually?

A—No. The level of detail in the asset management system is determined by the capitalization policies selected and implemented by the government. (See also Q29 about capitalization policies.) Capital assets may be recorded at the class, network, subsystem, or individual asset level. The following possibilities describe some of the alternatives:

- All of the roads of a government could be capitalized collectively as the road network.
- A government could record its roads at the subsystem level by considering interstate highways, state highways, and rural roads each as separate subsystems.
- Roads could be recorded as subsystems consisting of different geographic regions.
- Roads could be recorded as subsystems consisting of the major components of a road—for example, roadbed, overlay, curbs and gutters, lighting, traffic signals, signage.
- A government may capitalize one type of infrastructure asset at the network level and capitalize other infrastructure assets at the subsystem or even the individual asset level.
- If a government decided that a greater level of detail was needed for internal management purposes, it could select a lower capitalization threshold for management control, which would not be reflected in the financial statements. [p. 16]

70. Q—Is there a minimum condition level at which a government should preserve its infrastructure assets in order to apply the modified approach?

A—Statement 34 does not establish a minimum condition level. However, this level should be established in a formal, documented manner through appropriate administrative or executive policy, or by legislative action. This level and any subsequent changes to the established level should be disclosed annually in the notes to RSI. [p. 17]

71. Q—Who establishes the condition level of an infrastructure asset?

A—The government reporting the subsystem or network of infrastructure assets sets the condition level. This decision should be documented by administrative or executive policy or by legislative action and be disclosed in the notes to RSI. For example, a capital budget prepared by the executive branch and approved by the legislative branch could be used to document the established condition level. [p. 17]

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FHWA-IF-00-010