CHANGES IN FUND STRUCTURE AND THE USE OF FUNDS

The changes in the fund structure required by GASB 34 are summarized in the table below. The funds that were eliminated or added have been referenced in the table below.

SUMMARY OF CHANGES IN FUND STRUCTURE

Current Governmental Financial Reporting Model

Governmental Funds				**Proprietary Funds**		**Fiduciary Funds Trust and Agency Funds**				
General Fund	Special Revenue Funds	Debt Service Funds	Capital Projects Funds	Enterprise Funds	Internal Service Funds	Expendable Trust Funds	Nonexpendable Trust Funds	Pension Trust Funds	Investment Trust Funds	Agency Funds
						(Eliminated)	*(Eliminated)*			

New Governmental Financial Reporting Model

Governmental Funds					**Proprietary Funds**		**Fiduciary Funds**			
General Fund	Special Revenue Funds	Debt Service Funds	Capital Projects Funds	Permanent Funds	Enterprise Funds	Internal Service Funds	Private-Purpose Trust Funds	Pension (& Other Employee Benefits) Trust Funds	Investment Trust Funds	Agency Funds
				(Added)			*(Added)*	*(Added)*		

As you can see in the table above there were no dramatic changes in the governmental or proprietary funds, however, there will be significant changes in the fiduciary funds – trust and agency funds.

The GASB feared that the inclusion of the fiduciary funds resources that are not available to support a government's programs within a set of government-wide financial statements might be misunderstood by the financial statement users. Accordingly, fiduciary funds (and fiduciary-type component units) will be excluded from the new government-wide financial statements required by GASB 34. GASB 34 will allow fiduciary funds to be used only to report assets that *"cannot be used to support the government's own programs".* As a result of this change, many activities currently reported in fiduciary funds, particularly in expendable trust funds, now will be reported in some other fund type. In many cases, the new location of reporting such activities will be one of the governmental funds (general fund, special revenue funds).

GASB Statement No. 34 alters this existing fiduciary fund structure in four important ways: First, the new reporting model eliminates the trust and agency fund type, thereby elevating the various components of this fund type to fund-type status in their own right. Second, the new reporting model eliminates both the expendable and nonexpendable trust fund types. Third, GASB Statement No. 34 creates a new "private-purpose trust funds" fund type. Finally, the pension trust fund type is expanded to embrace other employee benefits as well as pensions.

The new fiduciary fund types consist of the following:

- Pension (and other employee benefit) trust funds – This fund type is used to report resources that are required to be held in trust for the members and beneficiaries of defined benefit pension plans, defined contribution plans, other post-employment benefit plans, or other employee benefit plans. If the noncertificated staff of a municipality do not participate in the South Dakota Retirement System, and if the governing board elected, prior to July 1, 1974, to provide a retirement plan for these employees, this fund type would be used to report the pension fund.

- Investment trust funds – This fund type is used to report the external portion of investment pools reported by the sponsoring government, as required by GASB Statement No. 31, paragraph 18.

- Private-purpose trust funds - This fund type is used to report all trust arrangements under which the principal and income benefit private individuals, private organizations, or other governments.

- Agency funds – This fund type is used to report resources held by the reporting government in a purely custodial capacity (assets equal liabilities). Agency funds typically involve only the receipt, temporary investment, and remittance of fiduciary resources to individuals, private organizations, or other governments. Section 125 medical and daycare escrows would be an example of agency funds.

Under the current reporting model fiduciary funds do not all present the same basic financial statements. Under the new governmental financial reporting model, all fiduciary funds will report the same two basic financial statements: a Statement of Net Position and a Statement of Changes in Net Position. This change is the natural result of the elimination of the expendable and nonexpendable trust fund categories.

INTERNAL SERVICE FUNDS – As a general rule, the assets and liabilities of internal service funds will be eliminated, for the most part, in the process of consolidation. Any remaining balances that are not eliminated normally will be reported in the "governmental activities" column of the statement of net position (rather than the "business-type activities" column), even though internal service funds are proprietary funds rather than governmental funds. The GASB reasons that this treatment is appropriate because the activities accounted for in internal service funds are usually more governmental than business-type in nature. (self insurance coverage for employees of governmental activities). Conversely, in situations where enterprise funds are, in fact, the predominant participants in internal service fund activities, residual balances should be reported in the "business-type activities" column of the government-wide statement of net position.

A key goal of consolidating internal service funds is to eliminate <u>duplication</u>. The revenues and expenses between the internal service fund and the entity fund it serves should not double up on reporting the revenues and expenses. For example, the charge to a General Fund function for health insurance and the payment of a claim from the internal service fund would essentially double up on reporting the same expenditure.

For purposes of consolidation, it is presumed that an internal service fund operates on a strictly break-even basis within the primary government. Accordingly, any profit on internal activity is presumed to indicate that participating functions have been overcharged. Likewise, any loss on internal activity is presumed to indicate that participating functions have been undercharged.

Therefore, consolidation is accomplished by reducing (if there is a profit) or increasing (if there is a loss) the amount of expense reported in the participating functions.

The GASB 34 also created a fifth governmental fund type, to be known as a “Permanent Fund”. The role of the permanent fund is “to report resources that are legally restricted to the extent that only earnings, and not principal, may be used for purposes that support the reporting government’s programs – that is, for the benefit of the government or its citizenry”. It is anticipated that this new fund type will be used to report a number of activities currently reported in nonexpendable trust funds, which will themselves be eliminated with the advent of GASB Statement No. 34.

Another significant change affects the reporting of the General Capital Asset Account Group and the General Long-term Debt Account Group. Governmental funds were designed to report sources and uses of current financial resources. Because capital assets and most long-term obligations represent neither, governments traditionally have been required to present account groups to report capital assets and long-term obligations associated with activities reported in their governmental funds. However, under the new financial reporting model, the assets and liabilities currently reported in the two account groups will henceforth appear on the face of the government-wide financial statements.

Along with the change in reporting of the general capital assets account group comes another change required by GASB 34, that of capital asset depreciation and infrastructure reporting. Accountants have used the term “infrastructure” to refer to assets that are immovable and of value only to the government (roads, bridges, dams). Under the current financial reporting model, state or local governments have not been required to report general infrastructure assets in their financial statements. However, the economic resources measurement focus and the accrual basis of accounting will be used in the future to report governmental activities in the government-wide financial statements. Under GASB 34 governments are to capitalize general infrastructure at their historical cost or estimated historical cost. Governments are required to capitalize all future infrastructure acquisitions, renovations, restorations, or improvements from the date of implementation of GASB 34 (prospective reporting). Different effective dates have been provided, however, for the retroactive reporting of infrastructure assets as follows:

> Phase 1 –Governments with total revenues of $100 million or more will be required to implement the retroactive reporting of infrastructure assets for fiscal years beginning July 1, 2005
>
> Phase 2 –Governments with total revenues of $10 million or more, but less than $100 million, will be required to implement the retroactive reporting of infrastructure assets for fiscal years beginning July 1, 2006
>
> Governments with total revenues of less than $10 million are exempt from the requirement to report their general infrastructure assets retroactively.

Although state and local governments traditionally have reported general capital assets in their financial statements, they have not depreciated those assets. Once again, the move to the economic resources measurement focus and the accrual basis of accounting will substantially change traditional practice. Governments will be required under the new financial reporting model to report depreciation expense for all of their capital assets, including general infrastructure assets discussed above.