

## **HAS GASB STATEMENT NO. 54 HAD A MAJOR IMPACT ON REPORTING UNRESTRICTED FUND BALANCES?**

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Key Words: GASB Statement No. 54, Fund Balance Reporting and Governmental Fund Type Definitions

JEL Classification(s): M41, M48

### **Abstract**

In February 2009, the Governmental Accounting Standards Board (GASB) issued its Statement No. 54 *Fund Balance Reporting and Governmental Fund Type Definitions* (GASB 2009). The Statement is effective for periods beginning after June 15, 2010. The objective of GASB Statement No. 54 is to improve transparency and to enhance the usefulness of fund balance information by clarifying existing governmental fund type definitions and providing fund balance classifications that can be more consistently applied (GASB 2009, ¶2).

Most governments implemented GASB No. 54 in 2011. But has there been a major shift in how these net resources are reported? To answer this question, a study was undertaken by Radford University's *Governmental and Nonprofit Assistance Center* (RU-GNAC 2012) to explore the changes in fund

balance reporting of the general fund for selected cities and counties in the Commonwealth of Virginia.

The purpose of this paper is to present: (1) a brief overview of the GASB and its new fund balance Statement, (2) some historical context that led up to the issuance of the new Statement, (3) a comparison of the old fund balance standards to the provisions of Statement No. 54, (4) a summary of the GNAC results of the study, and (5) some insights and conclusions on what impact GASB Statement No. 54 has had on fund balance reporting.

## **INTRODUCTION**

Governmental accounting and reporting standards are essential because governmental bodies are fundamentally different than for-profit entities (GASB 2013). Users of governmental financial statements have distinctively different informational needs because of the "unique characteristics of governments and the environment in which they operate" (GASB 2013, 1).

### **Government Accounting Standards Board**

The Governmental Accounting Standards Board (hereafter GASB or Board) is the independent organization that establishes accounting and financial reporting standards for U.S. state and local governments. The GASB was established in 1984 by agreement of the Financial Accounting Foundation (hereafter FAF) and ten national associations of state and local government officials (GASB 2013). The Board is "recognized by governments, the accounting industry, and the capital markets" (GASB 2013, 1) as the legitimate standards-setting body for establishing generally accepted accounting principles (GAAP) for state and local governments (GASB 2013). "The GASB is not a government

entity; instead, it is an operating component of the FAF, which is a private sector not-for-profit entity. Funding for the GASB comes primarily from accounting support fee established under the Dodd-Frank Wall Street Reform and Consumer Protection Act as well as the sale of certain publications. Its standards are not federal laws or regulations and the organization does not have enforcement authority. Compliance with GASB's standards, however, is enforced through the laws of some individual states and through the audit process, when auditors render opinions on the fairness of financial statement presentations in conformity with GAAP" (GASB 2013, 1).

#### **GASB Statement No. 54**

GASB Statement No. 54 *Fund Balance Reporting and Governmental Fund Type* (GASB 2009) was issued in February 2009. The objective of the Statement is to enhance the "usefulness, including the understandability, of governmental fund balance information" (GASB 2009, 1, ¶2) for classifications based on a hierarchy for constraints imposed on the use of resources reported in governmental funds (GASB 2009, ¶5). While early implementation was encouraged, the requirements of the Statement are effective for financial statements beginning after June 15, 2010 (GASB 2009). Fund balance reclassifications made to confirm to the provision of the Statement are to be "applied retroactively by restating fund balance for all prior periods presented" (GASB 2009, ¶36).

GASB research revealed inconsistencies in how the previous standards were being used by governments and interpreted by users. In short, GASB Statement No. 54 was issued to overcome these inconsistencies, address the different interpretations of the definitions of governmental funds types, and clarify the reporting of restricted net assets and reserve fund balances (GASB 2009, ¶1),

Most governments implemented GASB Statement No. 54 in 2011. But has there been a major shift in how these net resources are reported? To answer this question, a study was undertaken by Radford University's Governmental and Nonprofit Assistance Center (GNAC) to explore the changes in fund balance reporting of the general fund for selected cities and counties in the Commonwealth of Virginia (RU-GNAC 2012). The purpose of this paper is to present: (1) a brief overview of the GASB and its new fund balance Statement, (2) some historical context that led up to the issuance of the new Statement, (3) a comparison of the old fund balance standards to the provisions of Statement No. 54, (4) a summary of the GNAC results of the study, and (5) some insights and conclusions on what impact GASB Statement No. 54 has had on fund balance reporting.

#### **HISTORY OF GASB STATEMENT NO. 54**

Reporting of restricted net assets was first required with the issuance of GASB Statement No. 34 *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*. It required governments to report net assets in three categories: invested in capital assets net of related debt, restricted, and unrestricted. Permanent endowments or permanent fund principal amounts included in restricted net assets were to be further reported as either expendable or nonexpendable.

The GASB first initiated its fund balance reporting project in August 2002 because of concerns by some users regarding the distinctions between reserved and unreserved funds and the relationship between reserved fund balances and restricted net assets (GASB 2009, ¶37). Research associated with the implementation of Statement No. 34 revealed that some governments had difficulty interpreting the requirement that those restrictions be legally enforceable, thereby resulting in inconsistent reporting of reserved fund balance information (GASB 2009, ¶40). This led to the issuance of GASB Statement No. 46 *Net Assets*

*Restricted by Enabling Legislation—an amendment of GASB Statement No. 34* in December 2004 (GASB 2009, ¶41). Statement No. 46 clarified that a legally enforceable enabling legislation replaces existing enabling legislation or if legal enforceability is reevaluated. Finally, it required governments to disclose the portion of total net assets that is restricted by enabling legislation (GASB 2009, ¶7-9).

Subsequent research was conducted on improving fund balance reporting. An Exposure Draft of proposed fund balance standards was issued in April 2008 (GASB 2009, ¶46). While the scope of the fund balance reporting project was originally limited to only fund balance classification and display issues, the Board determined that the fund balance reporting issues should include improving the consistency in how governmental fund types were reported (GASB 2009, ¶49). However, the Board elected not to alter the existing fund type definitions in ways that would generally impose more restrictive interpretations regarding the resources that may be reported in those fund types beyond what was originally concluded (GASB 2009, ¶50). GASB Statement No. 54 was adopted by a 6-1 affirmative vote (with Mr. Williams dissenting) of the members of the GASB (GASB 2009, 15 and ¶135).

#### **GASB STATEMENT NO. 54**

GASB No. 54 significantly changed how fund balance is reported by state and local governments. However, it has been suggested that there are similarities with how amounts are reported between the old and new reporting standards. **Exhibit 1** reflects how the old reporting standards are to be reported under GASB Statement No. 54 (GASB 2009).

Fund balance represents the residual amount in a governmental fund and is perhaps the most important financial information used by external parties in judging a government's liquidity and resources that are available to fund future programs.

This is especially true for a government's main operating fund, the general fund (GASB 2009, ¶39).

GASB No. 54 classifies fund balance into five categories: nonspendable, restricted, committed, assigned, and unassigned (GASB 2009, i). These categories provide information about constraints placed on the net resources of the fund, as well as the amounts available for future spending. The new classifications are intended to provide better transparency of governmental financial statements (GASB 2009, ¶2).

GASB No. 54 uses a hierarchical approach to classify fund balances based on constraints placed on resources at the fund level, which includes nonspendable and spendable fund balances. Nonspendable funds include amounts that cannot be spent, while spendable funds include restricted, committed, assigned, and unassigned fund balances, with the unassigned amount being available for future appropriation.

As noted, GASB Statement No. 54 takes a different approach to classifying fund balance than the previous standard. The five fund categories identified in Statement No. 54 are defined below (GASB 2009):

- *Nonspendable* funds include amounts that cannot be spent because they are either not in spendable form, such as prepaid items, inventories, and long-term receivables *or* funds that are legally or contractually required to be maintained intact, such as the corpus of a permanent fund (GASB 2009, ¶6-7).
- *Restricted* funds include amounts restricted to specific purposes that can be imposed by external parties, such as creditors, grantors, and other governments, constitutional provisions, and enabling legislation, which authorizes the government to levy, assess, or change external resource providers and includes a legally enforceable requirement that the resources be used for a particular purpose specified in the legislation (GASB 2009, ¶8-9).

- *Committed* funds include amounts that can only be used for specific purposes pursuant to formal action of the government's highest level of decision-making authority. Such amounts cannot be used for any other purpose unless the constraint is changed by similar action (Chase and Roybark 2010). Note that the committing action must be taken prior to year-end, while the amount may be determined in the subsequent period (GASB 2009, ¶10-12).
- *Assigned* funds include amounts that are constrained by the government's intent to be used for specific purposes, but are neither restricted nor committed. The intent should be expressed by the governing body or governmental official possessing the appropriate authority. However, the expression of intent does not have to be made prior to year-end, as with committed fund balances. A residual classification of positive fund balance amounts should be reported for funds other than the General Fund (GASB 2009, ¶13-16).
- *Unassigned* funds represent the residual fund balance classification for the general fund. The general fund should be used to account for and report all financial resources not accounted for and reported in another fund (GASB 2009, ¶29). A positive unassigned fund balance should not be reported in any governmental fund other than the general fund, while it is possible, under certain circumstances, to report negative unassigned fund balances in other governmental funds. In the general fund, report the residual amount, either positive or negative, as *Unassigned Fund Balance* (GASB 2009, ¶17-19). In funds other than the general fund, the balance is reported in one of two ways (GASB 2009, ¶18-19):
  - If the balance is *positive*, the fund is reported as *Assigned to Fund Purposes*.
  - If the balance is *negative*, the fund is reported as *Unassigned Fund Balance*.

Prior to Statement No. 54, fund balances were reported as either reserved or unreserved. GASB's research revealed that some governments reported amounts as reserved that should have been classified as unreserved. Governments were allowed to break the unreserved portion of fund balance into designated and undesignated. The designated portion reflected some intended use of resources, while the undesignated portion was available for future appropriation. However, not all governments chose to report unreserved fund balance into designated and undesignated components (GASB 2009, ¶1).

Based on Statement No. 54, a specific fund balance constraint will not be reported for encumbrances, unless existing resources are to be used for encumbrances that have not already been restricted, committed, or assigned. In practice, this can only happen in the General Fund because all other funds have a fund balance that is at least assigned (GASB 2009, ¶24). Prior to Statement No. 54, most governments reported some amounts as reserved for outstanding encumbrances. Under GASB No. 54, outstanding encumbrances do not place additional constraints on restricted, committed, or assigned resources (GASB 2009, ¶24). This change could result in a higher amount being reported as unrestricted. Some governments also reported restricted resources as being unreserved-designated. Under GASB No. 54, such resources will be reported as restricted. It is unclear how these two items may offset the amounts being reported as unrestricted under GASB No. 54.

GASB No. 54 is effective for fiscal periods beginning after June 15, 2010. Fund balances must be reclassified for all prior periods presented in financial statements; thus, any changes in fund structure should be reflected through a restatement of beginning fund balances (GASB 2009, ¶36).

### **Governmental Fund Type Definitions**

In addition to the five governmental fund types, changes to existing definitions were made to the following four types of funds: (1) special revenue funds; (2) capital project funds; (3) debt service funds; and (4) permanent funds (GASB 2009, ii). Of the four types of funds, the special revenue fund included the most significant changes. The four types of funds are defined below.

**Special revenue funds.** Special revenue funds are used to account for and report the proceeds of specific revenue sources that are *restricted* or *committed* to expenditure for specified purposes other than debt service or capital projects. Note that one or more specific restricted or committed revenues serves as the criteria for a special revenue fund. Revenues that are restricted or committed should continually comprise a *substantial portion* of the special revenue fund inflows (GASB 2009, ¶30-32). **Figure 1** depicts a decision-tree for determining whether such funds should be reported as a special revenue fund or combined with the general fund.

Note that there is no requirement under GAAP to report restricted or committed revenues in a special revenue fund (Brooks and Mead 2010); hence, each special revenue fund must be evaluated to determine if the total of restricted and committed revenues make up a substantial portion of the fund. If not, reporting of the fund should be discontinued and the fund should be combined with the general fund or other appropriate governmental fund. Under such conditions, the beginning fund balances should be restated. Note that while a state law may require certain revenue to be deposited in a special revenue fund, the revenue does not have to be reported as such on GAAP-based financial statements. This is because GASB reporting standards supersede state law for reporting purposes (GASB 2009, ¶30-32).

**Capital project funds.** Capital projects funds are used to account for and report financial resources that are restricted, committed, or assigned to expenditures for capital outlays including the acquisition or construction of capital facilities and

other capital assets. Capital projects funds exclude those types of capital-related outflows financed by proprietary funds or for assets that will be held in trust for individuals, private organizations, or other governments. Note that GAAP does not require the use of capital project funds, so the capital activity may be reported in the general fund or a special revenue fund (GASB 2009, ¶33).

**Debt service funds.** Debt service funds are used to account for and report financial resources that are restricted, committed, or assigned to expenditures for principal and interest. Debt service funds should be used to report resources if legally mandated. Financial resources that are being accumulated for principal and interest maturing in future years also should be reported in debt service funds (GASB 2009, ¶34).

**Permanent Funds.** Permanent funds should be used to account for and report resources that are restricted to the extent that only earnings, and not principal, may be used for purposes that support the reporting government's program. Such funds do not include private-purpose trust funds, which should be used to report situations when the government is required to use the principal or earnings for the benefit of individuals, private organizations, or other governments (GASB 2009, ¶35).

## LOCAL GOVERNMENTS IN VIRGINIA

Local governments in Virginia have been recognized for their high-quality financial reporting practices in accordance with generally accepted accounting principles. For example, 42 municipal governments and 34 counties received the Government Finance Officers Association's (hereafter GFOA) *Certificate of Achievement for Excellence in Financial Reporting* in 2010 (RU-GNAC 2012).

The purpose of the GFOA is "to enhance and promote the professional management of governments for the public benefit by identifying and developing financial policies and best practices and promoting their use through education, training, facilitation of

member networking, and leadership" (GFOA 2013b). The GFOA established its *Certificate of Achievement for Excellence in Financial Reporting* Program "in 1945 to encourage and assist state and local governments to go beyond the minimum requirements of generally accepted accounting principles to prepare comprehensive annual financial reports that evidence the spirit of transparency and full disclosure and then to recognize individual governments that succeed in achieving that goal" (GFOA 2013a, 1). Submissions "are reviewed by selected members of the GFOA professional staff and the GFOA Special Review Committee (SRC), which comprises individuals with expertise in public-sector financial reporting and includes financial statement preparers, independent auditors, academics, and other finance professionals" (GFOA 2013a, 1).

This study examines the general funds from the 2010 (ending June 30, 2010) and 2011 (ending June 30, 2011) annual reports of independent cities and counties in the Commonwealth of Virginia with populations greater than 30,000. The Commonwealth of Virginia is made up of 39 independent cities and 95 counties, with 54 of the municipalities have populations over 30,000. Data were available for 51 governments. Fund balances were compared as a percent of general fund revenues (RU-GNOA 2012).

Under GASB No. 54, unrestricted fund balance consists of amounts reported as committed, assigned, and unassigned. Previous guidance reported similar amounts as unreserved fund balance. **Exhibit 2** compares the amount reported in 2011 as unrestricted fund balance to the amount reported in 2010 as unreserved fund balance by 51 local governments in Virginia governments (RU-GNOA 2012).

The 2011 unrestricted fund balance expressed as a percentage of revenue was 26.7% (Statement No. 54), while the 2010 unreserved fund balance expressed as a percentage of revenue was 25.2% (pre-Statement No. 54). This reflects a net increase of 1.5% (RU-GNOA 2012).

The portion of fund balance most available for future spending is the unassigned portion. The unassigned percentage of revenue in 2011 was 19.6% (Statement No. 54), while the unreserved-undesignated percentage of revenue in 2010 was 18.1% (pre-Statement No. 54). This also reflects a 1.5% increase. In 2011, only one government reported no amount in the unassigned classification (Statement No. 4), which compares with two governments that reported no amount in unreserved undesignated fund balance (pre-Statement No. 54) (RU-GNOA 2012).

The second comparison is between amounts reported as assigned in 2011 and designated in 2010. The 2011 assigned percentage of revenue was 3.6% (Statement No. 54), while the 2010 designated percentage of revenue was 7.1% (pre-Statement No. 54). This is a significant difference (3.5%). However, when you combine the 2011 percentage for committed and assigned funds, the total is 7.1% (Statement No. 54), which would suggest that most of the amount reported as committed in 2011 was previously reported as designated in 2010 (pre-Statement No. 54) (RU-GNOA 2012).

In 2010, 15 governments reported no amounts as being designated (pre-Statement No. 54). In 2011, 13 governments reported no amounts as committed (Statement No. 54) and 9 governments reported no amounts as assigned (Statement No. 54). This represents an overall increase in governments reporting fewer constraints in the unrestricted fund balance reported in 2011 (RU-GNOA 2012).

**Exhibit 3** reports the number of governments that had changes in amounts reported between unrestricted fund balance in 2011 (Statement No. 54) and unreserved fund balance in 2010 (pre-Statement No. 54). Thirty-eight governments reported an increase in the percentage of unrestricted fund balance reported in 2011 (Statement No. 54) compared to unreserved fund balance reported in 2010 (pre-Statement No. 54). Thirteen governments reported a decrease. Exhibit 3 also reports the means and ranges for

these changes. In all cases, the change was less than one percentage point (RU-GNOA 2012).

**Exhibit 4** reports changes in amounts reported between unassigned fund balance in 2011 (Statement No. 54) and unreserved-undesignated fund balance in 2010 (pre-Statement No. 54). Thirty-one governments reported an increase in the percentage of fund balance reported as unassigned in 2011 (Statement No. 54) compared to unreserved-undesignated fund balance in 2010 (pre-Statement No. 54). Nineteen governments reported a decrease. Exhibit 4 also reports the means and ranges for the changes. The mean change for governments reporting an average increase was 2.4 percentage points, the largest change in the study. The mean change for governments reporting a decrease was 0.289 (RU-GNOA 2012).

**Figure 2** depicts the amounts for the 51 governments reported by population as unrestricted fund balance in 2011 as a percentage of revenue (Statement No. 54) compared to the amount reported as undesignated fund balance in 2010 as a percentage of revenue (pre-Statement No. 54). With only a few exceptions, the graph reflects little difference between amounts reported as unrestricted in 2011 (Statement No. 54) and amounts reported as unreserved in 2010 (pre-Statement No. 54) (RU-GNOA 2012).

## CONCLUSIONS

GASB Statement No. 54 established a new approach to classifying and reporting fund balance. It is based on constraints placed on net resources. GASB Statement No. 54 should result in more consistent application of fund balance reporting and disclosures by governments. In summary, the Statement should reduce the uncertainty about fund classifications and provide users the necessary information to understand which constraints are imposed upon the use of resources, thereby improving informational utility to users. But has GASB Statement No. 54 had a major impact on reporting unrestricted fund balances? For local

governments in the Commonwealth of Virginia, this study reflects only a small increase in the amount being reported as unrestricted in 2011 (Statement No. 54) as compared to unreserved in 2010 (pre-Statement No. 54). A similar small increase was revealed for amounts reported as unassigned in 2011 (Statement No. 54) as compared to unreserved-undesignated in 2010 (pre-Statement No. 54).

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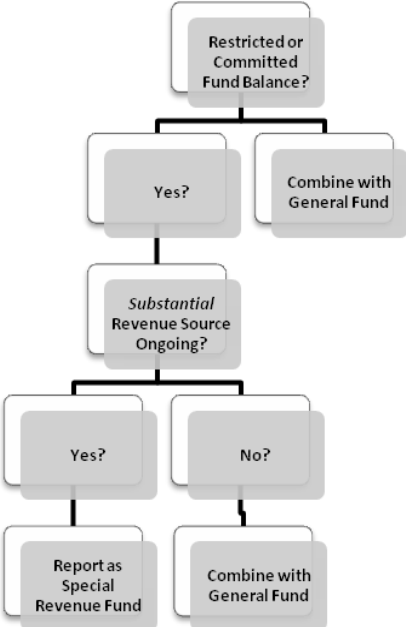
<b>Exhibit 1</b>			
<b>Comparison of GASB Statement No. 54 to Previous Reporting of Fund Balances</b>			
<i>Previous Reporting of Fund Balance</i>	<i>New Reporting of Fund Balance under GASB No. 54</i>		
<b>Previously reported as <i>Reserved</i></b>	<b>Nonspendable</b> Not in spendable form and/or legally or contractually required to be maintained intact		
	<b>Restricted</b> Externally constrained or legally enforceable	<i>Highest Level Constraint</i>	S P E N D A B L E  F U N D S
	<b>Committed</b> Internally constrained	<i>Mid Level Constraint</i>	
<b>Assigned</b> Internally Constrained	<i>Lowest Level Constraint</i>		
<b>Previously reported as <i>Designated</i></b>			
<b>Previously reported as <i>Unreserved</i></b>	<b>Unassigned</b> Residual classification for General Fund	<i>No Constraint</i>	

<b>Exhibit 2</b> <b>Comparison of 2010 <i>Unreserved</i> Fund Balance to</b> <b>2011 <i>Unrestricted</i> Fund balance as a Percent of Revenue</b> <b>(For the General Fund of 51 Local Governments in the</b> <b>Commonwealth of Virginia)</b>				
	Average	Range	Standard Deviation	Number Reporting "0"
2010 Designated	7.1%	0% – 31.7%	.080	15
2010 Undesignated	18.1%	0% – 53.5%	.113	2
2010 Total <i>Unreserved</i>	25.2%	9.3% – 58.6%	.111	
2011 Committed	3.5%	0% – 15.6%	.046	13
2011 Assigned	3.6%	0% – 26.0%	.055	9
2011 Unassigned	19.6%	0% – 53.3%	.115	1
2011 Total <i>Unrestricted</i>	26.7%	10.4% – 55.0%	.106	

<b>Exhibit 3</b>			
<b>Change in the Amount Reported as <i>Unrestricted</i> Fund Balance in 2011 to Amount Reported as <i>Unreserved</i> Fund Balance to 2010 as a Percent of Revenue (For the General Fund of 51 Local Governments in the Commonwealth of Virginia)</b>			
	Number	Range	Average
Increase	38	.004% – .781%	.392
Decrease	13	.008% – .453%	.230

<b>Exhibit 4</b>			
<b>Change in Amount Reported as <i>Unassigned</i> Fund Balance in 2011 to Amount Reported as <i>Unreserved-Undesignated</i> Fund Balance to 2010 as a Percent of Revenue (For the General Fund of 51 Local Governments in the Commonwealth of Virginia)</b>			
	Number	Range	Average
Increase	31	0.003% – 4.880%	2.441
Decrease	19	0.002% – 0.577%	0.289
Note that one government reported no amount as <i>Unassigned</i> and <i>Unreserved-Undesignated</i> fund balance.			

**Figure 1**  
**Decision-tree for determining how *Special Revenue* funds are to be reported under GASB Statement No. 54**



**Figure 2**  
**Comparison of *Undesignated* Fund Balance to *Unrestricted* Fund Balance by Population**

