



North Carolina Department of State Treasurer

RICHARD H. MOORE
TREASURER

State and Local Government Finance Division
and the Local Government Commission

JANICE T. BURKE
DEPUTY TREASURER

Memorandum #1023

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To: Finance Officers of Charter Schools and Certified Public Accountants

From: T. Vance Holloman, Director, Fiscal Management Section

Subject: GASB Statement No. 34 Implementation Issues for Charter Schools

The Governmental Accounting Standards Board (GASB) issued Statement Number 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments*, and several related statements, an interpretation, and implementation guides in order to establish a new reporting model for external financial reporting. As of June 30, 2004, charter schools are required to issue their annual financial reports according to the requirements of this new reporting model. While Statement No. 34 should minimally affect the day-to-day accounting for a charter school, several year-end reporting issues exist. In addition to implementing GASB Statement No. 34, charter schools should also consider the effect (if any) of GASB Statement No. 39 on their annual financial statements. For more information on GASB Statement No. 39 and its implementation, please see our Memorandum #1000, dated July 30, 2004.

Fund Categorizations

The governmental fund type still exists and consists of the general, special revenue, capital projects, debt service, and permanent funds. Funds treated as nonexpendable trusts and expendable trusts under the old reporting model will now be reported as permanent or special revenue funds if they benefit the school as a whole, or perform a function that is typically performed by the school itself, and as private-purpose trust funds if they benefit only a particular group or part of the school. The most typical example of a private purpose trust fund is a scholarship fund. If the school has a pension trust fund, that will continue to exist under the new model.

Just as importantly, Statement No. 34, for reporting purposes, no longer utilizes account groups to report capital assets or long-term debt. However, governmental funds must continue to maintain this information in order to report on the full accrual basis of accounting in the government-wide statements.

Charter schools have a General Fund that corresponds to the Local Current Expense Fund of a local educational agency (LEA). Funds passed to charter schools from LEAs that represent appropriations from counties who have students at the school are accounted for in this fund. In addition, the State Public School Fund and Federal Grants Fund are reported as Special Revenue Funds. Unlike the LEAs, charter schools are not required to account for capital outlays for

equipment, furniture and buses in a capital outlay fund. These expenditures may be accounted for in the General Fund. Charter schools should use a capital project fund for acquisition or construction of major capital assets. Based upon our review of reports, most charter schools will not have a capital projects fund. Also, debt service expenditures are most often accounted for in the General Fund, but a school may elect to establish a debt service fund for these activities instead.

The Child Nutrition (School Food Service) Fund and Child Care Fund continue to be reported as enterprise funds.

Government-wide Financial Statements

The new model will consist of two government-wide financial statements prepared on the full accrual basis of accounting. These are the Statement of Net Assets, similar to the current Balance Sheet, and the Statement of Activities, similar to the current Statement of Revenues, Expenses and Changes in Retained Earnings that is presented for enterprise funds. These statements will present the primary government's governmental and business-type activities in separate columns. For most units the governmental activities will consist of the General Fund, the State Public School Fund, and the Federal Grants Fund and any other special revenue or permanent funds the school may have. Business-type activities will consist primarily of the School Food Service Fund and/or the Child Care Fund.

There will not be many differences in the presentation of the business-type activities and the current presentation of the proprietary funds. The main differences will be in the equity section and the formatting of the operating statements. The presentation of the governmental activities will be different from the current presentation of the governmental funds. Governmental activities will be presented on the full accrual basis. On the Statement of Net Assets, capital assets and long-term debt will be included. On the Statement of Activities, additions to capital assets will not be recognized as an expense, depreciation expense will be recognized, and long-term debt proceeds will increase liabilities and not be recognized as an other financing source.

In order to accomplish these changes, there will need to be a series of conversion entries from the presentation of governmental funds in the fund statements to the governmental activities on the government-wide statements. These entries are for financial reporting only and **most will not be posted to the records of the unit**. We are preparing a conversion workbook in Excel that will assist charter schools in identifying and recording these entries in the workbook to produce the full accrual data. It should be available on our website very soon.

The Statement of Activities will attempt to match program revenues and program expenses, resulting in a net cost of a program. This statement will report expenses, program revenues, and net revenues (expenses) for each function for governmental activities or separately identifiable functions for business-type activities. General revenues will be reported at the end of the statement. See Memorandum # 928 for a more detailed description of the new model.

Revenues will be categorized as general or program specific. General revenues include all revenues that do not meet the criteria for program revenues. Program specific revenues include

charges for services, program specific – operating grants or program specific – capital grants. Charges for services represent revenues generated from exchange or exchange-like transactions of a function (program) or identifiable activity (segment). Program specific revenues can originate from operating grants or capital grants and contributions. They are restricted for use in a particular program by the resource provider. If a grant can be used for either operating or capital purposes at the recipient's discretion, it should be classified as an operating grant.

Expenses on the government-wide statements must be presented by program for governmental activities and by separately identified activities for business-type activities. In reviewing the financial statements of charter schools, we have found that expenditures are most often reported by governmental funds at the purpose code level. LEAs are reporting program revenues and expenditures at the function code level under GASB 34. However, charter schools have fewer activities and receive and expend a smaller amount of funds than LEAs. Therefore, reporting at the functional level would not provide significant information to statement users. Charter schools may report programs at the purpose code level, which is consistent with how most charter schools are currently reporting expenditures in their financial statements. For governmental-type activities, programs will be defined as the purpose codes of Instructional Programs (5000) and Supporting Services (6000), Community Services (7000) and Non-programmed Charges (8000).

For business-type activities the separately identified activities will typically be School Food Service and/or Child Care. Other activities may be added if the charter school accounts for other activities in its proprietary funds.

Specific Revenue Classifications

County and State Appropriations

County appropriations to charter schools will be treated as general revenue, as will most State funds (PRC 036 funds). Two exceptions to that are ABC Incentive Funds (PRC 033) and Behavioral Support Funds (PRC 029), which are program specific-restricted funds. These revenues will be reported as program specific operating grants for the programs (purpose codes) in which they are expended.

Charter schools may not have any program-specific capital grants. In order for a grant to qualify as a capital grant it must be restricted to capital outlay expenditures from which title, in the name of the school, to a capital asset results.

Federal Funds

Federal funds received through the North Carolina Department of Public Instruction, are a mixed lot of restricted and unrestricted funds. Federal funds classified in the 3500 revenue account codes are unrestricted and are recorded as general revenue. Federal funds classified in the 3600, 3700, and 3800 revenue account codes are restricted and are recorded as program specific-operating revenue. They would be reported as operating grants for the purpose code in which they were expended.

Grants received directly from the federal government may or may not be restricted. Grants that are intended to cover expenditures of a program are considered program revenues. These grants will be reported as program specific-operating revenues of the programs (purpose codes) in which the funds were expended.

Investment Earnings, Donations, and Other Revenues

Investment earnings are almost always general revenue. The only exception is if the earnings are specific to a restricted revenue source and the funding agency or lender dictates that the earnings follow the original revenue.

Donations

The classification of donations will depend on the nature of the contribution. General contributions to the school on which no restrictions have been placed are treated as general revenues. Contributions that are for a specific program will be program specific-operating revenues unless they are further restricted for capital use only. In that case, the donation is program specific-capital revenue. Keep in mind as well that material amounts of restricted donated cash on hand at the end of the fiscal year should be reported as a restricted net asset.

Contributions or donations that are not restricted will be accounted for in the General Fund. It will only be appropriate to account for these revenues in some other fund if the donations are restricted to that fund's activities.

A school may receive a donation or hold funds as a trustee and be restricted from spending the principal portion of those funds under the terms of the donation or trust. If these funds benefit the school as a whole, the funds will be accounted for in a permanent fund. If the funds only benefit a small group of students, such as a scholarship fund, the funds will be accounted for as a private-purpose trust fund.

Fines and Forfeitures

Fines and forfeitures that are received from counties who have students enrolled at the charter schools will be reported as general miscellaneous revenues. These funds pass through LEAs before going to charter schools.

Other Revenues

Like donations, other revenues can be classified in a variety of ways. Most other revenue is general in nature and will be reported as general revenue. If it is restricted to a specific program, it will be reported as such. Indirect cost charges would be reported as charges for services for the support services program (purpose code 6000).

Charges for Services

The fees charged for food service and child care (4200 and 4300 revenues) are recorded as charges for services in the activity type to which they relate. For example, fees charged for lunch are charges for services in the child nutrition or school food service activity. Fees charged for before and after school care are charges for services in the child care activity.

Indirect Costs

When reporting on the government-wide statements, indirect cost payments from the Federal Grants Fund, the School Food Service Fund and the Child Care Fund, to the General Fund need to be eliminated in order to avoid overstating revenues and expenses. In the case of the payment from the Federal Grants Fund, the indirect cost revenue (4880), which will be reported as charges for services for support services program (6000), and the payments to other governmental units function/program 8000 (Non-Programmed Charges) would need to be reduced by the amount of the indirect cost payment. Because governmental activities include both the General Fund and the Federal Grants Fund, you will be left with the federal grant revenue and the expenses in the appropriate functional categories.

In the case of payments by the School Food Service Fund or the Child Care Fund to the General Fund, the indirect cost revenue (4880), which will be reported as charges for services for support services program (6000), and the program 6000 (Support Services) for the governmental activities would need to be reduced by the actual amount of the indirect cost payment. Program 6000 (Support Services) was chosen because it appears to include most of the indirect expenses. This adjustment will not apply to indirect costs not paid by one fund to another. No entry would be required in the business-type activities because the cost of providing this service should include these payments. All entries mentioned above should be made during the process of converting from the fund to the government-wide statements and should not be posted to the general ledger.

Debt Service

Debt service principal and interest payments should be presented as a separate expenditure category on the fund statements. Some units have not done this in the past because the amount was considered immaterial. If amounts are immaterial, units may continue this practice. However, material amounts of debt service should be reported as a separate category of expenditure on the fund statements rather than in the non-programmed cost purpose code (8000) or other purpose codes.

For all debt service payments, the principal portion of the expenditure will not be considered an expense on the government-wide statements. It will be reclassified as a reduction in a liability. In addition, the interest expense on the government-wide statements should not be based upon the cash

payment, but on the amount of interest expense accruing each month of the year. These adjustments will not be posted to the records of the charter school.

Depreciation

Depreciation will be calculated on all capital assets that meet or exceed the capitalization threshold set by each school's board or financial staff. The school also must determine the useful lives of each asset and which method of depreciation will be used. The staff of the LGC highly recommends that units use the straight-line method of depreciating its assets. We offer an Excel workbook, available on our website, which will calculate straight-line depreciation for each asset once the pertinent data (date in service, date out of service, if applicable, cost or value of asset, useful life, and salvage value) is entered.

Once the amount of depreciation for each asset is calculated, GASB Statement No. 34 requires that the depreciation expense be assigned to a program. LEAs do not allocate depreciation, but they report program expenditures at the function level. Allocation of depreciation at that level would be very difficult, if not impossible. Charter schools are reporting program expenditures at the purpose code level. Charter schools should be able to distinguish assets used in instructional programs and support services. Depreciation on assets that serve multiple programs must be allocated across those programs, based on some reasonable allocation method. For example, depreciation on a copier that is used by the instructional staff and the support staff could be allocated based on a reasonable estimate of the percentage of use by those two groups.

Other Costs

Other costs are salaries and benefit expenditures that are not assigned to the function from which the employee is paid. They are charged to function codes 5900 or 6900. LEAs report program expenditures at the function level and therefore must allocate these costs to the function from which the employee is paid on the government-wide statements. However, charter schools report at the purpose code level and do not have to allocate these costs.

Club and Activity Funds

Funds raised to support club and student activities and the associate expenses should be accounted for in a Special Revenue Fund or in the General Fund. If there are material amounts of cash on hand at year end that is restricted in purpose (i.e. funds raised for a specific activity or for a capital fundraiser, etc) the unit should show these amounts as restricted net assets in the governmental activities column on the Statement of Net Assets. If restricted funds are accounted for in the General Fund, the school must track revenues and expenditures of those funds to be certain that the funds are expended for the intended purpose.

Management's Discussion and Analysis

Because annual budgets are not a legal requirement for charter schools, the MD&A will not include any discussion of a budget for a charter school, regardless of whether or not the school adopted a budget.

If you have any questions regarding this memorandum, please contact Sharon Edmundson at 919-807-2384 or sharon.edmundson@treasurer.state.nc.us.

EXHIBIT A

**GASB 34 Funds
North Carolina Charter Schools**

Governmental Funds

General

Special Revenue

State Public School

Federal Grants

Club Activities

Capital Projects

Permanent

Proprietary Funds

Enterprise

Child Nutrition

Child Care

Fiduciary Funds

Pension and Other Employee Benefit Trust

Private Purpose Trust

Scholarships/Awards