

GASB 34: Look before you leap

Editor's note: The goal of this article is to present objective information. CTRE is heavily involved in developing and supporting the implementation of pavement and bridge management systems, both important elements of the modified approach to managing assets.

AT FIRST GLANCE, local agencies might assume the most straightforward approach to complying with GASB 34 (see background information below) is to use the depreciation method for reporting capital assets. After all, as described in earlier articles in *Technology News*, using the depreciation method does not require a system for managing assets, as does the modified approach. And most public agency financial officers are already very knowledgeable about depreciation.

Before adopting the depreciation method, however, agencies should understand that depreciating the value of capital assets like roads and bridges may be a much more complex process than it seems.

An example of depreciation's complexity

One area where depreciation gets complicated is the necessity for capitalizing preservation expenses. Preservation expenses are generally 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 asset¹. Using the depreciation method, any asset preservation expenses must be added to the value of the assets (in other words, capitalized).

Highway agencies using the depreciation method will generally divide highways into segments representing construction projects. On each segment, preservation activities will have to be expensed and depreciation computed. Depreciation and preservation will be totaled across all segments to arrive at a valuation for the Comprehensive Annual Financial Report.

If at some time part of a segment is rebuilt and the remainder is preserved, tracking costs and value for that segment will require dividing the original segment into two or more segments and keeping track of each. The figure at right illustrates one possible scenario.

As this one simple example shows, the challenge of expensing preservation activities changes depreciation from a fairly straightforward formula to a complex, time-consuming, and, possibly, error-prone activity.

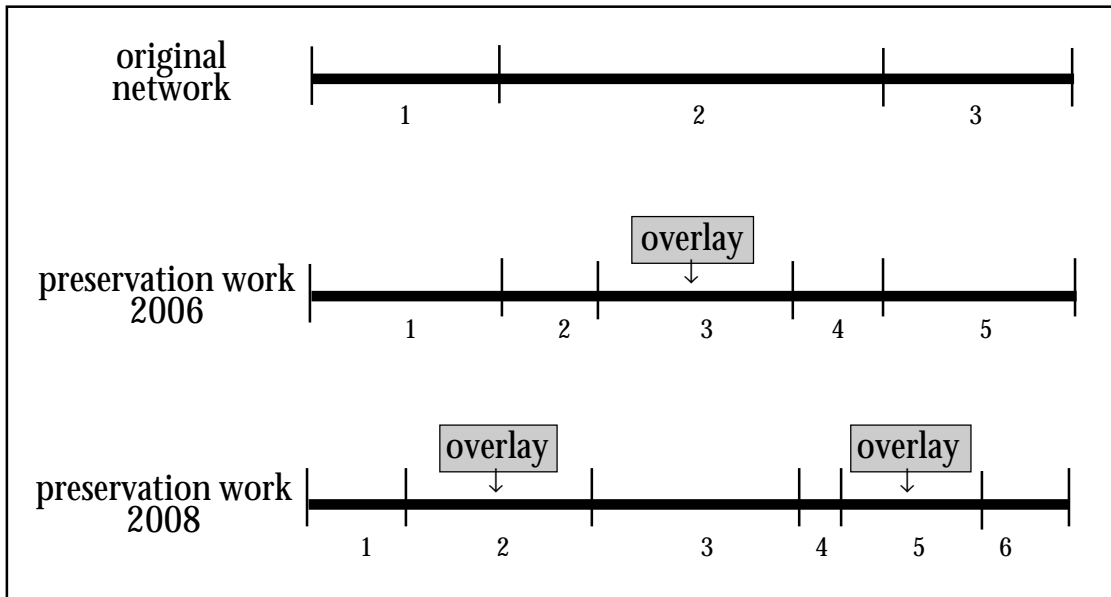
Ultimately, establishing a record keeping system to use with depreciation formulae or software may require nearly the same level of effort as that required for using the modified approach.

GASB 34: Background

GOVERNMENT Accounting Standards Board Statement 34 (GASB 34), issued in June 1999, outlines the broadest changes in government accounting practices since Generally Accepted Accounting Practices (GAAP) were developed in the 1930s.* Primarily, GASB 34 requires government agencies using Consolidated Annual Financial Reports to report the value of their capital assets.

GASB 34 identifies two acceptable methods for reporting capital assets: the depreciation approach and the modified approach. See earlier GASB 34-related articles from *Technology News* (www.ctre.iastate.edu/gasb34/), which outline who is affected by GASB 34, a schedule for compliance, and, very generally, characteristics of the depreciation and modified approaches.

* Statement made by Jay Fountain, Jr., CPA, Assistant Director of Research, GASB, at the "GASB Statement 34 Compliance Peer Exchange: What, Why, and How," organized by the American Association of State Highway and Transportation Officials, Nashville, Tennessee, April 27, 2001.



The depreciation method will require a fairly complex recordkeeping system that will allow agencies to, for example, capitalize preservation expenses appropriately for different segments of roadway.

The modified approach

GASB 34 allowed the modified approach because it was argued that public agencies' goal is not to depreciate the value of roads and bridges but to maintain roads and bridges at or above a certain condition level. Over several years an asset may be substantially renewed (preserved), but it is still fundamentally the same asset, performing the same function.

As discussed in earlier articles in *Technology News* (see www.ctre.iastate.edu/gasb34/), the modified approach requires that agencies (1) use a system for monitoring and managing the performance of infrastructure assets (e.g., pavement or bridge management systems) and (2) maintain assets at or above a minimum condition level, set by the agency itself. The GASB requirements for bridge or pavement systems that satisfy the modified approach are really quite modest. For example, to manage a street or highway network, any multiyear, network-level pavement management system will do.

Important decisions

GASB 34 is quite flexible. Agencies can decide to use one reporting method and later switch to the other. Agencies can use the modified method on one network of assets and the depreciation method on others. For example, the Texas Department of Transportation is using the modified method on its highways and the depreciation method on its bridges.

The benefit of selecting the modified approach is that it represents a more sound approach to managing long-lived infrastructure assets—that is, to implementing management systems that help agencies make better decisions about maintaining and preserving their roads and bridges.

In fact, because the modified approach supports better management practices, the American Public Works Association (APWA) Board of Directors recently passed a policy statement urging local and state governments to adopt the modified approach to meet GASB 34 requirements where feasible.²

It's up to each agency to decide which approach to apply. The level of effort required to implement either of them will likely be similar. •

¹ Definition taken from http://www.Window.State.TX.US/comptrol/san/gasb/local/gasb34_localintro.html. Preservation costs should be capitalized under the depreciation approach and expensed under the modified approach.

² GASB-34 Policy Statement Passed by Board of Directors, posted December 8, 2000, at <http://www.apwa.net/HotTopics/index.asp?PrinterFriendly=Yes&topic=73>

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