



State of North Carolina

Department of State Treasurer

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TREASURER

*State and Local Government Finance Division
and the Local Government Commission*

August 20, 2002

Memorandum #975

TO: County and School Board Financial Officials and Their Auditors

FROM: Vance Holloman, Director
Fiscal Management Section

SUBJECT: Reporting School Capital Assets

With the implementation of Governmental Accounting Standards Board (GASB) Statement No. 34, the reporting of school capital assets has become a critical issue to both schools boards and counties. Prior to the implementation of GASB Statement No. 34 general capital assets and the long-term debt on those assets were not directly matched with one another on the financial statements. General long-term liabilities were offset by future resources to be provided and fixed assets were offset by an investment in general fixed assets account. Capital assets and long-term liabilities will be placed in a single column for Governmental Activities on the Statement of Net Assets under GASB Statement No. 34. We are concerned that this presentation will mislead the statement users about the responsibilities of counties and school boards for these assets and about the financial condition of each party.

Under State law counties are fiscally responsible for providing and maintaining school buildings. Counties raise the resources necessary to provide and maintain schools or to repay debt issued for this purpose. Counties are accountable to the citizens for how those resources are used. School buildings currently in use represent an economic asset to the county because the county would need to provide additional school buildings if the current buildings were not in place. As each year passes, the county is a year closer to having to replace or pay for major repairs to the school building. The results of operations for the county are misstated if depreciation on the school buildings is not included in the county's financial statements. Expensing the full amount in the year of construction results in the county's economic assets being misstated.

Although the school is not fiscally responsible for providing and maintaining school buildings, these buildings will appear as an asset in the school's Governmental Activities column on the government-wide Statement of Net Assets. This will increase the net assets (equity) of the Governmental Activities and make the schools appear to be in better fiscal condition than they are. Counties who have issued debt to construct those buildings will then look fiscally weaker than they actually are. The building that was constructed represents one less school building that must be constructed in the future, and therefore is an economic asset to the county.

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After conversations and correspondence with the staff of the GASB, they have stated the fiscal responsibility for providing and maintaining school assets is not the most critical factor in determining how these assets should be reported. Rather, the entity holding legal title to the school buildings should be the controlling factor in how these buildings are reported.

For most school buildings, title is held by the school board. However, there are some school buildings that are titled to the counties under G.S. 153A-158.1. This most often occurs when a county has used installment purchase financing to construct the school building, although nothing in the law prohibits its use for other reasons. In most cases a lease agreement is signed between the school board and counties leasing the building to the school board for the term of the lease. The agreement also provides for either a bargain purchase or actual transfer of the title to the school board at the end of the lease.

The bargain purchase or transfer of the asset at the end of the lease term makes this a capital lease. This results in the asset being recorded in the school board's financial statements while the debt remains on the county's statements. Since these leases involve both land and a building, the lease would be classified as an operating lease if it did not contain the bargain purchase or transfer of asset clauses. Leases involving land must meet one of those two criteria to be classified as a capital lease.

We have been asked by units and auditors what would be the appropriate financial reporting treatment for a building owned by the county under G.S. 153-158.1 if, for whatever reason, the bargain purchase or transfer of asset clauses were not in the lease agreement. Based upon the response that we have received from the staff of the GASB, title would be the controlling factor. Without those clauses in the lease, it is an operating lease. Under an operating lease, the county would reflect the school building in its financial statements since it holds title to the building. The building would appear in the Governmental Activities column of the Statement of Net Assets and depreciation of the building would appear on the Statement of Activities.

We are concerned about the inconsistencies in how this transaction would be recorded compared to a transaction in which the county does not hold title under G.S. 153-158.1. However, we feel that the presentation of the buildings in the counties financial statements is theoretically correct for reasons stated earlier in this memorandum. Further, the staff of the GASB has indicated that title should be the deciding factor in reporting school buildings. Therefore, it is correct to report two buildings used in the same manner differently if the buildings are titled to different parties in the transaction.

If you have any questions concerning this memorandum, please contact me at 919-807-2380.