Governmental Accounting Standards Board
of the Financial Accounting Foundation

June 2012

GASB Statement Reclassifies Certain Items Previously Reported as Assets and Liabilities

The GASB recently issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*, which reclassifies certain items that were previously reported as assets and liabilities as deferred outflows resources, deferred inflows of resources, or current-period outflows and inflows.

Informally, deferred outflows resources and deferred inflows of resources are referred to as "deferrals." Deferrals are reported in a statement of financial position and they result from outflows and inflows of resources that have already taken place but are not recognized in the financial statements as revenues and expenses/expenditures because they relate to a future period.

Why did the Board need to issue Statement 65?

Before this question can be answered, a bit history is in order. Concepts Statement No. 4, *Elements of Financial Statements,* which was issued in 2007, identifies consumptions and acquisitions of net assets related to future periods as deferred outflows of resources and deferred inflows of resources, respectively. Those were both new, separate financial statement elements for the first time.

A deferred outflows of resources balance, similar in this respect to assets, has a positive effect on net position. A deferred inflows of resources balance, similar in this respect to liabilities, has a negative effect on net position. Yet Concepts Statement 4 establishes definitively that deferrals are neither assets nor liabilities and cannot properly be reported as such in a statement of net position (previously the statement of net assets).

In practice, the Board had noted a number of balances that were reported as assets and liabilities in the government environment that did not meet the Concepts Statement 4 definitions of an asset or a liability. However, Concepts Statement 4 states that only those instances that are specifically identified in the GASB's authoritative literature are properly reported as deferred items. In other words, people should not choose on their own to reclassify assets and liabilities as deferrals based on the GASB's definitions; the result could have been a significant reduction in the consistency and comparability of financial reporting. It was incumbent on the GASB to provide authoritative guidance.

Why are these reclassifications important?

Prior to the issuance of this pronouncement, governments had some items—like certain types of deferred revenue—that did not really fit the definition of an asset or liability, but had to be reported somewhere in the financial statements. Traditionally, because there had never been a better option, governments often carried deferred items on their balance sheets as assets or liabilities until it was time to recognize them through the operating statement.

Statement 65 reclassifies a number of items in a way that accurately portrays their nature and reduces related uncertainty, which makes the “trying to fit a square peg into a round hole” approach no longer necessary. The pronouncement’s requirements serve to standardize the use of deferrals in financial statements and reduce uncertainty about the classification of items that may seem to meet the definition of a deferral.

It distinguishes, for example, a $5 million liability for bonds payable (a liability) from a $5 million inflow representing cash that has been received but is applicable to future periods (a deferred inflow of resources). With respect to a liability for bonds payable, the government would have to sacrifice resources, that is, make payments to settle the obligation. The definition of a liability is a present obligation to sacrifice resources that a government has little or no discretion to avoid. With regard to the deferral, that amount will eventually be recognized as revenue in future periods and no resources would be sacrificed. In other words, no payment is required and no performance obligation is incurred.

What are some examples of items as classified in Statement 65?

Under the approach the Board applied to determine whether or not certain items should be reclassified, it first assessed whether a given item met the definition of an asset or liability. Those items that did meet the definition of either an asset or a liability were not reclassified. If the item did not meet the definition of an asset or liability, the Board then determined if the item met the definition of a deferred outflow of resources or a deferred inflow of resources. In instances in which the item did not meet the definition of an asset or a deferred outflow of resources or a liability or a deferred inflow of resources, the item was then reclassified as a current-period outflow or inflow.

As a result of that process, under the requirements of Statement 65 certain items currently reported as assets will continue to be classified as such, while others will be reported as deferred outflows of resources or current-period outflows of resources. Similarly, certain items currently reported as liabilities will continue to be classified as such, others will be reported as deferred inflows of resources, and some will be inflows of resources.

The following are some examples of how items were classified in the Statement:

- Prepayments, such as rent for the first six months of next year paid in advance, are currently reported as assets, and will continue to be reported as such.
- State aid to a local government that cannot be spent until the next year (but all other eligibility requirements, if any, have been met) is currently reported as an asset of the state and a liability of the locality. Under Statement 65, such items will now be classified as deferred outflows of resources and deferred inflows of resources, respectively.
- Underwriter fees associated with the issuance of long-term bonds and other debt issuance costs—other than prepaid insurance—are currently reported as assets (an offset to the liability). Under Statement 65, they will now be classified as current-period outflows of resources (expenses).
- Payments for next year's income tax liability that were received in the current year and other resources received in advance in relation to a derived tax revenue are currently reported as liabilities and called deferred revenues. Under Statement 65, they will continue to be classified as liabilities; however, they would not be referred to as deferred revenue.
- Payments for next year's property tax levy that are received this year and other resources received in advance from imposed nonexchange transactions are currently reported as liabilities (deferred revenues). Under Statement 65, they will now be classified as deferred inflows of resources.
- Loan origination fees—excluding portions related to points—associated with lending activities are currently reported as a liability and are amortized and reported as annual revenue over the maturity of the loan. Under Statement 65, they will now be reported as current-period inflows of resources (revenue).

Deferrals and Interperiod Equity

In developing this pronouncement, the Board believed it was of great importance that deferrals be defined with precision as standalone financial statement elements in order to allow for revenues and expenses/expenditures to be recognized in the period they apply to and displayed accordingly.

Under the guidance set out in Statement 65, the use of deferrals in the government environment directly ties revenues and expenses/expenditures to their related periods. This assists users of government financial statements to determine for themselves whether governments are living within their means from year to year.

Enabling users of governmental financial statements to make these kinds of assessments is central to the idea of interperiod equity, which refers to whether sufficient current-year resources have been raised to pay for the cost of services rendered in the current year.

What other issues does Statement 65 address?

There are two other issues that Statement 65 addresses that are important to note: limiting the use of the term *deferred* and the impact on major fund criteria.

To avoid confusion, Statement 65 states that the use of the term *deferred* should be limited to items reported as deferred outflows of resources and deferred inflows of resources (as noted earlier in the examples that were provided).

In addition, with respect to the major fund criteria, as established in Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments,* assets should be combined with deferred outflows of resources and liabilities should be combined with deferred inflows of resources. This guidance provides consistency in applying the major fund criteria.

When Does the Statement Take Effect?

Governments are required to implement Statement 65 for financial statements for periods beginning after December 15, 2012. Earlier application is encouraged.

Order Statement 65

Read the news release