

**GASB #34/35 Issue Paper #6**  
**Reporting Depreciation Expense**  
April 24, 2001

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GASB #34, as amended by GASB #35, requires special-purpose governments engaged only in business-type activities to prepare financial statements using the guidance required for enterprise funds, (GASB #34, ¶138). Enterprise fund financial statements are to be prepared using the economic resources measurement focus and the accrual basis of accounting. (GASB #34, ¶92). Under the economic resources measurement focus, capital assets must be depreciated over their estimated useful lives and depreciation expense reported on the SRECNA.

Depreciation expense is generally shown as a separate line under Operating Expenses in the illustrations provided for colleges and universities using the BTA model under GASB #34/35. Those illustrations, though, also list operating expenses by natural (object) classification. Colorado institutions have elected to report operating expenses using functional classifications. When functional classifications are used, there are three options for presenting depreciation expense on the SRECNA:<sup>1</sup>

1. Report depreciation expense as a separate line (program) under Operating Expenses.
2. Allocate depreciation expense to the other functional classifications (e.g. Instruction, Academic Support, etc.), based on an allocation formula established by the college, university, system or CHEASC.
3. Allocate depreciation expense to Operations and Maintenance of Plant.

The following discussion summarizes some of the advantages and disadvantages of each approach.

Depreciation Expense Reported as a Separate Line (Program)

This option allows the user to readily identify total depreciation expense on the SRECNA. Proponents argue that depreciation expense is not a controllable cost and as a result should not be included in key performance measurements, such as the cost of instruction. To do so would make it difficult to compare performance among institutions within the State. For example, a college that has a high classroom utilization percentage would appear to have a lower instruction expense/SFTE than a college with the same enrollment and a low classroom utilization percentage. A college with new administrative office space would find its Institutional Support costs higher than its peers who house administrators in fully depreciated facilities. It is also important to keep in mind that depreciation expense will include depreciation on donated property. If depreciation expense is allocated, a donation of depreciable property would result in revenue recognition in the year of donation and a program expense (depreciation) over the estimated useful of the donated asset.

Reporting depreciation expense as a separate line improves articulation between the SRECNA to the Statement of Cash Flows. The amount displayed as depreciation expense on the SCRECNA will be the same amount included in the reconciliation of operating income to cash flows from operations. This approach also highlights that an operating statement prepared using the BTA model is not comparable to an operating statement prepared under FASB guidelines.

Depreciation Expense Allocated to Other Functional Classifications

This option is consistent with GASB's position on reporting all expenses by function<sup>2</sup>, including "depreciation expense for capital assets that can specifically be identified with a function." This is the approach required by public colleges and universities adopting the governmental activities model. It also is consistent with FASB's requirements for private non-profit colleges and universities.

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<sup>1</sup> NACUBO Advisory Report 2000-8, *Footnote Requirement When Public Higher Education Institutions Report Natural Classifications On Their Statement of Revenues, Expenses, and Changes in Net Assets*, December 22, 2000.

<sup>2</sup> Statement No. 34 of the Governmental Accounting Standards Board, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, June, 1999, paragraph 41.

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The underlying basis of this approach is that facilities' costs, including depreciation, are program costs and not a separate function and therefore should be included in the cost of each function. GASBS 34, paragraph 44., discusses allocating depreciation expense to functions in more detail.

It would appear that adopting this option would result in more comparability among higher education institutions, but that is not true. Private non-profit colleges and universities must not only allocate depreciation expense but operations and maintenance of plant, as well. Public colleges and universities, using the governmental activities model, will also be required to allocate operations and maintenance of plant to the extent that those costs are directly attributable to a particular function. On the other hand, public colleges and universities, using the BTA model, are not required to allocate depreciation expense to functions<sup>3</sup> and there is nothing in the authoritative literature that suggests allocating operations and maintenance of plant. In other words, the three models will lack comparability regardless of whether or not depreciation is allocated under the BTA model.

Allocate Depreciation Expense to Operations and Maintenance of Plant

This approach suggests that depreciation expense is a facility cost that it is appropriately reported with all other facility costs in Operations and Maintenance of Plant. If this approach were adopted, it would appear that at a minimum depreciation expense associated with auxiliary facilities should be allocated to those functions. The advantage of this approach is that it would consolidate facility costs associated with education and general in one category (i.e. operations and maintenance of plant). The disadvantage would be that this approach tends to obscure the fact that the BTA model is not comparable to the Governmental Activity model or FASB's Statement of Activities.

(Note: Based on email discussions with Mary Fischer, NACUBO is working with GASB to resolve some of the significant differences between GASB and FASB college and university reporting. Those discussions could lead to further authoritative guidance on the allocation of depreciation.)

DECISION POINTS:

- Which of the three options for reporting depreciation expense will be used?
- If Colorado institutions elect to allocate depreciation, should broad allocation guidelines be established to assist the institution's, such as?
  - Will it be allocated only to O & M or will it be allocated, in whole or part, to all functions?
  - Will 100% of depreciation expense be allocated or only some portion?

**ISSUE RESOLUTION**

Record and present depreciation as a unique functional classification and separate line on the SRECNA.

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<sup>3</sup> NACUBO, *GASB 35 Implementation Guide*, 2001, Question 48.