

*Math. Civ. Accounting Handbook*

Other Assets 11.05

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**PRACTICE POINT:** NCGA-1 does not specifically refer to an allocation method and a non-allocation method but rather describes the process of allocation.

*Allocation Method*

When the allocation method is used to account for prepayments and deferrals, an asset is established at the date of payment and subsequently amortized over the accounting periods that are expected to benefit from the initial payment. For example, if a state or local government purchased a three-year insurance policy for \$45,000, the transaction would be recorded as follows under the allocation method (NCGA-1, par. 73):

Prepaid Insurance	45,000	
Vouchers Payable		45,000

At the end of each year, the partial expiration of the insurance coverage would be recorded as follows:

Expenditures—Insurance	15,000	
Prepaid Insurance		15,000

Prepayments and deferrals are reported as assets of the specific governmental fund that will derive future benefits from the expenditure. In the above example, the governmental unit's fund would report prepaid insurance as an asset of \$30,000 at the end of the first year of the insurance coverage.

Because prepayments and deferrals are not current financial resources, the fund's fund balance should be reserved by the amount presented in the asset balance. Thus, at the end of the first year in the current example, the following entry would be made:

Fund Balance—Unreserved	30,000	
Fund Balance—Reserved for Prepaid Insurance		30,000

The balance in the reserved fund balance would fluctuate each year as a result of changes in the carrying value of the prepayment and deferral accounts.

The allocation method is not consistent with the basic governmental fund concept that only current financial resources should be presented in the fund's balance sheet.

**PRACTICE POINT:** Upon implementation of GASB-54, this reserve would be a restricted fund balance because it still would not represent expendable financial resources. The credit entry above would be titled "Fund Balance—Nonspendable for Prepaid Insurance."

## 504 Prepaid Items

504.1 Governmental entities may prepay expenditures or expenses in a manner similar to that of business enterprises. The types of prepayments include operating costs, such as insurance, rents, or leases. Prepayments may occur in many funds but are most common to the general fund or a proprietary fund.

### Governmental Fund Accounting for Prepayments

504.2 According to GASB Cod. sec. 1600.127b, expenditures by governmental funds for insurance or similar services that extend over more than one reporting period are not required to be allocated, but may be accounted for as expenditures in the period paid. The nonallocation method of accounting for prepayments may be more consistent with the concept that only expendable financial resources should be included in the governmental fund balance sheet. The following paragraphs discuss reporting the nonallocation and interperiod allocation alternatives. (Prepayments may include certain capitalization contributions made to public entity risk pools. See the discussion beginning at paragraph 507.58.)

504.3 If the interperiod allocation method is used, a prepaid expenditure is reported in the asset section of the governmental fund balance sheet. However, the prepaid item is not considered a current expendable resource (because a resource was already used when the expenditure occurred and because the item is not a resource that can be spent). Fund balances resulting from prepaid amounts must be reported as nonspendable. (See paragraph 207.6. As related to prepaid amounts, nonspendable indicates fund balance that is not in spendable form.)

504.4 As previously discussed, in governmental funds existing standards permit either expenditure recognition for prepaid items in the period of acquisition (paragraph 504.2) or allocation of the expenditure among periods (paragraph 504.3). Factors affecting the choice between these alternatives include:

- a. The significance (materiality) of the prepayment amount.
- b. Consistency—all prepayments should be treated the same, within the accounting period and from year to year, unless the accounting policy is changed.
- c. Practicality or convenience—full recognition of an expenditure in the period in which the prepayment is made may be easier than allocating the payment among periods and more consistent with the actual flow of financial resources.

### Proprietary Fund, Governmental Activity, and Business-type Activity Accounting for Prepayments

504.5 In proprietary funds and in government-wide financial statements, interperiod allocation is required for significant prepaid expenses. (See the discussion of the term "significant" in paragraph 503.5.)

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