		SUBJECT:	**CONVERTING A GOVERNMENTAL FUND TO A PROPRIETARY FUND**
SECTION:	**7**	**CATEGORY:**	**GENERAL LEDGER POLICIES**
POLICY NUMBER:	**707**		
REVISED DATE:	**12/1/2024**	**APPROVED BY:**	Ben J. Benoit

PURPOSE: To provide guidance when converting a governmental fund into a proprietary fund.

SCOPE: Applies to all County departments, agencies, special districts, and authorities that are governed by the Riverside County Board of Supervisors, and/or which maintain funds in the County Treasury.

POLICY: This policy describes general steps and items to consider when converting a governmental fund to a proprietary fund.

PROCEDURE: Ensure that there is an understanding between the full accrual accounting method (proprietary and fiduciary funds) and the modified accrual accounting method (governmental funds) and the impacts they have on financial information.

FULL ACCRUAL AND MODIFIED ACCRUAL ACCOUNTING

Full accrual: Under the accrual basis of accounting, transactions are recognized when they occur, regardless of when cash is received or disbursed. For example, a utility recognizes revenue when it provides services to its customers. Similarly, an employer recognizes expense as the employees earn vacation leave.

Full accrual is used for proprietary funds (enterprise and internal service funds) and fiduciary funds.

Modified accrual: Revenues are recognized only to the extent that they are susceptible to accrual, which means "when they become both measurable and available to finance expenditures of the fiscal period." Revenue is considered to be available when it is "collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period." If accrued revenue is not yet available, the related receivable is matched by a deferred inflow of resources for unavailable revenue, and revenue recognition occurs only when the revenue eventually does become available.

Modified accrual is used for the general fund, special revenue funds, capital project funds, debt service funds, and permanent funds.

ITEMS TO CONSIDER WHEN MOVING TO A PROPRIETARY FUND

Departments will need to research the definitions and rules of proprietary funds to determine if converting to this type of fund is appropriate under Generally Accepted Accounting Principles (GAAP) and Governmental Accounting Standards Board (GASB) accounting.

Compensated absences: Under full accrual accounting, a liability for compensated absences should be recognized as employees earn their right to paid time off. This liability is not accrued in governmental funds, but it is in proprietary funds. This should be considered a liability and corresponding expenses will be booked yearly in proprietary funds and will need to be budgeted.

Capital assets and depreciation: In governmental funds, when an asset is purchased, it is fully expensed in the year of purchase. In proprietary funds, the asset is capitalized on the Statement of Net Position, and useful life is determined for the asset to calculate the depreciation expense. The asset will then be depreciated evenly over the course of its useful life. Therefore, the asset's total value will be expensed evenly throughout its life as depreciation, and this will need to be budgeted.

Long-term debt: When bonds, notes, financed purchases, leases or other long-term debt items are issued in a governmental fund, the total amount of the debt items are recorded as other financing sources.

When the items are issued with a proprietary fund, they need to be recorded as a long-term liability on the Statement of Net Position. As payments are made, the principal portion of the payment reduces the liability, and the interest portion is expensed in the year of payment.

Other long-term items: There are other various long-term items that will be recorded under a proprietary fund that is not recorded under a governmental fund.

One example is net pension liabilities (NPL). The NPL is recorded as a liability on the proprietary funds' Statement of Net Position, as well as corresponding deferred inflows and outflows of resources. This liability is not recorded on governmental funds and should be considered.

Another item is unavailable revenues. Under the modified accrual basis of accounting, revenues cannot be recognized until it is available to liquidate liabilities of the current period. For example, if services are performed or goods are delivered, but payment will not be received within 90 days after the year-end, a governmental fund cannot recognize revenue in that period. It will need to record a receivable and a corresponding deferred inflow of resources on the balance sheet.

DEPARTMENT'S RESPONSIBILITIES

1. Departments shall contact the Auditor-Controller's Office before converting to a proprietary fund. There may be other items to consider other than the ones addressed in this procedure and must be evaluated on a case-by-case basis.

2. Departments will be responsible for considering the items previously written in this procedure before converting to a proprietary fund.

3. Departments will be required to determine the necessary budget adjustments and calculations associated with a transition from a governmental fund to a proprietary fund. The interfund transfers are usually required for this transition.

AUDITOR CONTROLLER'S OFFICE RESPONSIBILITIES

1. The Auditor-Controller's office will assist departments in determining the effects of converting to a proprietary fund.