CPAs & BUSINESS ADVISORS

GOVERNMENTAL UPDATE, AUDITING UPDATE AND THINGS THAT KEEP US UP AT NIGHT

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AGENDA – GASB UPDATE

June 30, 2018 Year Ends:

GASB 81 – Irrevocable Split-Interest Agreements

GASB 75 – Accounting and Financial Reporting for Postemployment Benefits Other than Pensions (OPEB)

GASB 85 – Omnibus 2017

GASB 86 – ***Certain*** Debt Extinguishment Issues

Implementation Guide Update 2017-1

OPEB Employers' Implementation Guide

June 30, 2019 and beyond

GASB-83 – Asset Retirement Obligations

GASB-84 – Fiduciary Activities

GASB-87 – Leases

GASB 88 – Debt Disclosure and Direct Borrowing

GASB 89 – Accounting for Interest Cost during the Period of Construction

Likely GASB 90 - Accounting and Financial Reporting for Majority Equity Interest

The Latest on the Financial Reporting Model Project

AUDIT UPDATE AND THINGS THAT KEEP US UP AT NIGHT

- Eye of the Cyberstorm – Managing Cyber Risks
- Common Financial Reporting Deficiencies and Using the GASB's *Codification* to Help
- The Uniform Guidance and Procurement Controversy
- What's the Deal with the Yellow Book?
- SAS-132 – *Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*
- SAS-133 – *Auditor Involvement with Exempt Offerings*
- Other AICPA Stuff
- What's the Difference Between Internal Audit and Forensics and how they may help your government
- The New COSO Provisions on ERM
- Ethics in the Office

AND AWAY WE GO!!

IMPLEMENTATION DATES

Effective Date – Periods Beginning *After*	Statement	First Fiscal Years Affected	
		June 30th	December 31st
June 15, 2016	**GASB-74 -** *OPEB Plans*	2017	2017
June 15, 2016	**GASB-80 –** *Blending Requirements for Certain Component Units*	2017	2017
December 15, 2016	**GASB-81 –** *Irrevocable Split-Interest Agreements*	2018	2017
June 15, 2016	**GASB-82 –** *Pension Issues*	2017	2017
June 15, 2016	**IGU-2016-1**	2017	2017
December 15, 2016	**IGU-2017-2 –** *(Financial Reporting for Postemployment Benefit Plans Other than Pension Plans)*(Implementation Guide) (3 questions delayed periods beginning after 6/15/17)	2018	2017

IMPLEMENTATION DATES

Effective Date – Periods Beginning *After*	Statement	First Fiscal Years Affected	
		June 30th	December 31st
June 15, 2017	**GASB-75 -** *OPEB Employers*	2018	2018
June 15, 2017	**GASB-85 -** *Omnibus 2017*	2018	2018
June 15, 2017	**GASB-86 -** *Certain Debt Extinguishments*	2018	2018
June 15, 2017	*IGU-2017-1*	2018	2018
June 15, 2018	**GASB-83 -** *Asset Retirement Obligations*	2019	2019
June 15, 2018	**GASB-88 –** *Certain Disclosures Related to Debt, Including Direct Borrowings and Direct Placements*	2019	2019
December 15, 2018	**GASB-84 –** *Fiduciary Activities*	2020	2019
December 15, 2018	**GASB-89**–*Accounting for Interest Cost During the Period of Construction*	2020	2019
December 15, 2018	**Likely *GASB-90*** –*Accounting and Financial Reporting for Majority Equity Interests*	2020	2019
December 15, 2019	**GASB-87 –***Leases*	2021	2020

IMPLEMENTATION DATES – OTHER PROJECTS ONGOING

- **Financial Reporting Model**
- Revenue & Expense Recognition Project
- Note Disclosure Reexamination
  - Going Concern Disclosures Reexamination – (GASB-56)
  - Information Technology Arrangements, including Cloud Computing
  - Conduit Debt
  - Public – Private Partnerships, including Reexamination of GASB-60
  - Social Impact Bonds
    - **All of these are too early to tell…**

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GASB UPDATE

June 30, 2018 Year Ends

IRREVOCABLE SPLIT-INTEREST AGREEMENTS (ISIAS)

GASB-81

IRREVOCABLE SPLIT INTEREST AGREEMENTS (ISIAS)

Inconsistent reporting of giving arrangements by donors to governments of all types

Government may be a trustee, beneficiary or both

Common types

- *Charitable lead trusts* – government receives the rights to benefits <u>only during term of agreement</u>
- *Charitable remainder trusts* – government receives some (or all) benefits remaining <u>at end of agreement</u>
- *Charitable annuities* – government receives a specific amount or percentage (fixed or variable) throughout agreement (if % of fair value then it's a unitrust)
- *Life interest in real estate* – very common – government receives right to use asset dependent upon life of donor

  Upon death, government or beneficiary gets real estate

SCOPE OF GASB-81

- **Irrevocable split-interest agreements** for which the government is the intermediary (trustee or agent) and a beneficiary
  - Donor gives resources to government that also is a beneficiary in the agreement – government could be:
    - **Lead interest**: payments during the life of the agreement, generally to non-governmental beneficiary (donor or donor's relative)
    - **Remainder interest:** assets remaining at termination of the agreement; generally goes to government
- **Beneficial interests** in resources held and administered by 3rd parties
  - Refers to the right to receive resources in a future reporting period, from resources administered by a 3rd party
- **Major exclusion – beneficial interests in permanent endowments, pledges and perpetual trusts – <u>not part of GASB-81</u>**

IRREVOCABLE SPLIT INTEREST AGREEMENTS (ISIAS)

	When to Measure	Assets	Liabilities	Deferred Inflows of Resources
Held by 3rd Parties (**Most** Common)	Initial Agreement Date	Fair Value	**Should be none**	Same as Asset
	Subsequent reporting dates	Same as above		Net amount
If held by Government (**Least** Common)	Initial Agreement Date	Fair Value	If *nongovernmental* beneficiary – settlement amount	Remainder if to the government – assets less liability
	Subsequent reporting dates	-Investments in accordance with GASB-72 at fair value -Changes in fair value in deferred inflow of resources	Distributions to lead interest beneficiary would reduce liability	Net of asset and liability (including fair value change)

IRREVOCABLE SPLIT INTEREST AGREEMENTS (ISIAS)

Life interest in real estate – most common

- If *capital asset* – per GASB-72, asset = acquisition value, NOT fair value
- If *investment* – record at fair value per GASB-72
- Liabilities could be present for obligations assumed (maintenance, repairs, mortgage…)
- Deferred inflow of resources = value of right to use property
  - Value would be present value of rent payment if the donor was to ever pay rent
  - Also include in deferred inflow of resources the difference between assets, liabilities and value of right to use property.

IRREVOCABLE SPLIT INTEREST AGREEMENTS (ISIAS) – TO RECAP

In general - assets would be recognized by reporting government if ALL are met:

1. Government is named as the beneficiary legally
2. Government has an *unconditional* interest
3. Interest is irrevocable
4. Donor cannot vary the resources
5. Government is not under the control of the donor
6. Government may assign interest without approval of the donor, and
7. If interest is assigned, the government's interest is not terminated / invalidated

Effective date for periods beginning after 12/15/16

OPEB

SUMMARY OF ALL 3 STANDARDS

- **What:** GASB issued Statements 74 (plans) and 75 (employers), making OPEB accounting and financial reporting consistent with the pension standards in Statements 67 and 68
- **What:** GASB Statement 85 (Omnibus 2017) adjusts some provisions of GASB-74 and 75
- **Why:** Pension and OPEB standards are now almost aligned —objective was to establish a consistent set of standards for all postemployment benefits, providing more transparent reporting of the liability and more information about the liability and costs of benefits
- **When:** Became effective for year end June 30, 2017 (plans) and June 15, 2018 (employers)
  - GASB-85 also effective year end June 30, 2018

SOME ABBREVIATIONS / DEFINITIONS YOU MAY WANT TO KNOW…

- AVR – Actuarial Valuation Report (or AV)
- OPEB – Other Postemployment Benefits
- TOL – Total OPEB Liability
- NOL – Net OPEB Liability
- MD – Measurement Date
- VD – Valuation Date
- Service Cost – Portion of actuarial present value of projected benefit payments that is attributed to a year

PLAN AND ASSET REPORTING

- Scope includes defined benefit and defined contribution OPEB plans administered through trusts that meet specified criteria
- Few changes from Statement 43 for financial statement recognition
- Notes/RSI changes primarily to reflect changes in measurement of defined benefit liabilities of employers

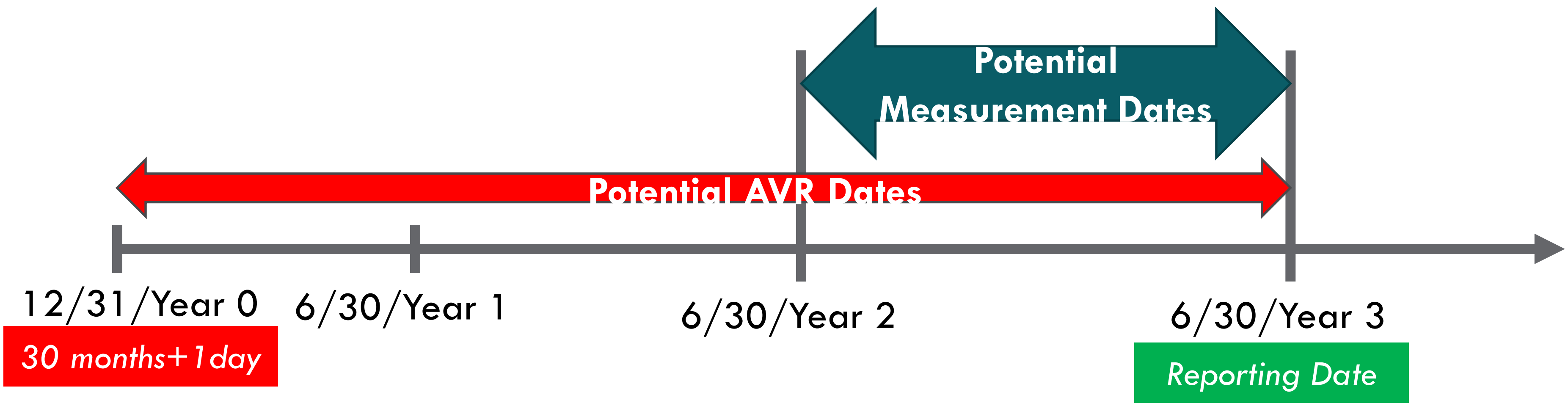
EMPLOYER SCOPE AND APPLICABILITY

- Applies same definition of OPEB as used in Statement 45
  - All postemployment healthcare benefits
  - Other forms of postemployment benefits not provided through a pension plan
- Applies to employers and nonemployer contributing entities that have a legal obligation to make contributions directly to an OPEB plan or to make benefit payments as those payments come due

LIABILITY TO EMPLOYEES FOR OPEB

- Based on total OPEB liability—the portion of the actuarial present value of projected benefit payments that is attributed to past periods of employee service
- Is OPEB administered through a trust that meets the specified criteria?
  - Yes—recognize net OPEB liability (total OPEB liability, net of OPEB plan fiduciary net position)
  - No—recognize total OPEB liability
- Employer's liability to employees for OPEB measured as of a date no earlier than the end of the employer's prior fiscal year and no later than the employer's current fiscal year
  - Based on an actuarial valuation obtained at least biennially no more than 30 months and 1 day earlier than the employer's most recent fiscal year-end

HOW TO THINK ABOUT THE DATES



GASB-74 – Plans

- TOL in employer's financials *no earlier* than the end of the employer's prior fiscal year
- AVR no earlier than 30 months+ 1 day of employer's year end
    - If not at measurement date, use roll-forward to MD

GASB-75 – Employers

- Measurement of TOL must be as of **plan's fiscal year end**
- Must be based on an AV report performed within 24 months of **plan's** year end
    - If not at the measurement date, roll-forward needed

WHY DIFFERENT DATES ARE VITAL

- Strategic decision to
  - Facilitate timely financial reporting
  - Minimize the need for rolling forward information
  - Facilitate a quality AV report
    - Allowing for census gathering and claims data gathering
    - Alignment with plan year to be able to incorporate plan changes
  - Plan and employer should not have different measurement dates if the plan statements are included in the employer's financial statements (situation at SCO)
    - Different AVR date OK as long as in parameters of GASB-74 / 75

MEASUREMENT OF THE TOTAL OPEB LIABILITY: PROJECTIONS OF OPEB PAYMENTS

- Consider established pattern of practice with regard to sharing of benefit-related costs with inactive employees
- Based on claims costs *or* age-adjusted premiums approximating claims costs, in accordance with Actuarial Standards of Practice
- Includes taxes or other assessments expected to be imposed on benefit payments
- Consider legal or contractual benefit caps if determined to be effective

CHANGES IN LIABILITY

- Recognize most changes in liability for the current reporting period as OPEB expense immediately, except:

  Changes in total OPEB liability:

  - Differences between expected and actual experience with regard to economic and demographic factors in the measurement of the total OPEB liability
  - Changes of assumptions in the measurement of the total OPEB liability
  - For OPEB not administered through a trust in which specified criteria are met, benefit payments

  For OPEB administered through trust in which specified criteria are met:

  - Difference between projected and actual earnings on OPEB plan investments
  - Employer contributions

HOW IS OPEB EXPENSE CALCULATED?

- Almost identical to pensions
  - **Service Cost**
  - *Plus* administrative costs
  - *Plus* interest on TOL (beginning of year amount)
  - *Plus* – change in TOL due to:
    - Changes in benefit provisions
    - Amortization due to non-investment experience
    - Amortization due to change in assumptions
  - *Plus* - amortization of investment gains (negative expense) or losses
  - *Plus or Less* – other changes in fiduciary net position
  - *Less* member contributions
  - *Less* expected investment income

WHAT APPEARS IN THE FINANCIAL STATEMENTS

Where	Irrevocable Trusts	Non-Trust OPEB
Statement of net position	Net OPEB Liability (or asset) (NOL)	Total OPEB liability (or asset – rare) (TOL)
Statement of net position	Deferred outflows of resources or inflows of resources related to investments and TOL	Same except no investments likely
Statement of net position	Deferred outflows of resources for employ***er*** contributions after measurement date but before reporting date	Same, but unlikely
Statement of Activities	Change in NOL adjusted for deferrals / amortization = expense	Same

COST-SHARING EMPLOYERS (RARER THAN PENSIONS)

- Relevant only for OPEB administered through trust in which specified criteria are met
- Recognize proportionate shares of collective net OPEB liability, OPEB expense, and deferred outflows of resources/deferred inflows of resources related to OPEB
- Proportion (%)

  Basis required to be consistent with contributions

  Use of relative long-term projected contribution effort encouraged
- Collective measure × proportion = proportionate share of collective measure

NOTES AND RSI

- Similar to those required for pensions
- Disclosure of effect on net/total OPEB liability of a discount rate +/- 1 percent
- Disclosure of effect on net/total OPEB liability of a healthcare cost trend rate +/- 1 percent
- Single and agent employers: 10-year RSI schedules for changes in the net OPEB liability, ratios, and actuarially determined contributions (statutorily or contractually determined contributions, if no actuarially determined contribution is calculated)
- Cost-sharing employers: 10-year RSI schedules for proportionate share/ratios, and statutorily or contractually determined contributions

DIVING INTO THE DETAILS - WHAT IS OPEB?

- Other postemployment benefits – all postemployment benefits promised to employees other than pensions
- Principally, retiree health insurance – but also life insurance, disability, legal services, and other benefits
- Includes:
  - Payments made to insurance companies on behalf of retirees,
  - Payments directly to retirees, and
  - Subsidizing retiree premiums by allowing them to be insured in the same group as active employees

OPEB REPORTING—KEY PROVISIONS

- Mirrors pension standards
- Measurement may increase size of long-term obligation and annual cost for OPEB
- Recognize the net liability on the face of the financial statements
- Present more extensive note disclosures and supporting schedules

OTHER HIGHLIGHTS

- ***Identical*** in most respects to pension standards in GASB-67 and 68
- Recognize net OPEB liability in accrual-basis financial statements
- Recognize many portions of change in net OPEB liability as OPEB expense immediately; others deferred and recognized as OPEB expense over shorter periods than previously
- Cost-sharing governments and nonemployer contributing entities report proportionate shares of collective net OPEB liability, OPEB expense, and OPEB-related deferrals
- Enhanced notes and RSI
  - All old GASB-43 Plan / GASB-45 Employer schedules / notes removed
- **Key difference from pensions - most OPEB plans are single employer**

OPEB

- Both GASB-74 and 75 include provisions for trusts and non-trust arrangements –
- To have a Trust:
  - Irrevocable contributions no matter what source
  - Plan assets dedicated to providing OPEB
  - Creditor protection
- Special funding situations guidance included
- Single / agent employers recognized 100% of NOL
- Cost-sharing employers recognize proportionate share of NOL

OTHER WORRIES OF OPEB PLANS

- Only the entry age normal method is acceptable in GASB-74 / 75 – may cause change in actuarial valuation process
- Former 3 year valuation cycle now is capped at biennial actuarial valuations
- Sensitivity analysis is 2 way – discount rate **and** health care cost trend rate
- Discount rate setting process is the same as GASB-67 / 68 – BUT
  - Most plans have little / no assets, likely at the AA rate
  - No longer blended like GASB-43 / 45
- Measurement date is plan's fiscal year end

SENSITIVITY ANALYSIS IS DIFFERENT FROM PENSIONS

Sensitivity of the net OPEB liability to changes in the discount rate and healthcare cost trend rates. The following presents the net OPEB liability of the City, calculated using the discount rate of 7.0 percent and healthcare cost trend rates of 9.5–5.5 percent, as well as what the City's net OPEB liability would be if it were calculated using a discount rate that is 1-percentage-point lower (6.0 percent) or 1-percentage-point higher (8.0 percent) than the current discount rate:

	1% Decrease (6.0%)	Discount Rate (7.0%)	1% Increase (8.0%)
Net OPEB Liability	$ 54,687	$ 6,366	$ (51,620)

The following presents the net OPEB liability of the City, calculated using the discount rate of 7.0 percent and healthcare cost trend rates of 9.5–5.5 percent, as well as what the City's net OPEB liability would be if it were calculated using healthcare cost trend rates that are 1-percentage-point lower (8.5–4.5 percent) or

1-percentage-point higher (10.5–6.5 percent) than the current healthcare cost trend rates:

	1% Decrease (8.5%–4.5%)	Healthcare Cost Trend Rates (9.5%–5.5%)	1% Increase (10.5%–6.5%)
Net OPEB Liability	$ (61,284)	$ 6,366	$ 88,512

GASB IMPLEMENTATION GUIDE 2017-2, *FINANCIAL REPORTING FOR POSTEMPLOYMENT BENEFIT PLANS OTHER THAN PENSION PLANS* (GASB-74)

- Most Questions Align to GASB-67's and 73's provisions, updated for OPEB
- Appendix with 7 Illustrations
  - Determination of Benefit Payments if blended premium rates are stated
  - Determination of the discount rate in circumstances in which benefit payments are made by the employer with its own resources (PAYGO)
  - Calculation of money-weighted rate of return
  - Reconciliation of amounts in the plan statements to money-weighted rate of return
  - RSI schedules
  - Note disclosures and RSI for a cost-sharing multiple-employer OPEB Plan
  - Alternative measurement method calculations

SOME OF THE MORE INTERESTING Q&AS…

Q4.12 – If OPEB and some other benefit that is not OPEB (for example, pensions or active employee healthcare) are administered through a single trust, are OPEB plan assets *dedicated* to providing OPEB to plan members in accordance with the benefit terms?

Q4.13 – A city's DB pension plan for firefighters provides a health insurance subsidy in the form of an additional monthly cash payment to each pension recipient. There is no limitation on the use of the additional cash payment. Is the subsidy OPEB for financial reporting purposes?

SOME OF THE MORE INTERESTING Q&AS…

Q4.55 - In a healthcare plan through which an employer provides benefits to active employees and inactive employees, the amounts to be paid by the employer, active employees, and inactive employees receiving benefits are stated in terms of the blended premium rates for all covered individuals. The employer remits premium payments directly to the insurer and is not reimbursed from trust resources for any portion of those payments. What amount of the total current-period (blended) premiums for active employees and inactive employees should the OPEB plan report as employer contributions?

Q.4.101 - When a single-employer or cost-sharing multiple-employer OPEB plan has biennial actuarial valuations, does GASB- 74 require an update in the intervening year for financial reporting purposes?

EMPLOYER INFORMATION

BIG DEALS FOR OPEB EMPLOYERS

- GASB-75 replaces all provisions of GASB-45 (and 57) as applicable
  - Discount rate will no longer be blended like GASB-45 – for most employers that are not funded, AA bond index rate like GASB-68 (may be a benefit by the way…)
  - OPEB expense will likely be more volatile due to funding levels
  - Slightly different terminology (Normal Cost = Service Cost)
  - Nearly all other aspects similar to GASB-68 as amended
  - Note disclosure and RSI all replaced upon implementation
  - Beginning balance restatement required like GASB-68

ADDITIONAL BIG DEALS FOR OPEB EMPLOYERS

- Revision of recognition, measurement, disclosure for **all** employers (GASB-45, 57)
  - Net OPEB Liability (NOL) =
    - OPEB Fiduciary Net Position (allocated or direct) less
    - Total OPEB liability
  - Recognized in full accrual financial statements
  - Changes in liability
    - Expense in period
    - Other elements include deferred outflows / inflows of resources with expense recognized over defined future periods

ADDITIONAL BIG DEALS FOR OPEB EMPLOYERS

- Liability may be heavily influenced by:
  - Excise taxation (ACA ‘Cadillac Tax’ – delayed until 2020)
  - Medicare ‘toggle’ (conversion to Medicare upon being eligible) – many states use
  - Insured plans (where insurer assumes risk of healthcare liability and employer only risk is for premiums)

OPEB

- Measurement process same as Total Pension Liability:
  - Project benefit payments
  - Discount payments to actuarial present value
  - Attribute the PV to periods
- Assumptions
  - Follow actuarial standards of practice
  - General assumptions like pensions for GAAP
  - No change needed for funding purposes

OPEB

- Non-trust provisions
  - TOL provisions carry forward
  - Agent employers similar (all liability reported on employers books)
- Other stuff similar to pensions
  - RSI
  - Transition provisions / restatement of beginning balances
  - Exception for **employer** contributions subsequent to measurement date always deferred outflows of resources (Same as GASB-71)

NOTE DISCLOSURE REQUIREMENTS

- ✓Basic information (name of plan, PERS, type of plan)
- ✓*Brief* description of benefits including census data
- ✓Availability of standalone report and how to obtain
- ✓Authority to establish / change contributions and contribution rates
- ✓Contributions to the plan
- ✓Significant assumptions and other inputs to measure OPEB liability (include healthcare cost trends, COLAs, mortality, etc.)
- ✓Experience study dates
- ✓Sensitivity analyses
- ✓Discount rate disclosures
- ✓Schedule of changes in Net OPEB liability

NOTE DISCLOSURE REQUIREMENTS

- ✓Measurement date information
- ✓Deferred inflows / outflows of resources amortizations
- ✓OPEB expense
- ✓RSI Schedules – 10 years (instead of schedule of funding progress and three valuations)
- ✓Schedule of changes in NOL
- ✓Contributions schedules
- ✓Notes on trends changes that are result of elements under management's control

EMPLOYER NOTE DISCLOSURES DIFFER BY PLAN TYPE

Description	1	2	3	4
Name of plan, administrator, type of plan	**Y**	Y	Y	Y
Benefit terms (classes of employees covered, types of benefits, key elements, terms of policies for benefit changes, COLAs, legal authority	**Y**	Y	Y	Y
Number of employees covered	**Y**		Y	
Fact that no assets held in trust			Y	Y
Contribution requirements (authority, legal or maximum rates, contributions made)	**Y**	Y		
Authority to pay OPEB benefits due and amount			Y	Y
Availability of audited financial statements	**Y**	Y		

Type
1 – **Trust – Single / Agent**
2 – Trust – Cost sharing
3 – Non-Trust – Single
4 – Non-Trust – Primary Government and Component Unit Stand-Alone reporting

EMPLOYER NOTE DISCLOSURES DIFFER BY PLAN TYPE

Assumptions and Other Inputs	1	2	3	4
Inflation, healthcare cost trend rates, salary changes, benefit changes	**Y**	Y	Y	Y
Mortality source	**Y**	Y	Y	Y
Experience studies	**Y**	Y	Y	Y
Projections of sharing benefit costs follow established practices	**Y**	Y	Y	Y
NOL sensitivity – healthcare cost trend rate (± 1%) and discount rate	**Y**	Y		
TOL sensitivity – healthcare cost trend rate (± 1%) and muni bond rate			Y	Y
Discount rate used, muni bond rate	**Y**	Y	Y	Y
Projected cash flow assumptions, long term expected rate of return, benefit payments applied to rates, asset allocation	**Y**	Y		

Type
1 – **Trust – Single / Agent**
2 – Trust – Cost sharing
3 – Non-Trust – Single
4 – Non-Trust – Primary Government and Component Unit Stand-Alone reporting

EMPLOYER NOTE DISCLOSURES DIFFER BY PLAN TYPE

Additional Elements	1	2	3	4
Plan's fiduciary net position if not publicly available	**Y**	Y		
Schedule of changes in NOL	**Y**			
Schedule of changes in TOL			Y	
Measurement date / AV date	**Y**	Y	Y	Y
Employer's proportionate share of NOL and basis for allocation		Y		Y
Changes in benefit terms, changes after MD (subsequent event), OPEB expense for current period, deferred inflows / outflows amortization (5 years)	**Y**	Y	Y	Y

Type
1 – **Trust – Single / Agent**
2 – Trust – Cost sharing
3 – Non-Trust – Single
4 – Non-Trust – Primary Government and Component Unit Stand-Alone reporting

RSI SCHEDULES

RSI elements	1	2	3	4
Changes in NOL by source	**Y**			
Changes in NOL and related ratios	**Y**			
Proportionate share of NOL		Y		
Employer contributions	**Y**	Y		
Changes in TOL by source			Y	
TOL as a percent of covered employee payroll			Y	
Proportionate share of TOL				Y
Notes to RSI	**Y**	Y	Y	Y

Type
1 – **Trust – Single** / **Agent**
2 – Trust – Cost sharing
3 – Non-Trust – Single
4 – Non-Trust – Primary Government and Component Unit Stand-Alone reporting

EMPLOYER'S *IMPLEMENTATION GUIDE* IS OUT

- **507** Questions and Answers (You read that right…)
  - But – only 19 'new' questions – rest are from existing Guides
- 4 New Questions and Answers that May Change GASB-74 reporting *in limited circumstances*
- Categories of Illustrations
  - Determination of Benefit Payments If Blended Premium Rates Are Stated
  - Determination of the Discount Rate in Circumstances in Which Benefits Are Paid by the Employer with Its Own Resources as They Come Due and the OPEB Plan Is Administered through a Trust
  - Determination of Certain Amounts to Be Presented in a Single or Agent Employer's RSI Schedule of Contribution-Related Information
  - Note Disclosures, RSI and Calculation of Certain Recognized Amounts for a Cost-Sharing Employer

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OMNIBUS 2017

GASB-85

OPEB TOPICS ADDRESSED

- Pensions and other postemployment benefits (OPEB)
  1. Timing of the measurement of pension and OPEB liabilities and related expenditures in financial statements prepared using the current financial resources measurement focus
  2. Recognition of on-behalf payments for pensions or OPEB in employer financial statements
  3. Presentation of payroll-related measures in required supplementary information for purposes of reporting by OPEB plans and employers that provide OPEB

OPEB TOPICS ADDRESSED

- Pensions and other postemployment benefits (OPEB)
  4. Requirements for employer-paid member contributions for OPEB
  5. Simplifications related to the alternative measurement method
  6. Applicability of GASB-75 for employers whose employees are provided with OPEB through multiple-employer defined benefit OPEB plans that have characteristics similar to those identified in GASB-78 (aka 'Taft-Hartley' or VEBAs)

KEY POINTS OF FOCUS – FOR OPEB CHANGES

- Governmental Fund Reporting of OPEB
  - Liabilities to employees (likely refunds) measured as of the end of the reporting period
  - OPEB expenditures = payables + amounts incurred by the employer when not administered through a trust

KEY POINTS OF FOCUS – FOR OPEB CHANGES

- Governmental Fund Reporting of OPEB
  - OPEB or Pensions expenditures that are the result of on-behalf payments =
    - Amounts paid during period by nonemployer contributing entity to pension / OPEB plan +
    - Change in nonemployer contributing entities' beginning and ending balances of amounts normally expected to be liquidated with expendable available financial resources (change in payables)
    - Except for defined contribution plan payments, revenues = expenditures (DC plans use GASB-24)

KEY POINTS OF FOCUS – FOR OPEB CHANGES

- Payroll Measures for Defined Benefit OPEB plans – Similar to GASB-82
  - **Covered payroll** is the payroll on which contributions to the OPEB plan are based
  - Single and Cost-Sharing Multiple-Employer Plans- measure of payroll used in RSI *should be covered payroll* *<u>unless contributions to plan ARE NOT based on a measure of pay</u>*
    - If not based on measure of pay, do not present ratio (could be common)

AUDIT FOCUS AREAS FOR OPEB

AUDITING BASICS

- Audit guidance in AICPA Audit and Accounting Guide – *State and Local Governments* Chapter 14
- 4 parts largely mirror Chapter 13 on pensions
  - Exception is part IV on non-trust OPEB
- Assertions and risks largely the same as pensions if plan provisions are similar and census data is similar
- AU-C 805 schedules the same
- Auditors reports the same

AUDIT FOCUS AREAS - PLANS

- Plan investments (if any) and related income
- Contributions (if any)
  - Claims-based or age-adjusted premium testing for subsidies
- Deposits against future losses for claims maintained at insurance carriers
- Benefit payments / payable
- Administrative expenses
- GASB-74 / 75 financial statement elements, note disclosures and RSI
- Census data
  - *Sound familiar?*

AUDIT FOCUS AREAS – EMPLOYER DATA

- Auditors will focus on
  - Actuarial valuation report development (assumptions, actuary credentials, underlying data)
  - Census data integrity
  - Reasonableness and methodology
  - How employer recorded GASB-75 information (FY 2017-18 beginning balance adjusts)
  - Process of internal controls separating healthcare claims of beneficiaries from active employees

AUDIT FOCUS AREAS – EMPLOYER DATA

- Why Actuary Credentials are Important
  - Far fewer healthcare actuaries than pensions
  - Far more variability in healthcare costs
  - Plan provisions are less defined than pensions (in most cases) and subject to a major factor – utilization
  - Multiple-employer plans are extremely difficult to allocate information (especially if employers do not contribute)
  - Many plans have 2 valuations
    - Accounting (GASB-74 / 75)
    - Funding (internal for management)

AUDIT FOCUS AREAS – EMPLOYER DATA

- Census Data
  - Testing will be similar to pensions and <u>may</u> involve the same population (or maybe not if different plan provisions)
  - Focus is on incremental changes from prior year as long as the prior year was tested and had no issues
    - 1st year testing will be similar to 1st year of GASB-68
  - Testing covers the period of the AV report – NOT the fiscal year of the audit
    - Can be either the year of the measurement date *or*
    - If a roll forward, the rolled data from the AV report

AUDIT FOCUS AREAS – EMPLOYER DATA

- Census Data
  - Example:
    - State fiscal year end is June 30, 2018
    - Measurement date is June 30, 2017
    - Actuarial valuation report is as of July 1, 2016 with data rolled forward to the measurement date
  - **Question - Where will the auditors focus their testing of census data?**

AUDIT FOCUS AREAS – EMPLOYER DATA

- Census Data
  - Testing will include
    - Census data elements for active members for the 12 month period preceding AV report
  - Cost-sharing plans will likely have census data tested by plan auditor perhaps in coordination with employer auditor (similar to pensions)
  - Agent plans will have either a SOC-1 type 2 or AT-C 205 examination report (similar to pensions)
  - Single-employer plans (and non-trust) will test incremental changes in members focusing on active and inactive members

AUDIT FOCUS AREAS – EMPLOYER DATA

- Test Data
  - Payroll may not be as big of a deal in non / low-contribution situations
  - Pensions is based on salary / time
  - **OPEB is based on claims –**
    - In most cases, pension formula has no impact on OPEB liability (other than eligibility)

AUDIT FOCUS AREAS – EMPLOYER DATA – INSURANCE ASPECTS

SELF INSURED

- Plan or employer retains the risk
- Claims paid by a third party administrator (or the employer)
- **Audit focus is on the claims data**

INSURED

- Insurance company (e.g. Blue Cross) accepts the risk
- Plan / employer has no obligation for benefits other than premiums
  - Major exception is in experience-rated, minimum premium or stop-loss insurance
- **Audit focus is on the premiums**
- Calculation of age-based or claims based subsidies is important

AUDIT FOCUS AREAS – EMPLOYER DATA – WHO IS PAYING CLAIMS?

TRUSTS

- Plan ***or*** employer may be paying claims (employer reimbursed by trust)
- Employer may pay claims **but not** reimbursed by trust (CERBTF situation in California)

NON-TRUSTS

- Employer is paying benefits PAYGO
- Still results in a reduction of TOL
- Testing focuses on benefit payment separation of actives vs. beneficiaries

AUDIT FOCUS AREAS – EMPLOYER DATA

- Because of self insured vs. insured, trusts vs. non-trusts, claims audits will be hard
  - Reconciliation of claims data needed
  - Sampling of claims data for
    - Eligibility
    - Approval
    - Accuracy
    - Verification for retiree or beneficiary and not active member
  - Insured situations premium auditing similar to auditing other insurance

AUDIT FOCUS AREAS – ACTUARIAL ASSUMPTIONS

Assumptions	Pensions	OPEB
Long-term rate of return	Main driver	Not a major issue – especially if no assets
Mortality	Vital – determines payment period	Not as much especially if Medicare toggle
Inflation / salary	Basis for benefit	Rare element
Retirement age / rate	Payment may be based on age	Rates crucial for cash flow and liability
COLAs / Healthcare cost trends	Only if offered	Healthcare cost trend rate is the driver of OPEB
Options	Options usually dependent on established plan provisions	Many which may have an impact on liability – many plans only subsidize

AUDIT FOCUS AREAS – ACTUARIAL ASSUMPTIONS

Assumptions	Pensions	OPEB
Utilization	Not applicable	**Big deal** – older you get, more healthcare needed
Participation rate	Not applicable	Retirees often pay into the plan, higher premiums = lower participation (or go onto Medicare)
Taxation	Not applicable	Dependent upon plan provisions (e.g. Cadillac Tax) if paid

AUDIT FOCUS AREAS – AU-C 805 SCHEDULES

- Putting it all together – Auditor's report will be similar to pensions
- Should not be on the same report
- Notes to schedules similar

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OMNIBUS 2017 – NON-OPEB STUFF

GASB-85

COMBINATIONS WHERE GOODWILL WAS PRESENT

- Many combinations occurred before GASB-69 (2013)
- If consideration provided in the transaction was more than net position acquired – deferred outflow of resources
  - Amortization most common over the remaining service lives of capital assets acquired
  - If consideration was less than net position, adjust capital assets and if still ‘negative’ then special item in P&L
- GASB-85 now applies those provisions to all combinations that existed prior to GASB-69 and still had goodwill recognized on a government’s books
- Prior period adjustment may be necessary to apply provisions

ADJUSTMENTS TO GASB-72 BY GASB-85

- Governmental insurance entities may hold real estate
  - GASB-85 allows *either* capital asset or investment, depending on if it meets the definition of an investment in GASB-72
- Money market investments and participating interest-earning investment contracts (adjust with rate changes)
  - Can be measured at amortized cost per GASB-31, par. 9
  - Must have a remaining maturity of less than 1 year
  - Must have minimal credit risk in investment

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CERTAIN DEBT EXTINGUISHMENTS (DEFEASING DEBT WITH CASH *NOT* BONDS)

GASB-86

CERTAIN DEBT EXTINGUISHMENT ISSUES

- **What:** GASB issued GASB-86 to establish guidance for certain issues related to debt extinguishments
- **Why:** Research found that GASB-7 and GASB-23 on debt refundings and GASB-62 on debt extinguishments are working effectively, but that certain issues need to be addressed
- **When:** Effective date is periods beginning <u>after</u> June 15, 2017.

IN-SUBSTANCE DEFEASANCE USING *ONLY EXISTING RESOURCES*

- Debt considered defeased in substance (like other advance refundings) when:
  - *Only* existing resources are used to acquire cash and other monetary assets placed in an irrevocable trust, if trust restricted to only essentially risk-free monetary assets (like for refundings)
- Notes to the financial statements:
  - Describe the transaction in the period it occurs (like other refundings)
  - Disclose remaining outstanding balance in each period the defeased debt remains outstanding (may combine with refunded amount)

PREPAID INSURANCE FOR *ALL* DEBT EXTINGUISHMENTS

- Recognize the difference between the net carrying amount of the debt and the reacquisition price as a gain or loss in the period of defeasance (*unlike* other advance refundings)
- At the time debt is extinguished / defeased:

  Any related prepaid insurance that remains - include in the net carrying amount of the debt to calculate gain / loss

NOTE DISCLOSURE ON SUBSTITUTION RISK

- Applies to *all* in-substance defeasances
- If substitution of the essentially risk-free monetary assets in escrow with monetary assets that <u>are not essentially risk-free</u> is *not* prohibited, then disclose in the notes to the financial statements:
  - In the period of the defeasance: the fact that substitution is not prohibited
  - In subsequent periods: the amount of debt defeased in substance that remains outstanding for which that risk of substitution exists

IMPLEMENTATION GUIDE UPDATE 2017-1

IMPLEMENTATION GUIDE UPDATE 2017-1

- 41 new questions and answers
  - 1 on cash flow and OPEB
  - 1 on GASB-80
  - 33 on pension plan accounting and financial reporting (GASB-67, 68, 71, 73, 78)
  - 2 on GASB-79
  - 1 on GASB-54 (*still there's questions??*)
  - 3 on GASB-77
- 33 questions amended in existing guide – some amending 2016-1!
- Implementation for periods beginning after June 15, 2017

KEY QUESTION ON GASB-72 AND 79 – 4.36

- How should a local government's investment position in an external investment pool be categorized within the fair value hierarchy for purposes of the note disclosure requirement of paragraph 81a(2) of GASB- 72, *Fair Value Measurement and Application?*
  - If the pool elects at amortized cost – investments then not measured at fair value –
    - Should not be categorized within the fair value hierarchy.
  - If the pool is at fair value – (either floating value or stable $1)
    - Should also not be categorized within the fair value hierarchy
    - Do not look through to underlying investments
    - Present below the levels or as cash / cash equivalents

JUNE 30, 2019 AND BEYOND

NO. 360 | NOVEMBER 2016

Governmental Accounting Standards Series

Statement No. 83 of the Governmental Accounting Standards Board

Certain Asset Retirement Obligations

GASB

GOVERNMENTAL ACCOUNTING STANDARDS BOARD
OF THE FINANCIAL ACCOUNTING FOUNDATION

CERTAIN ASSET RETIREMENT OBLIGATIONS: GASB-83

WHAT IS THE DEFINITION OF AN ARO?

- Asset retirement obligation—A legal obligation associated with the retirement of a capital asset
  - Retirement of a tangible capital asset—The other-than-temporary removal of a capital asset from service (such as from sale, abandonment, recycling, or disposal)
    - Doesn't matter if capital asset was acquired or constructed
    - May also occur when government is a lessor
    - Legal obligation **<u>must be enforceable</u>**

WHAT IS THE SCOPE OF GASB-83?

- Retirement of tangible capital assets - Examples:
  - Nuclear power plant decommissioning
  - Coal ash pond closure (those that are not landfills)
  - Contractually required land restoration such as removal of wind turbines
  - Other similar obligations
- <u>Disposal</u> of a <u>replaced part</u> that is a component of a capital asset (example – x-ray tube)
- Environmental remediation associated with a requirement of tangible capital assets that results from the normal operations of those tangible capital assets

WHAT IS EXCLUDED FROM THE SCOPE OF THE GASB-83?

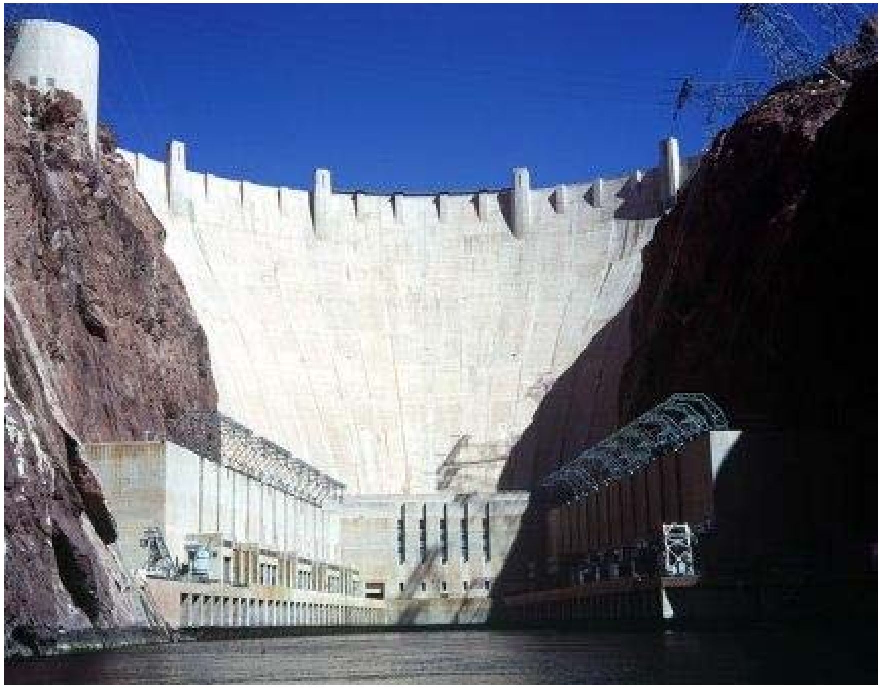
- Obligations associated with:
  - Plan to sell or otherwise dispose of a tangible capital asset
  - Preparation of a tangible capital asset for an alternative use
  - Asbestos removal or pollution remediation (GASB-49
  - Maintenance of a tangible capital asset
- Cost of replacement part that is a component of a capital asset
- Landfill closure and postclosure care obligations
- <u>Conditional</u> obligations to perform asset retirement activities

ARO MEASUREMENT EXCEPTION FOR MINORITY OWNERS (<50%) – HUGE EXCEPTION

- When government owns a minority share (<50%) of an undivided interest
- Government and one or more entities jointly own a tangible asset (common in utilities) <u>and</u> each owner is liable for its share of ARO
- Only limited GASB-83 measurement applies
  - Measurement date should be no more than one year + 1 day prior to the government's reporting date

ARO MEASUREMENT EXCEPTION FOR MINORITY OWNERS (<50%) – HUGE EXCEPTION

- Example
  - City Utility District owns 10% of a dam in an undivided interest
  - Dam is in jurisdiction that requires ARO by statute
  - 75% of dam is owned by publicly traded energy company
- Energy Company reports ARO under **FASB Guidance**
- City Utility District would report its share of ARO – 10%



ARO MEASUREMENT EXCEPTION 2

- Exception *could* also occur when
  - Minority interest in jointly owned tangible capital asset
  - **None** of the joint owners has a majority ownership (more than 50%)
  - **Non-governmental** joint owner has assumed the responsibility for operations
    - Reports ARO in accordance with applicable standards (likely FASB)
- Similar limited initial and subsequent measurement provisions in GASB-83

RECOGNITION OF LIABILITIES

- Similar to GASB-49
  - Liability has to be incurred and *reasonably estimable*
  - Must be external **and** internal events to obligate the government
    - External events
      - Federal, state, local laws / regulations
      - Legally binding contracts
      - Court judgment imposing legally enforceable liability
    - Internal events
      - For **contamination related** events – occurrence
      - Non-contamination
        - Pattern of incurrence based on use (mine excavation)
        - Placing of capital asset into service
        - Abandonment before use (permanent construction stoppage)
    - Acquisition of a capital asset with existing ARO

RECOGNITION OF REST OF ACCOUNTING ELEMENTS

- Once liability is recognized, **deferred outflow of resources** is debit *unless* capital asset <u>is abandoned before use</u>
  - Example – ban on nuclear power plant *<u>prior</u>* to start up
- Liability is recognized based on legal requirements as of reporting date
  - Based on **current value of outlays** to settle liability
    - Current value is amount that would be paid if all equipment, facilities, services etc., in estimates during the current year
    - Based on best estimate of all available evidence
    - Outcomes weighed just like GASB-49 (probability)

RECOGNITION OF REST OF ACCOUNTING ELEMENTS

- After first year
  - Adjust liability for inflation / deflation / increases / decreases – could occur by
    - Price increases
    - Technology changes
    - Changes in laws, regulations, contracts, judgments
    - Changes in types of equipment needed to retire capital asset
  - If adjustment occurs <u>before</u> the asset is retired, adjust deferred outflow of resources (no P&L effect)
  - If <u>after</u> retirement, inflow / outflow (P&L effect)
- Deferred outflow recognized by amortization over useful life of asset (debit expense / credit deferred outflow)

RECOGNITION OF REST OF ACCOUNTING ELEMENTS

- If funding required in an escrow account - Restricted asset
- Any costs to comply with funding / assurance provisions are separate transactions
- If amounts are paid from escrow to retire the asset – debit liability / credit restricted asset
- If bonds are sold – separate liability / asset for proceeds
- Note disclosure is standard GASB
  - Description / source of obligations
  - Methods / assumptions to measure the liabilities
  - Estimated useful life of associated asset
  - Funding / assurance provisions
  - Restricted assets to be used to pay liabilities (if not separately displayed)
  - Disclosure of not reasonably estimable liabilities

NOTE DISCLOSURE IN MINORITY INTEREST SITUATIONS

- General description of the ARO and associated tangible capital asset
  - Total amount of the ARO shared by the nongovernmental majority owner or the nongovernmental minority owner(s)
  - Reporting government's minority share of the total amount of the ARO (percentage)
  - Dollar amount of the minority share of the ARO
- Date of the ARO measurement (if different from the government's reporting date)
- How any legally required funding / assurance provisions are being met (bonds, insurance etc.)
- Amount of assets legally restricted for government's share of ARO (if not displayed separately)

PUTTING IT ALL TOGETHER - RECOGNITION & MEASUREMENT

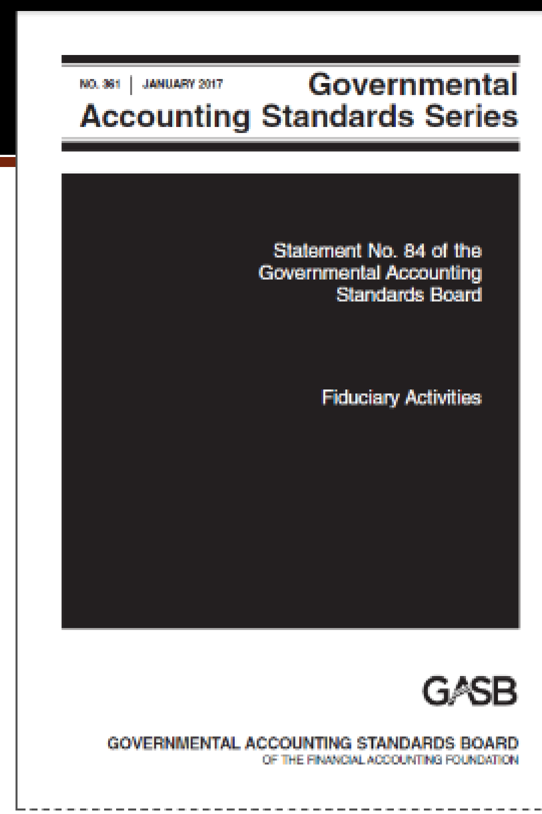
Initial Recognition	Deferred outflow of resources—same amount as the ARO liability	ARO liability when incurred and reasonably estimable—measured based on the best estimate of the current value of outlays expected to be incurred
Subsequent Recognition	Recognize a reduction as an outflow of resources (for example, expense) in a systematic and rational manner over the estimated useful life of the tangible capital asset	• At least annually adjust the current value for the effects of inflation or deflation • At least annually evaluate relevant factors to determine if there is a significant change in the estimated outlays; remeasure liability when significant

ASSET RETIREMENT OBLIGATIONS – GASB-83

- Implementation –
  - Periods beginning after June 15, 2018
  - Prior period adjustment / restatement
- Auditing of ARO will focus on recognition and estimation process
  - Independent verification of estimates
  - Potential engineering specialist needed
  - Confirmation of restricted assets

ACCOUNTING AND FINANCIAL REPORTING FOR FIDUCIARY ACTIVITIES

GASB-84


NO. 361 | JANUARY 2017 Governmental Accounting Standards Series

Statement No. 84 of the Governmental Accounting Standards Board

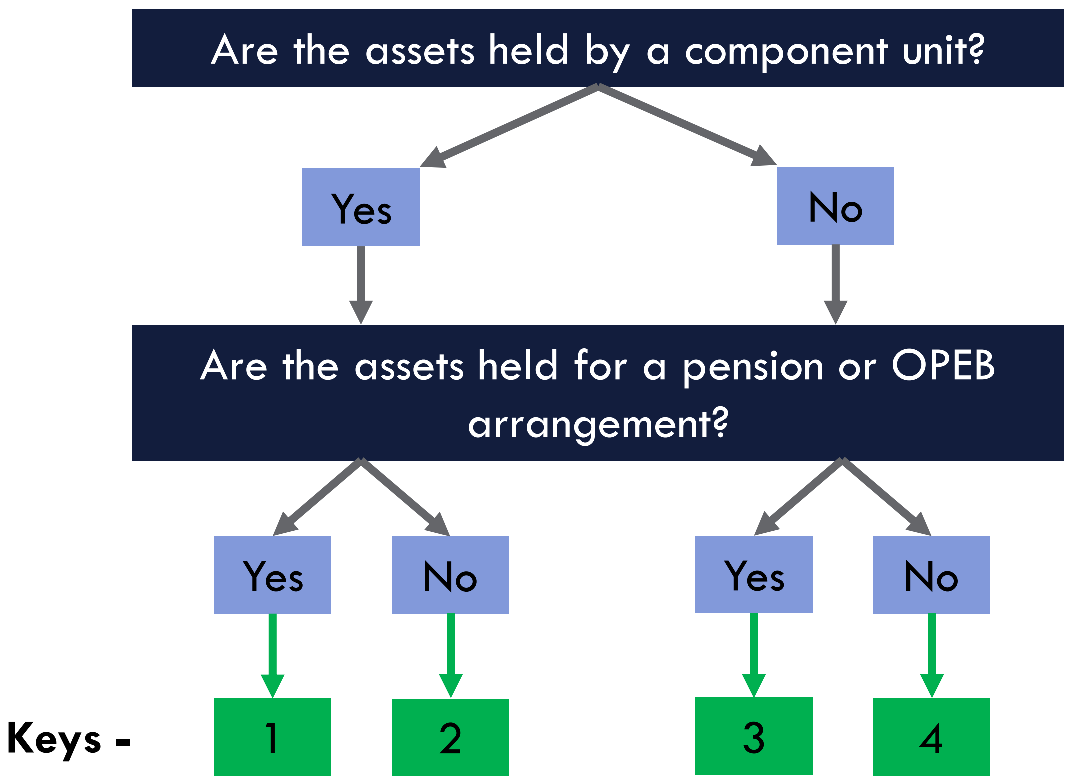
Fiduciary Activities

GASB

GOVERNMENTAL ACCOUNTING STANDARDS BOARD
OF THE FINANCIAL ACCOUNTING FOUNDATION

WHEN SHOULD A GOVERNMENT REPORT ASSETS IN A FIDUCIARY FUND?

Four Keys to making this determination:



FOUR KEYS TO DETERMINING WHEN ASSETS SHOULD BE REPORTED IN A FIDUCIARY FUND

1. Is there **a component unit** that is providing postemployment benefits (Pensions or OPEB)?

2. Is there **a component unit** that does not provide postemployment benefits, *but is a fiduciary?*

Example –Statewide PERS is a component unit of a State

Example – Foundation of an Institution of Higher Education that is a component unit

FOUR KEYS TO DETERMINING WHEN ASSETS SHOULD BE REPORTED IN A FIDUCIARY FUND

3 Are there postemployment benefit arrangements that are ***not component units***?

4 Are there any other fiduciary activities – such as:

- Investment Trust Funds?
- Other Endowments?
- Funds or activities that are *currently* Agency Funds?

If yes to any of these, you might have a Fiduciary Activity.. Maybe…

Example – Municipal Plan that is not an irrevocable trust and is currently reported as an Agency Fund

Examples – Conservation Trust, Library or School Endowment, Clearing Accounts reported as Agency Funds

IN OTHER WORDS… YOU MIGHT BE A FIDUCIARY IF….

The government has All Three of the following:

The government **controls** the assets (see slide after next)

Those assets are *not* derived solely from:

1. The government's own-source revenues
2. Government-mandated and voluntary nonexchange transactions that
   a) ***are not*** pass-through grants ***and***
   b) for which the government ***does not*** have administrative or *direct* financial involvement in the program

***AND* One** of the criteria on the next slide is met

YOU MIGHT BE A FIDUCIARY IF…

<u>REMEMBER - JUST ONE</u> of the following criteria:

1. The assets are **administered through a trust agreement** or equivalent arrangement **in which the government itself <u>is *not*</u> a beneficiary. OR**
2. The assets are **for the benefit of individuals** that **<u>are *not*</u>** required to be residents or recipients of the government's good and services as a condition of being a beneficiary, **and**
   a) The use of those assets ***<u>does not</u>*** **require** substantive approval (aka **administrative involvement** or **direct financial involvement**) by the government – **and**
   b) The assets **<u>are *not* derived</u>** from the government's provision of goods or services to those individuals. **OR**
3. The assets are **for the benefit of organizations or other governments** that **<u>are *not*</u>** part of the financial reporting entity, **and**
   a) The assets **<u>are *not* derived</u>** from the government's provision of goods or services to those organizations.

AS A RESULT….

- **Many** existing Fiduciary Component Unit relationships **may not change solely due to implementation of GASB-84**, including
  - Defined Benefit Pension Plans in accordance with GASB-67 or 73 (trust or non-trust)
  - Defined Benefit OPEB Plans in accordance with GASB-74 (either trust or non-trust)
  - Other non-Pension / non-OPEB component units that are fiduciary (investment pools, endowments and similar)

AS A RESULT….

Many non-Pension / non-OPEB component unit potentially fiduciary relationships may have to be reviewed

- Key question – is there ***administrative involvement*** or ***direct financial involvement*** with the assets?
  - If **NO** – **not a fiduciary**

ADMINISTRATIVE INVOLVEMENT VS. DIRECT FINANCIAL INVOLVEMENT

- *Administrative Involvement* Could Be:
  - Monitoring compliance - (Sub-recipient relationship)
  - Determining eligible expenditures (Sub-recipient relationship)
  - Having the ability to exercise discretion in how assets are allocated
- *Direct Financial Involvement Could Be –*
  - Providing matching resources for the activities

AGAIN - WHAT IS CONTROL?

A government controls the assets of an activity if:

- The government *holds* the assets.
- The government has the ability to *direct* the
  - Use,
  - Exchange, or
  - Employment of the assets in a manner that provides benefits to the <u>specified</u> or <u>intended</u> beneficiaries.

Without Control There is Chaos – Agent 86 – Get Smart!

FIDUCIARY FUND TYPE CHANGES

- New definitions for pension trust funds, investment trust funds, and private-purpose trust funds that focus on the resources that should be reported within each.
  - Trust agreement or equivalent arrangement should be present for an activity to be reported in a trust fund.
- ***Biggest Deal? – Agency Funds will now be Custodial Funds***
  - Will report fiduciary activities for which there is no trust agreement or equivalent arrangement.
    - **External portions of investment pools** that are ***not*** held in trust should be reported in a separate column under the custodial fund umbrella
      - Use "*external investment pool fund*" instead to distinguish from other custodial funds (rare occurrence)

AGENCY FUNDS CURRENTLY IN STAND-ALONE BTAS

- A stand alone BTA's fiduciary activities should be reported in separate fiduciary fund financial statements.
- Resources expected to be held 3 months or less can be reported instead in the statement of net position, with inflows and outflows reported as operating cash flows in the statement of cash flows
  - BTA Agency Funds are relatively rare

457 / 403 / 529 PLANS COULD CHANGE…WELL MAYBE..

- If primary government / PERS plan has <u>nothing to do</u> with
  - Directing
  - Employing
  - Using (controlling) the investments then
- Primary Government / PERS plan only reports:
  - Inflows
  - Outflows
  - Restricted net position
  - Receivables / payables only for timing differences
- GASB-32 rescinded upon implementation (457 Plans) – use GASB-84
- *Implementation Guide* questions coming in 2018 specific to 457 / 403 / 529 plans

OTHER FUN STUFF – REPORTING – NOT MUCH CHANGING OTHER THAN AGENCY FUNDS

- Present additions disaggregated by source and, if applicable, separately display investment income and investment costs
- Present deductions disaggregated by type and, if applicable, separately display administrative costs
- Applies to statement of changes in fiduciary net position for all fiduciary funds *except* custodial funds held for three months or less
  - For these custodial funds, governments would be allowed to report total additions and total deductions in the aggregate, as long as the descriptions of the totals are sufficient to indicate the nature of the resource flows

OTHER FUN STUFF…

- Liabilities would be recognized in fiduciary funds when an event has occurred that compels the government to disburse fiduciary resources.
  - No further action would be needed to pay a beneficiary that is entitled to receive the resources
    - Example – state government collects taxes on behalf of other governments but must make transfers to other governments within 5 days – liability would be declared upon collection
    - Example – 529 plan that qualifies as a fiduciary fund (many may not be) when a participant requests tuition

OTHER FUN STUFF…

- Student Activity Funds generated a lot of buzz –
  - Holding resources for the benefit of students *could* result in the school district being an administrator of the funds
    - **Would be a Fiduciary and therefore a Fiduciary Fund**
  - If activity is similar to providing goods and services as a result of fees paid, *may not be a fiduciary – may be a governmental fund*
- In Basis for Conclusions (pars. B20 and B21) – GASB concludes no specific requirements addressing all student activities included in GASB-84

Government ABC
Statement of Fiduciary Net Position
Fiduciary Funds
June 30, 20X2
(in thousands)

	Pension (and Other Employee Benefit) Trust Funds	Investment Trust Funds	Private-Purpose Trust Funds	Custodial Funds
ASSETS				
Cash and cash equivalents	$ 184,351	$ 840,693	$ 104,747	$ 58,196
Receivables:				
Employee	2,123	—	—	—
Employer	83,004	—	—	—
Taxes for other governments	—	—	—	206,937
Interest and dividends	175,402	12,166	—	—
Sale of investments	30,879	—	—	—
Total receivables	291,408	12,166	—	206,937
Investments at fair value:				
Short-term investments	2,268,960	241,645	61,591	—
Bonds, notes, mortgages, and preferred stock	14,115,391	804,576	187,650	—
Common stock	20,342,440	—	520,196	—
Real estate	3,408,145	—	—	—
International investments	1,723,951	—	—	—
Mutual funds	72,315	178,046	—	—
Pooled investment funds	23,128	—	—	—
Total investments	41,954,330	1,224,267	769,437	—
Securities lending collateral	1,746,544	—	—	—
Other assets	13,519	181	81,157	361
Total assets	44,190,152	2,077,307	955,341	265,494
LIABILITIES				
Accounts payable and other liabilities	130,846	1,361	61,447	1,451
Due to local governments	—	—	—	164,201
Obligations under securities lending	1,346,544	—	—	—
Other long-term liabilities	1,617	—	7,870	—
Total liabilities	1,479,007	1,361	69,317	165,652
NET POSITION				
Restricted for:				
Pensions	29,897,802	—	—	—
Postemployment benefits other than pensions	12,813,343	—	—	—
Pool participants	—	2,075,946	—	—
Individuals, organizations, and other governments	—	—	886,024	99,842
Total net position	$ 42,711,145	$ 2,075,946	$ 886,024	$ 99,842

Similar except for Custodial Funds

Government ABC
Statement of Changes in Fiduciary Net Position
Fiduciary Funds
for the Year Ended June 30, 20X2
(in thousands)

	Pension (and Other Employee Benefit) Trust Funds	Investment Trust Funds	Private-Purpose Trust Funds	Custodial Funds
ADDITIONS				
Contributions:				
Members	$ 297,846	$ —	$ —	$ —
Employers	1,259,384	—	—	—
Other plans	148,792	—	—	—
Gifts and bequests	—	—	197,256	—
Total contributions	1,706,022	—	197,256	—
Investment earnings:				
Net increase in fair value of investments	1,852,408	64,663	33,702	—
Interest, dividends, and other	1,416,448	58,465	30,378	—
Securities lending income	76,075	—	—	—
Total investment earnings	3,344,931	123,128	64,080	—
Less investment costs:				
Investment activity costs	32,281	50,236	63	—
Securities lending costs	73,642	—	—	—
Net investment earnings	3,239,008	72,892	64,017	—
Capital share and individual account transactions:				
Shares sold	—	2,817,210	—	—
Reinvested distributions	—	72,892	—	—
Shares redeemed	—	(2,776,843)	—	—
Net capital share and individual account transactions	—	113,259	—	—
Sales tax collections for other governments	—	—	—	1,811,120
Miscellaneous	1,130	—	—	1,468
Total additions	4,946,160	186,151	261,275	1,812,588
DEDUCTIONS				
Benefits paid to participants or beneficiaries	1,963,047	—	—	—
Medical, dental, and life insurance for retirees	536,027	—	—	—
Refunds and transfers to other systems	170,514	—	—	—
Administrative expense	19,920	—	43	293
Beneficiary payments to individuals	—	—	211,179	—
Payments of sales tax to other governments	—	—	—	1,811,120
Distributions to shareholders	—	72,892	—	—
Total deductions	2,689,508	72,892	211,222	1,811,413
Net increase (decrease) in fiduciary net position	2,256,652	113,259	50,053	1,175
Net position—beginning	40,454,493	1,962,687	835,971	98,667
Net position—ending	$ 40,454,493	$ 1,962,687	$ 835,971	$ 99,842

Similar except for Custodial Funds

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LEASES

GASB-87
Implementation – periods beginning after
December 15, **2019**

LEASES – BIG DEALS

- Single approach—right of use
  - No classification of leases into operating/capital or other categories
  - Potentially develop some exceptions
  - Underlying assumption that leases are financings
- Practicality exceptions—short-term lease
  - At the beginning of the lease, has <u>maximum possible term</u> under the contract, <u>including any options to extend</u>, of <u>12 months or less</u>

EXCEPTIONS FROM LEASE ACCOUNTING

- Leases for Intangible Assets
  - Exploration / mining rights for natural resources
  - Licenses for performing arts, copyrights, patents, software, other than subleases
- Biological assets / timber / living plants or animals
- Inventory
- Power purchase agreements that are leases
- Service Concession Arrangements (GASB-60)
- Leases where underlying asset is financed with conduit debt *unless* asset and conduit debt are reported by lessor
  - Conduit debt is common in state revolving fund loans
- Regulated leases (airports) where cost recovery is controlled – lessor only recognizes payment provisions in contract and limited disclosures
- Ownership transfers without termination options = financed sales (notes receivable)
- Leases that are investments – limited disclosure

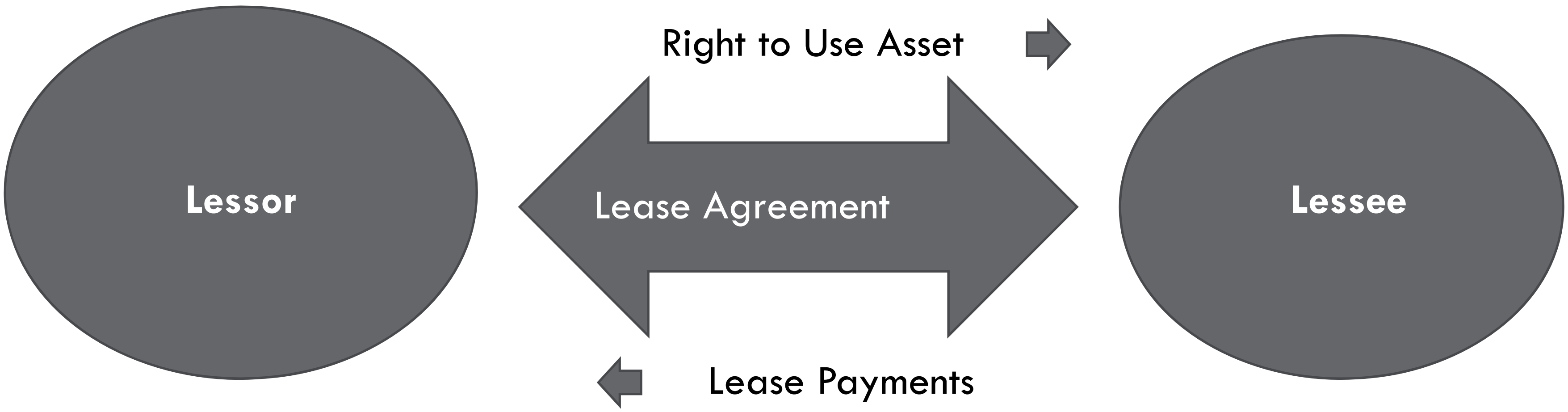
LEASES

- What is a Lease?
  - Contract that conveys control of the right the right to use
    - Another entity's nonfinancial asset (the underlying asset)
    - For a period of time as specified in the contract
    - In an exchange or exchange – like transaction
  - Control of the right is evidenced by <u>both</u>:
    - Obtaining of service capacity from the use of the asset as specified in the contract
    - Ability to determine the nature / use of the asset as specified in the contract
- <u>Bottom line</u>
  - No capital vs. operating leases
  - Underlying assumption that nearly all leases are similar to financing (but of period of time)
  - **Transfers of ownership without termination also are financings**

LEASES

- Lessees – Recognition and Measurement
  - Intangible asset for ***the right to use*** the underlying asset and
  - Liability for future payments
    - Day 0 liability =
      - Fixed payments over lease term
      - Variable payments based on an index / rate in effect at that date
      - Variable payments that are in-substance fixed
      - Residual value guarantees that are *probable* of being required
      - Termination penalties if based on the determination of the leas term, the termination option is *probable* of being exercised
    - Liability does not include lease payments that are dependent on a lessee's performance or usage of an underlying asset

SO WHAT IS THE RIGHT OF USE MODEL?



LEASES

- Lessees – Recognition and Measurement
  - Liability remeasured by calculating interest and reducing liability for actual payments *less* interest
  - Lease asset amortized using a systematic and rational basis over the *shorter* of
    - the useful life of the underlying asset *or*
    - the lease term
  - Amortization is based on lessee's depreciation policy if the lease transfers ownership or if a purchase option is determined to be *probable* of being exercised
    - Amortization of the lease asset classified as amortization expense
    - Amortization of the discount is interest expense in statement of activities

LEASES

- Lessees – Recognition and Measurement
  - Short-term leases
    - Measured at beginning of lease
    - Has a maximum possible term, including options to extend < 1 year regardless of probability of being exercised
    - End result may be very few operating leases
  - Leases in Business-Type Activities – Statement of Cash Flows Impact as follows:
    - If lease asset recognized, cash flows is in capital and related financing (including interest)
    - Short-term leases in operating activities

OTHER LEASE PROVISIONS ON TERM OF LEASE

- Lessee's *or lessor's* options to extend and terminate the lease evaluated throughout lease term **at the point when a renewal or termination option is elected contrary to original lease term determination**
  - **Likelihood of occurrence of options is a *reasonably certain standard* (more than probable)**
- Options include all relevant factors including penalties (economic disincentives)
  - Fiscal funding clauses would be considered like any other termination option – only if it is reasonably certain the clause will be exercised

SAMPLE CALCULATION OF ASSET / LIABILITY AT INCEPTION - LESSEE

Lease Term: 5 years
Renewal Options: two 2-year options
Payments: 1,000 per mth

Reasonably certain there's a renewal

	2nd 2 year	1st 2 year	No renewal
Lease term	9	7	5
Probablility	35%	60%	5%
Cumulative Probablity	35%	95%	100%

PV of Future Payments $68,453 (Based on incremental borrowing rate of 6%)

Initial Measurement	DR	CR
Right-to-use asset	$ 68,453	
Lease Obligation		$ 68,453
Subsequent Measurement		
Lease Obligation	$ 658	
Interest Expense	$ 342	
Depreciation Expense	$ 815	
Accumulated Depreciation		$ 815
Cash		$ 1,000

LEASES

- May have multiple components
  - Lease principle and interest
  - Maintenance
  - Utilities
  - Security
  - Other
- Should separate lease and non-lease components or multiple lease components if practical
- **GASB 87 discusses how setting a high capitalization threshold policy for leases should *not* result in a lack of reporting of assets and liabilities that are material collectively**
  - Small item exception considered but not adopted

LEASES

- **Governmental lessor**
  - Symmetrical accounting to lessees
  - Lessor would recognize receivable for the right to receive payments
    - Payments discounted by the rate charged lessee
  - No de-recognition of underlying asset
  - No recognition of performance liability (e.g. security)
  - Deferred inflow of resources is credit = [receivable + cash received]
  - Lease revenue recognized systematically & rationally over lease term (e.g. effective interest method)
  - If in Business-Type Activities, Lessor's Statement of Cash Flows would show lease consistent with how underlying asset is shown (investing or capital and related financing)
    - Short-term lease would be operating cash flow like lessee

LEASES

- **Governmental lessor**
  - Receivable includes
    - Residual value guarantees
    - Purchase options
    - Termination penalties (if measured, exercised and unpaid)
  - Direct costs expensed (just like GASB-65)
- Sub-lease situations
  - **2 separate transactions**
  - **Do not net**
  - **Apply all applicable guidance**
- Sale-Leasebacks, Lease-Leasebacks and Intra-entity leases all have guidance

DEBITS AND CREDITS ON ONE SHEET

	Party	Assets	Liabilities	Deferred Inflow of Resources
Initial Reporting	**Lessee**	Intangible asset (lease liability + prepayments + initial direct costs placing asset into use)	Present value of future lease payments (fixed, variable, including guarantees etc.)	None
	Lessor	Lease receivable, capital asset remains on books	Should be none	Lease receivable + cash that relates to future period
Subsequent Reporting	**Lessee**	Amortize intangible over shorter of useful life or term of lease	Reduce by lease payments (effective interest)	None
	Lessor	Depreciate capital asset unless required to be returned in original or better condition Reduce receivable, taking into account accrued interest	Should be none	Recognize revenue in effective interest method (systematic & rational)

DISCLOSURES

- Lessees - Similar to current model, other than short-term leases – grouped for purposes of disclosure
  - General Description including
    - Basis terms / conditions on which variable lease payments not included in the liability are determined
    - Existence / terms / conditions of residual value guarantees provided by *lessee* not included in the lease liability
  - Total lease assets, accumulated amortization (reported separately from capital assets)
  - Lease assets by major classes (also separate from capital assets)

DISCLOSURES

- Lessees - Similar to current model, other than short-term leases – grouped for purposes of disclosure
  - Outflows of resources recognized for period for variable lease payments not included in liability
  - Principal and interest – 5 years and 5 year increments to maturity (like today)
  - Commitments for leases not begun
  - Impairment losses recognized on lease asset for the period
- Lessors – similar, but including termination provisions

REGULATED LEASES – (MOSTLY AIRPORTS)

- Lessor – revenue recognized based on payment provisions in the contract – regulator usually sets
  - Lease rates – subject to reasonableness tests
  - Common lease terms – all airlines have similar rates
  - Rights transfer if facilities are available
- Lessor records receivable based on factors including
  - Fixed payments
  - Variable payments (based on an index – example: CPI)
  - Variable payments that are in substance fixed (based on percentages of sales with minimum payments)
  - Residual value guarantees
  - Discounted based on rate in lease – no imputation of interest required
    - Any discount between rate and market rates is amortized annually
  - Remeasurement provisions are the same as unregulated leases

REGULATED LEASES – (MOSTLY AIRPORTS)

- Lessor – additional recording
  - Deferred inflow of resources = initial value of lease receivable + downpayments at beginning of lease relating to future periods (e.g. final month's rent)
    - Amortization to revenue
- Notes for regulated leases (other than short-term leases)
  - General description
  - Inflows recognized in the current period (if not on face of financials)
  - Terms and conditions to terminate / abate
  - Schedule of future payments

EFFECTIVE DATE

- Periods *beginning* after December 15, **2019**
- Existing Leases –
  - Adjust based on the *remaining lease payments as of the <u>beginning of the period of implementation</u>* <u>or the beginning of any earlier periods restated</u>
    - June 30, 2021 = July 1, 2020
  - Airports –
    - Leases bound by regulatory language follow that language
    - Other concessions would use GASB
- Preparers may want to start reviewing software now that determines capital vs. operating lease (if applicable)

HOT OFF THE PRESS – GASB-88

CERTAIN DISCLOSURES RELATED TO DEBT, INCLUDING DIRECT BORROWINGS AND DIRECT PLACEMENTS

- Amends GASB-34 and GASB-38
- Results in redrafted debt note disclosure ***for the better!***
- Clear definition of the word "debt" – definition drives disclosure
- Effective date – periods *beginning* after June 15, 2018

WHAT IS THE NEW DEFINITION OF "DEBT"?

- For purposes of disclosure in notes to financial statements:
  - A liability that arises from a contractual obligation
    - To pay cash (or other assets that may be used in lieu of payment of cash)
    - In one or more payments
    - To settle an amount that is fixed at the date the contractual obligation established
  - Interest to be accrued and subsequently paid such as variable rate debt, or interest to be added to the principal amount of the obligation (capital appreciation bonds) does *not* preclude the amount from being fixed (meaning – debt)
- For disclosure purposes, "debt" ***does not*** include
  - *Most* Leases (see GASB-87) or
  - Accounts payable
- **Leases that are financed purchases are still debt**

BASED ON THE DEFINITION OF DEBT – DISCLOSURE WILL THEN BE:

- SUMMARIZED Information (Not Details) on the following:
  - Amount of unused **lines** of credit
  - Assets pledged as collateral for debt
  - Terms specified in debt agreements related to *significant*:
    - Events of default with finance-related consequences **or** termination events with finance-related consequences
    - Subjective acceleration clauses
- Debt disclosures separated into the following categories:
  - Direct borrowings and direct placements of debt
  - Other Debt

PUTTING IT ALL TOGETHER…

- If multiple unused lines of credits, asset pledges etc., use a table – summarized information only needed
- Required disclosure will now be
  - Principal and interest requirements to maturity – first 5 years and 5 year increments thereafter – interest requirements for variable rate debt continue
  - *Summarized* information on unused lines of credit, etc. from GASB-88
  - Information on:
    - Long-term liabilities (bonds, notes, loans) and
    - Other long-term liabilities (compensated absences, leases payable, claims and judgments)
      - Beginning and ending balances
      - Increases and decreases
      - Portions of each item due within one year
      - Which governmental funds have been used to liquidate other long-term liabilities
  - Schedule of changes in short-term debt / purpose of issuance

POTENTIAL DISCLOSURE

	Balance at July 1, 20X1	Increases	Decreases	Balance at June 30, 20X2	Due within One Year
Governmental activities:					
General obligation bonds	$ 21,500,000	$ -	$ 8,970,000	$ 12,530,000	$ 7,050,000
Notes from direct borrowings and direct placements	1,412,877	-	470,959	941,918	470,959
Total	$ 22,912,877	$ -	$ 9,440,959	$ 13,471,918	$ 7,520,959
Business-type activities					
Notes from direct borrowings	$ 76,800	$ -	6,400	$ 70,400	$ 6,400

The County's notes from direct borrowings related to business-type activities are secured with collateral of an undeveloped lot zoned for commercial use. The County also has an unused line of credit in the amount of $1,500,000. The notes from direct borrowings related to business-type activities have provisions that change the schedule of repayment of outstanding amounts to due immediately if the County terminates its line of credit. All notes from direct borrowings and direct placements have provisions that change the schedule of repayment of outstanding amounts to due immediately if the county is unable to make payment.

POTENTIAL DISCLOSURE - CONTINUED

The County's notes from direct borrowings contain subjective acceleration clauses that allow the lender to accelerate payment if a material adverse change, as determined by the lender, occurs.

Debt service requirements on long-term debt at June 30, 20X2, are as follows:

	Governmental Activities				Business-Type Activities	
	Bonds		Notes from Direct Borrowings and Direct Placements		Notes from Direct Borrowings	
Year Ending June 30,	Principal	Interest	Principal	Interest	Principal	Interest
20X3	$ 7,050,000	$ 497,700	$ 470,959	$ 30,024	$ 6,400	$ 2,640
20X4	4,880,000	215,950	470,959	10,008	6,400	2,400
20X5	50,000	21,000	-	-	6,400	2,160
20X6	50,000	19,250	-	-	6,400	1,920
20X7	50,000	17,500	-	-	6,400	1,680
20X8-20Y2	250,000	52,500	-	-	32,000	4,800
20Y3-20Y7	200,000	17,500	-	-	6,400	240
	$ 12,530,000	$ 841,400	$ 941,918	$ 40,032	$ 70,400	$ 15,840

AND GASB'S JUST GETTING STARTED…
PROPOSED GAAP

CAPITALIZATION OF INTEREST COST

- *Could* result in **simplifying financial reporting**
- Tentative decision that construction-period interest cost should be accounted for as an outflow of resources (expense/expenditure) in the period in which it is incurred.
  - *In other words – **no more capitalized interest***
- Potential effective date – periods beginning after December 15, 2018
- Application of eventual standard likely to be **prospective** for all capital assets
  - Do not restate prior year's capital assets
    - Likely depreciated
- Likely GASB-89

ACCOUNTING AND FINANCIAL REPORTING FOR MAJORITY EQUITY INTERESTS

- May modify
  - Existing requirements for governments' majority equity interests in legally separate organizations
  - Reporting governmental component units in which the government has a 100% equity ownership
- Potentially will amend 5 GASB Standards (14, 31, 61, 62, 72) and 1 *Implementation Guide* question
- If equity interest
  - Is investment per GASB-72, report as an investment using equity method in GASB-62
    - Fiduciary funds or an endowment use fair value
    - Is not an investment – report as a component unit under GASB-14 – report at cost and then re-measure per GASB-14
      - Use GASB-69 provisions for acquisitions
- Likely GASB-90

REMINDER OF EQUITY METHOD ACCOUNTING

Investment	Component Unit
GASB-62, pars. 205-209 (as amended)	GASB-14, pars. 55, 73-74 (as amended)
Assumes "significant influence" even though < 50% ownership	100% ownership becomes an acquisition, otherwise, utilize GASB-62, equity method
Intra-entity profits and losses eliminated until realized	Equity interest adjusted for value changes (unless 100% ownership)
Difference between net assets of investee and cost deferred and amortized (deferred inflows / outflows of resources)	100% acquisition, difference between elements assumed / acquired and consideration deferred / amortized (GASB-69, pars. 29-42)
Annual earnings share shown as a single amount (investment revenue / loss) (unless extraordinary or gains / loss from sale or impairment)	Depends on blended or discrete – utilize those provisions
Changes in ownership / voting class may result in restatement	Could occur upon disposals / transfers of blended component units

CONDUIT DEBT

- **What:** The Board is considering improvements to the existing standards related to conduit debt.
- **Why:** Interpretation 2 had been in effect for 20 years before its effectiveness was evaluated. Based on GASB research, the Board improvements are needed.
- **When:** The Board added the project to the current technical agenda in August 2017.
- **Could be a very big deal for certificates of participation and similar**

TENTATIVE BOARD DECISIONS

- Elements of the definition of a conduit debt obligation:
  - Key characteristic – there are at least three participants:
    - The government-issuer,
    - The third-party obligor (borrower), and
    - The bondholder
  - A third-party obligor and an issuer ***should not*** be within the same financial reporting entity
  - Purpose is not limited to capital financing
  - The terms *revenue bonds, limited obligation*, and *limited-obligation revenue bonds* should not be included in the definition of conduit debt
  - Whether a government-issuer is the recipient of debt proceeds or the provider of debt service payments should not be a defining characteristic

TENTATIVE BOARD DECISIONS

- Financial reporting of conduit debt
  - A conduit debt obligation—the total financing—**should not be reported** as a liability of **the issuer**
  - The issuer should report a liability only when a payment by the issuer is more likely than not.
- **Look for Exposure Draft in July**

CONDUIT DEBT

- Conduit debt – inconsistent definition and disclosure
  - GASB Guidance (GASBI-2) issued prior to definitions of “asset” and “liability”
  - GASB 87 provisions and new GASB 88 may assist in definition
- Could result in clarification of reporting of obligations for housing authorities, state revolving funds, finance authorities etc.
  - Lease / Note payments from borrowers to issuers = assets?
- Watch for the Exposure Draft coming July 2018

WHAT'S GOING ON WITH THE FINANCIAL REPORTING MODEL?

FINANCIAL REPORTING MODEL

- Could change GASB-34, 35, 37, 41, 46 and Interpretation 6
- Key focus areas (ICYMI):
  - Funds
    - All tend to like them, except for lack of comparability
      - Some call for governmental funds to be full accrual
      - Others called for governmental funds to be RSI
  - Government-wide statements – users love them, preparers don't, auditors mixed
    - Biggest problem – *internal* decision-makers don't use them
    - Statement of Activities is weakest link
    - Government-wide statement of cash flows in our future?
  - MD&A – most valuable piece of reporting model but frequently last to get prepped / boilerplate / copied
  - Budgetary comparisons, modified approach, capital assets and debt are all on the table (among others)

RESULT OF ITC

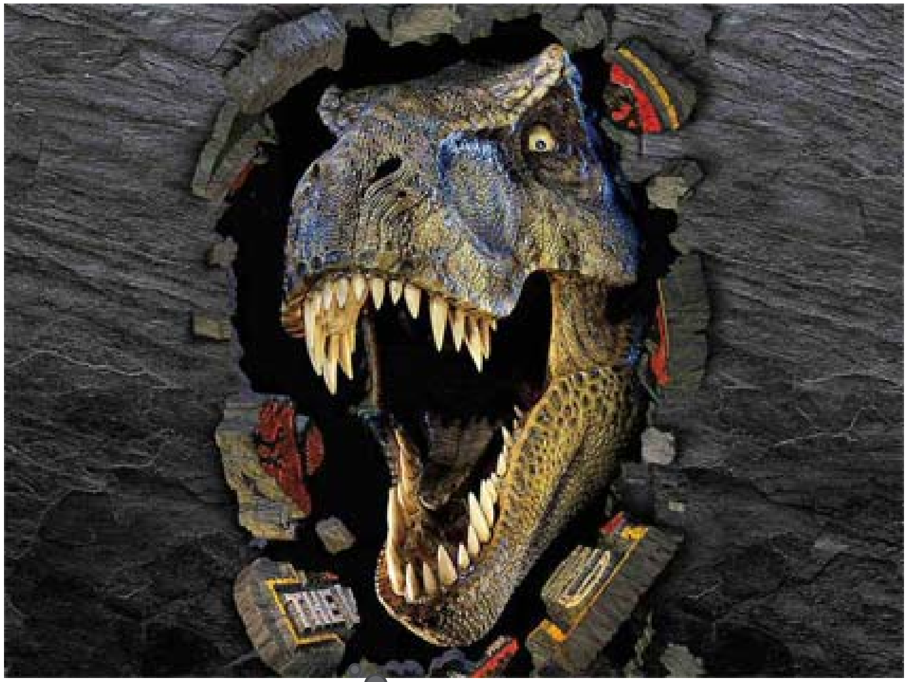
- Nearly 100 comment letters
- No single approach for governmental funds was universally accepted / discarded – BUT
  - **Preparers** seemed to prefer near-term approach
  - **Users** seemed to prefer other approaches (but no consensus)
  - **Auditors** saw plusses and minuses to all 3
- Next step – mix and match in the PV

ON TO ROUND 2 – PRELIMINARY VIEWS

- ***Biggest Deal*** **- Further refinement of Governmental Fund Accounting**
- ***2nd Biggest Deal*** **– Operating vs. Nonoperating Revenues and Expenses in Proprietary Funds / BTAs**
- **Budgetary Comparisons**—likely moved to RSI instead of having a choice
- **Format of the Government-Wide Statement of Activities**
  - Existing Format retained?
  - Traditional format (Revenues over expenses) by function or program?
  - Functional or programmatic expenses by natural classification?
- **Permanent Funds** – should these be still reported and if yes, where? Fiduciary Funds?

IMAGINE A WORLD WHERE GOVERNMENTAL FUNDS…

- … Are a combination of near-term and short-term recognition approaches from the ITC resulting in…
- … **Having a One-Year** (operating cycle) recognition timeframe (in other words, not 60 days)
- … Recognition of accrued interest when payable and normally due within one year, <u>which may not align to principal payments on the related debt</u>
- … Recognition of tax and revenue anticipation notes (TANs / RANs) as liabilities
- … Exclusion of the current portion of long-term assets and liabilities



GASB 34

MORE ON THE GOVERNMENTAL FUNDS

- Balance Sheet elements and inflows / outflows proposed to be on this one-year perspective
- Long-term obligations reported as they mature as well as year-end balances from short-term transactions (receivables / payables)
- *Reasonably* comparable to budgetary transactions (unless budget is pure cash basis)

MORE ON THE GOVERNMENTAL FUNDS

- What is ‘short term’?
  - ***Normally due*** to convert to or require use of cash (or other financial assets) within **one year** from the inception of the transaction
  - *Normally* is the same definition in Interpretation 6
    - Generalized transactions – what are a governments normal payables / receivables / flows transactions?
  - *Due* refers to the date when payment is scheduled / expected to be made
- All others are ‘long-term’
  - Assets / liabilities recognized in governmental funds when payments / receipts come due

WHY IS OPERATING VS. NONOPERATING A BIG DEAL?

- Revenue Bonds and Other Compliance May be Aligned to Definition of Operating Revenue / Expenses
- Some BTA's Want to be More Comparable to Non-Profit / For-Profit Counterparts
- Regulatory Accounting (HUD / FERC) may be an Issue
- Multiple types of Entities have different focuses (subsidies vs. performance)
- GASB could conclude what is **non-operating** first and then operating
- Non-operating **could** be
  - Subsidies received or provided
  - Expenses of financing
  - Capital asset purchase / disposal
  - Investment income / expenses (with adjustments for financing entities)

TENTATIVE DEFINITION OF "SUBSIDY"

Resources provided by another party or fund for the purpose of keeping the rates charged for the goods or services of the activity lower than what would otherwise be necessary for the level of goods or services provided

- **Examples of subsidies:**
  - Operating grants
  - Taxes levied by a public hospital district or college
- **Not subsidies:**
  - Passenger Facility Charges (airports)
  - Restricted taxes for specific purposes (water tax for maintenance of system)

WHY IS OPERATING VS. NONOPERATING A BIG DEAL?

Types of Entities Relying on Subsidies (Taxes / Grants etc.)	Types of Entities Gauging Performance	Types of Entities That Are Regulatory Aligned
Healthcare (relying on grants or taxes)	Airports	Housing Authorities (HUD)
Lotteries (cash flow for primary government)	Higher Education	Public Power (FERC – Nuclear)
Port authorities (capital grants)	Healthcare (non-tax districts)	
Turnpikes (construction)	Housing Finance Entities	
Transit (Farebox recovery ratio – 20% rest from grants / taxes)	Utilities (unless FERC)	
Tribal governments		
Water / Sewer		

REMAINDER OF PV LIKELY TO INCLUDE

- Budgetary comparisons
  - Would be presented in required supplementary information (no option for basic statements)
  - Required variances would be final-budget-to-actual and original-budget-to-final-budget
- Improved format for the government-wide statement of activities
  - Could result in a supplementary information schedule of expenses by object (like in higher education or not-for-profit)
    - Would only be in CAFRs

WHAT DOES A NATURAL CLASSIFICATION SCHEDULE LOOK LIKE?

	Program Activities				Supporting Activities			
	A	B	C	Programs Subtotal	Management and General	Fund-Raising	Supporting Subtotal	Total Expenses
Salaries and benefits	$ 7,400	$3,900	$ 1,725	$ 13,025	$ 1,130	$ 960	$ 2,090	$ 15,115
Grants to other organizations	2,075	750	1,925	4,750				4,750
Supplies and travel	890	1,013	499	2,402	213	540	753	3,155
Services and professional fees	160	1,490	600	2,250	200	390	590	2,840
Office and occupancy	1,160	600	450	2,210	218	100	318	2,528
Depreciation	1,440	800	570	2,810	250	140	390	3,200
Interest	171	96	68	335	27	20	47	382
Total expenses	$13,296	$8,649	$ 5,837	$ 27,782	$ 2,038	$2,150	$ 4,188	$ 31,970

Illustration in FASB ASU 2016-14 Not-for-Profit Entities (Topic 958)

- Fundraising unlikely in government (unless higher education)
- Natural classification categories may change
- Management and General may be ‘general government’
- Activities A, B, C would be other programs in Statement of Activities (public safety, education, cultural and recreation etc.)
- **AGAIN – if SI – only in CAFRs**

REMAINDER OF PV LIKELY TO INCLUDE

- Permanent funds
  - Determine recognition approach and presentation for permanent funds when preliminary view for recognition approach in governmental funds is finalized
- Reconciliation from funds to government-wide format
- Format of governmental funds flows statement
- Cash flow statement?

ROUND 3 – EXPOSURE DRAFT

- **Extraordinary and Special Items**—explore options for clarifying the guidance for more consistent reporting
- **Management's discussion and analysis (MD&A)**
  - Enhance the financial statement analysis component
  - Eliminate boilerplate
  - Clarify guidance for presenting currently known facts, decisions, or conditions

ROUND 3 – EXPOSURE DRAFT

- **Debt service funds**—explore options for providing additional information, either individually or in aggregate in the financial statements or the notes **(as a major fund like the General Fund?)**
- All items tentatively OK'd in the ITC and PV
- Any other elements added late
- In other words… **it's the last shot** before final, except if major changes needed (then re-exposed)

TENTATIVE REMAINING TIMELINE

Preliminary Views	September 2018
Exposure Draft	2nd Quarter - 2020
Final Statement Expected	**February 2022**
Implementation	**Anyone's guess….**

REVENUE AND EXPENSE RECOGNITION

- **What:** Development of a comprehensive application model for recognition of revenues and expenses from nonexchange, exchange, and exchange-like transactions
- **Why:**
  - How to account for revenues from transactions that are neither fully exchange or nonexchange;
  - Revenue recognition standards incorporated in GASB-62 have not been revised for governments in **nearly 50 years**;
  - Current literature does not provide guidance for exchange and exchange-like expenses

REVENUE / EXPENSE INITIAL PROJECT SCOPE

EXCLUDED FROM PROJECT (SO FAR)	INCLUDED IN PROJECT (SO FAR)
• Pensions / OPEB	• **Broadly defined rather than list of specific items**
• Investments, derivatives, leases, and insurance	• **Revenues from exchange, exchange-like, and nonexchange transactions (GASB-33, and amendments)**
• Recognition of capital assets or certain liabilities including: depreciation, ARO, pollution remediation	• **Expense from exchange and nonexchange transactions (GASB-36)**

WHAT'S IN THE ITC?

- Potential application models for the recognition of revenue and expense.
- Two primary models are in the ITC:
  - **Performance obligation model**
  - **Exchange/nonexchange model**
- **Plus – your opportunity to present your own**
- **Feedback requested on each as <u>no final decisions have been made</u>**

GASB STAFF OPTION 1 –PERFORMANCE OBLIGATION

- A **performance obligation** is

A binding promise with another party

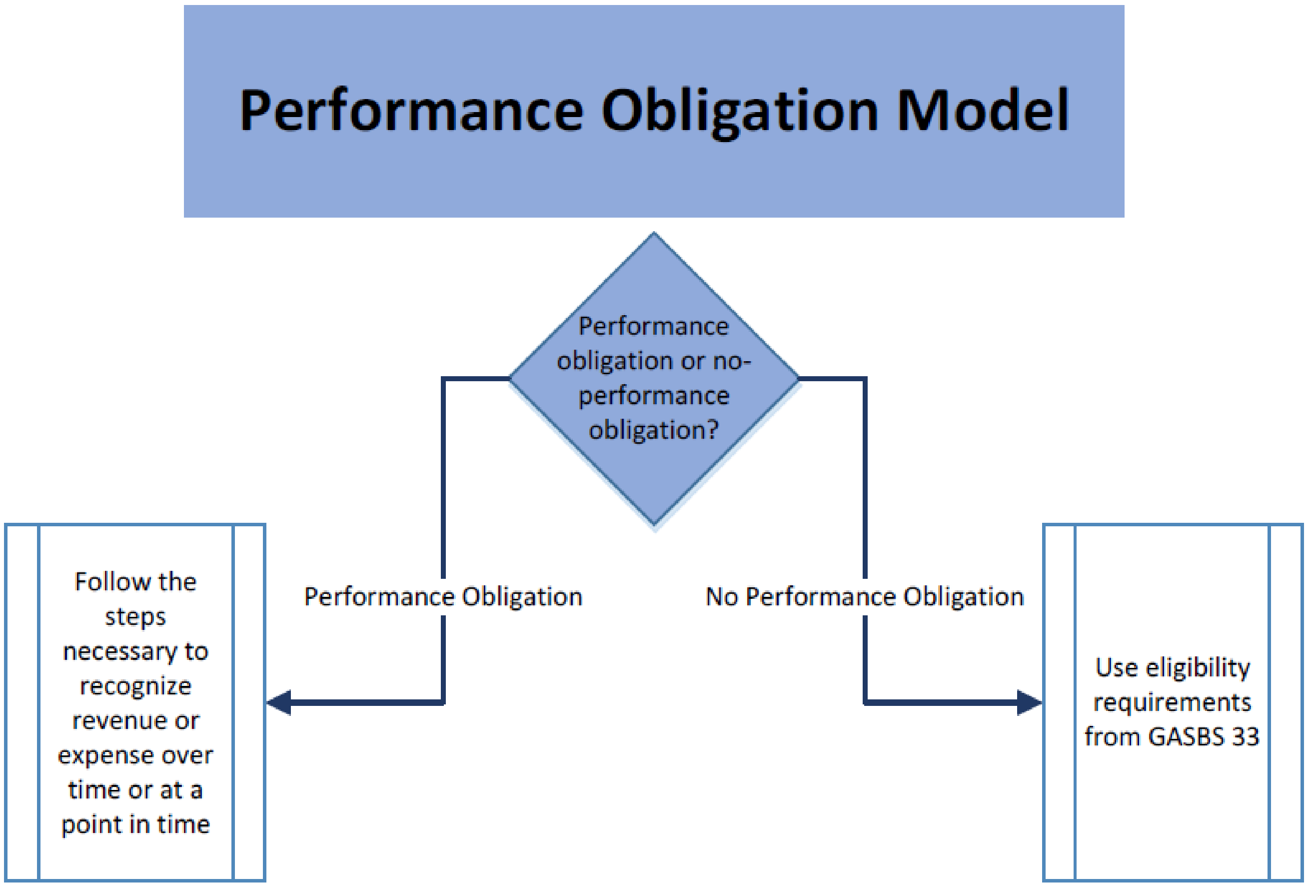
To provide a distinct good, service, or other resource (or a bundle of goods, services, or other resources).

Examples –

- Compliance Elements in Federal Grants
- EMS / Police / Fire Services in emergencies

- A performance obligation may exist if the transaction involves a specific individual or entity as either the resource provider or as the resource beneficiary.
  - Taxation may be excluded though

WHAT IS THE PERFORMANCE OBLIGATION MODEL?

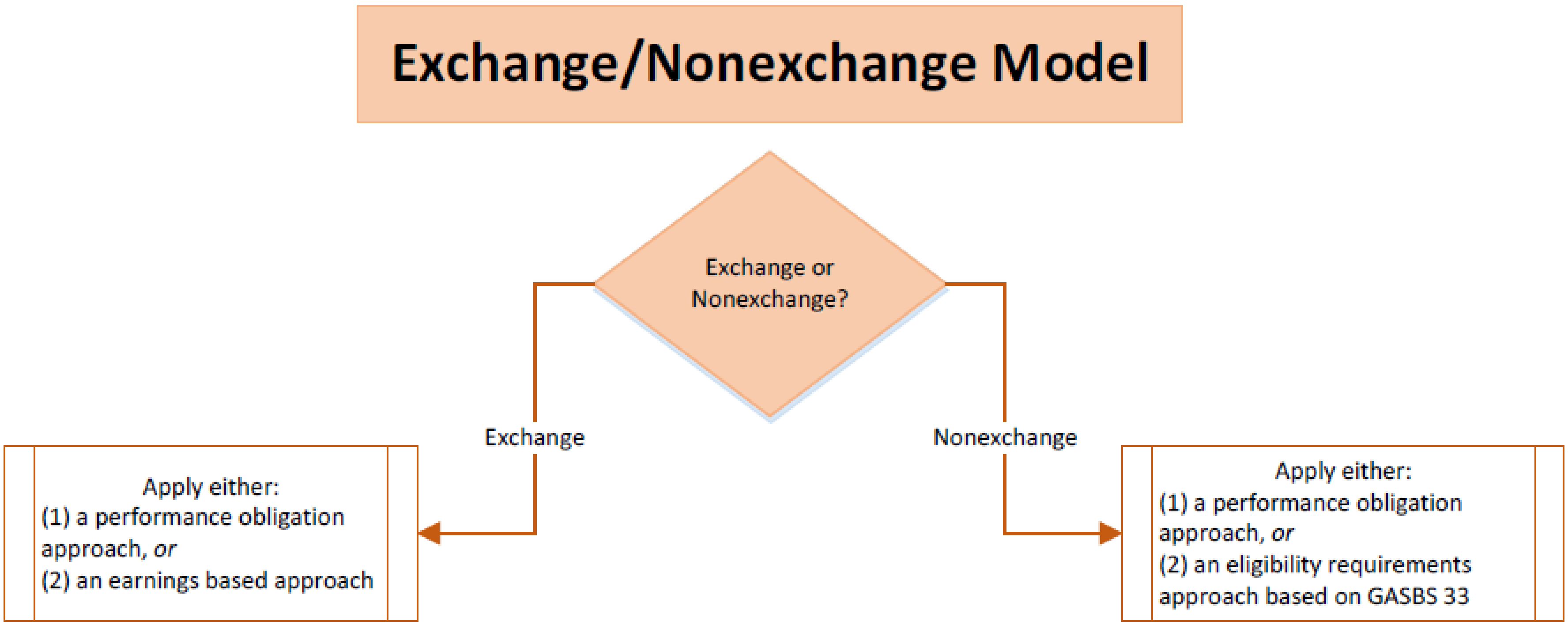


Revenue / Expense Transactions Reporting Model May Be Decided Based Upon This Decision-Tree (Alternative 1)

TENTATIVE DECISIONS: RECOGNITION

- For transactions that **have a performance obligation**:
  - Revenue and expense would be recognized as the performance obligation is satisfied either at a point in time or over time.
- For transactions that **do not** have a performance obligation:
  - Revenue and expense would be recognized with respect to key characteristics of those transactions
    - PRIME EXAMPLE - **Taxes**

WHAT IS THE EXCHANGE / NON-EXCHANGE MODEL?



Revenue / Expense Transactions Reporting Model May Be Decided Based Upon This Decision-Tree (Alternative 2)

TENTATIVE DECISIONS: EXCHANGE-NONEXCHANGE

- **Derived tax revenues:**
  - Recognition provisions in GASB-33 **are consistent** with the conceptual framework (May not change - *Yet*)
    - Potential modifications to the existing guidance will not be presented in the Invitation to Comment.
- **Imposed nonexchange transactions:**
  - Recognition provisions in GASB-33 **are consistent** with the conceptual framework
    - Additional research needed
- **ITC released – January 2018**
- **Comments were due April 27**
- **Public hearings started**
  - **Earlier in May at GFOA**
  - **May 18 – Burlingame, CA**
  - **May 30th - GASB**

NOTE DISCLOSURE REEXAMINATION

NOTE DISCLOSURES

- **What:** A review of existing standards related to note disclosures except for those required by pronouncements that **have not been effective for at least three years,** (GASB-66 and back in scope (for now) – GASB-72 and forward *excluded*)
- **EXCLUDED:**
  - Leases (GASB-87)
  - Debt extinguishments (GASB-86),
  - Outstanding debt (GASB-88)
  - Conduit debt, and going concern (which are the subjects of separate projects or research)
  - **Could change as part of project approval process**
- **Why:** A comprehensive review of note disclosures has not been conducted since 1997 (GASB-34 / 38)

ALSO – CONCEPTUAL FRAMEWORK PROJECT ON RECOGNITION RESTARTED

BACK TO THE FUTURE

- Project was stopped in 2011
- Key concepts – whether information should be reported in financial statements and more importantly – ***when?????***
  - What messages are financial statements intended to convey?
  - What are the relationships between objectives of financial reporting (users), financial statements (preparation) and measurement of transactions (basis of accounting)
  - What happens when elements are recognized?
  - What should be the threshold to recognize something?
- PV coming in September!
- Exposure Draft – June 2020??
- Final Concepts Statement – February 2022??

DIFFERENCES IN THE ELEMENTS COULD BE.. INTERESTING…

Element	Current Definition (GASB Concepts 4)
Assets	Resources with present service capacity that the government presently controls
Liabilities	Present obligations to sacrifice resources that the government has little or no discretion to avoid
Deferred Outflow of Resources	Consumption of net assets by the government applicable to a future reporting period
Deferred Inflow of Resources	Acquisition of net assets by the government applicable to a future reporting period
Net Position	Residual of all other elements in a statement of net position
Inflow of Resources	Consumption of net assets by the government applicable to the reporting period
Outflow of Resources	Acquisition of net assets by the government applicable to the reporting period

DIFFERENCES IN THE ELEMENTS COULD BE.. INTERESTING…

Element	POTENTIAL DEFINITION
Assets	Assets would include those from short-term transactions that are receivable at period-end as well as cash and other financial assets that are available to be converted to cash or are expected to be consumed in lieu of cash within the subsequent operating cycle. Short-term transactions are those that normally are due to convert to or require the use of cash (or other financial assets) **within one year from the inception of the transaction.** Assets arising from transactions that **normally are long-term** would be recognized when payments become due because the transactions involve structured payment terms.
Liabilities	Liabilities would include those arising from short-term transactions that are payable at period-end. Principal on long-term debt and other long-term liabilities would be recognized when they become due because the transactions involve structured payment terms.

DIFFERENCES IN THE ELEMENTS COULD BE.. INTERESTING…

Element	POTENTIAL DEFINITION
Deferred Outflow of Resources	Outflows of resources that do not meet the definition of an asset and are inherently related to **future spending.**
Deferred Inflow of Resources	Inflows of resources that do not meet the definition of a liability and are inherently related to **future spending.**
Net Position	Not addressed yet, but likely similar to today
Inflow of Resources	Inflows of resources for a reporting period would be recognized for **short-term transactions**, such as tax levies, grants, and investment earnings, **as the underlying transaction occur**s and for **long-term transactions as they mature.**
Outflow of Resources	Outflows of resources for a reporting period **would be recognized as spending occurs for the period.** Spending would not refer exclusively to cash payments. Spending would include **(a) short-term transactions**, such as acquiring goods, services, and capital assets, as they occur **and** (b) **payments on long-term transactions as they mature.**

TOTAL PROJECTS TIMELINE

	Financial Reporting Model	Revenue / Expense Project	Note Disclosure Project	Recognition Concepts Statement
2018	Preliminary Views	ITC	Research	Preliminary Views
2019	Deliberations	Preliminary Views	Due Process Document?	Deliberation
2020	Exposure Draft	Deliberations	Unclear	Exposure Draft
2021	Deliberations	Exposure Draft		Deliberation
2022	**Final**	**Final NOW 2023**		**Final**
Unknown	Implementation			

Tentative – Subject to Change at Any Time

AUDIT UPDATE AND....

CPAs & BUSINESS ADVISORS

EYE OF THE CYBER STORM

Managing Cyber Security Risks

EQUIFAX DATA BREACH

Occurred: May – July 2017
Discovered: July 29, 2017
Announced: September 7, 2017

- Hackers took advantage of vulnerability in unpatched web server
- Compromised personally identifiable information for 143 million people
- Resulting in over 23 class-action lawsuits against Equifax
- Already cost the company $4 billion

EQUIFAX

Consumer Reports

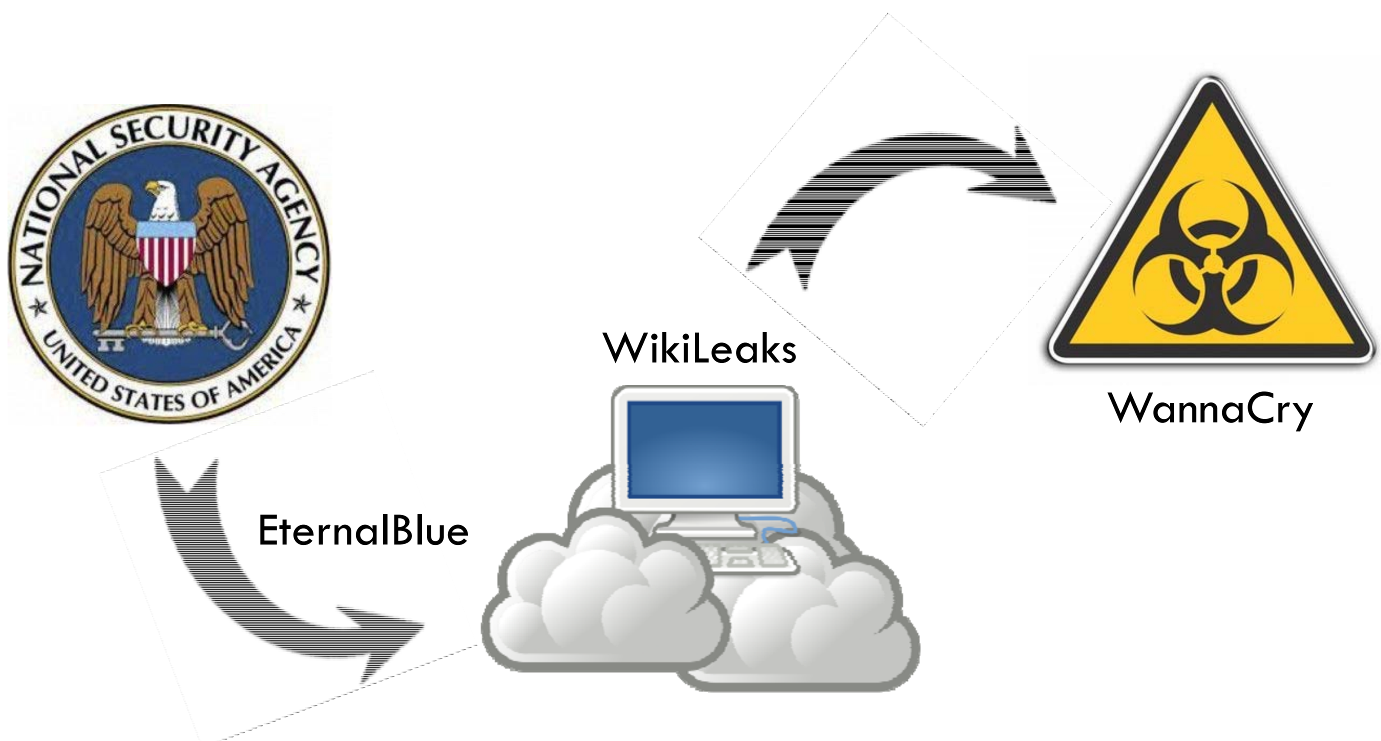
10 Steps on how to Fight Identity Theft

WANNACRY RANSOMWARE

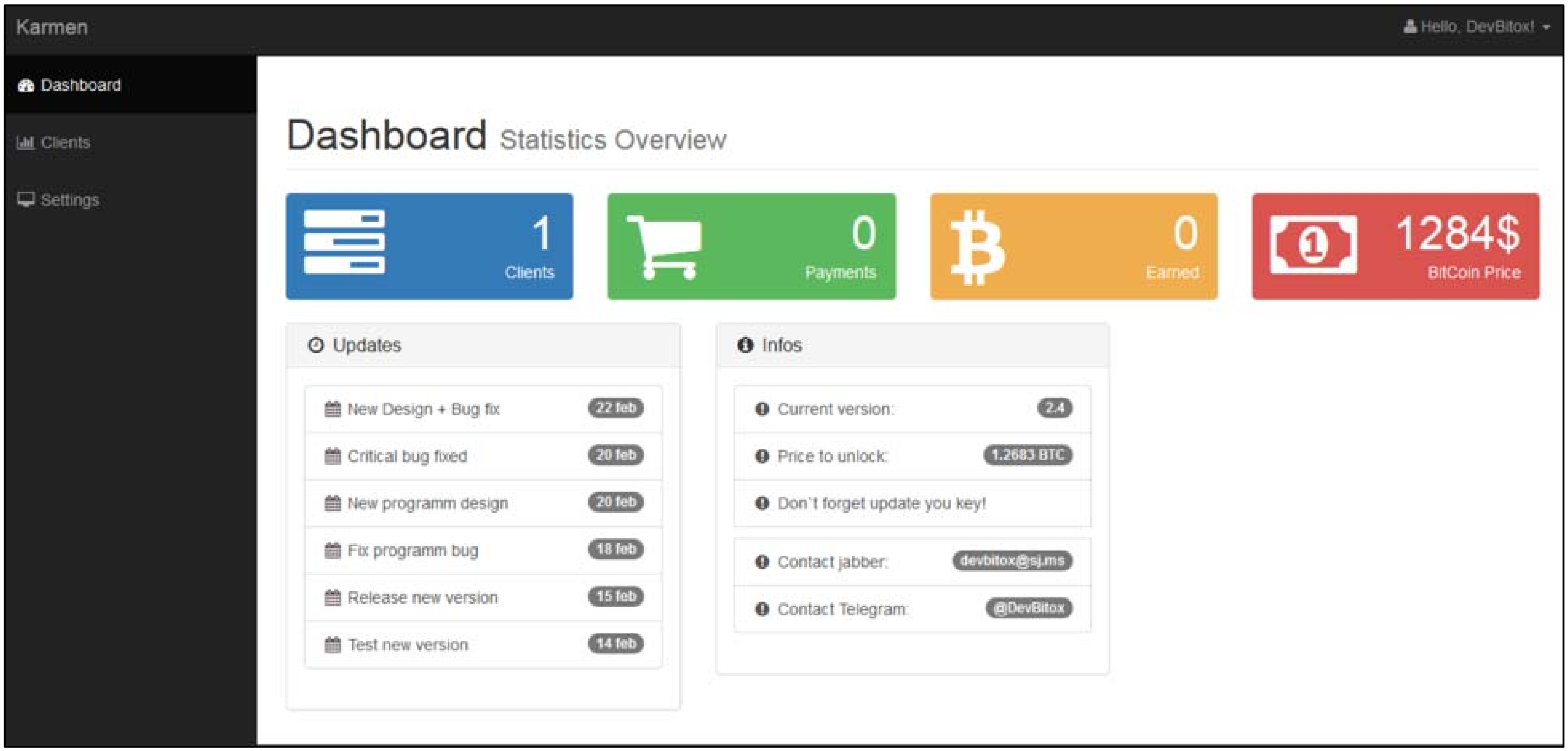
Attacks were first recorded in Europe on May 12, 2017.

Virus embedded in .zip files sent to users as an email attachment.

Exploits a vulnerability in Windows called “EternalBlue”



NOT SOFTWARE AS A SERVICE…
RANSOMWARE AS A SERVICE



CYBER RISK IS BUSINESS RISK

Small construction company in Utah

Victim of ransomware attack.

Data backups compromised.

Unable to sustain business.

COMMON AREAS OF CONCERN

THE HBO DATA BREACHES

Three separate, unrelated data breaches in 2017

All occurred between July 30 and August 16

Indicative of the cyber security challenges facing society

HBO DATA BREACH #1

July 30, 2017
Hackers announce breach.

July 30, 2017
Hackers leak first batch of data.

August 6, 2017
Hackers release second batch of data.

August 9, 2017
Hackers release personal information.

August 11, 2017
Hackers release email from HBO.

ballers

ROOM 104

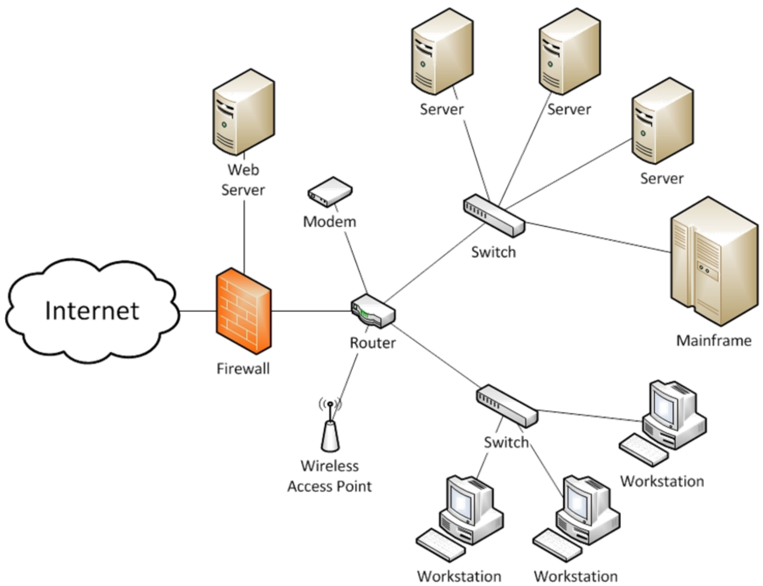
GAME OF THRONES

LESSONS LEARNED FROM HBO BREACHES

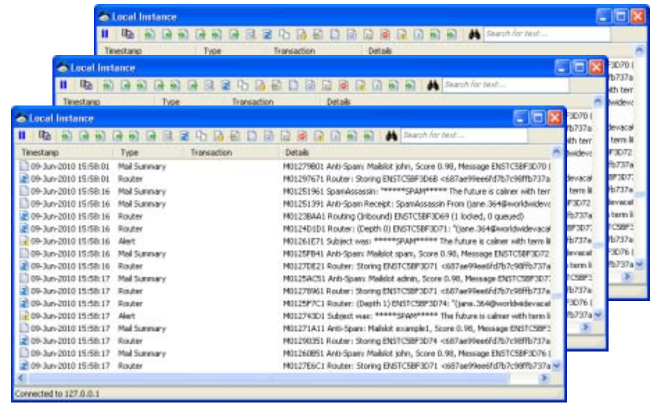
Common areas of concerns where organizations struggle with cyber security:

1. Monitoring, Detection and Response

INCIDENT MONITORING AND DETECTION

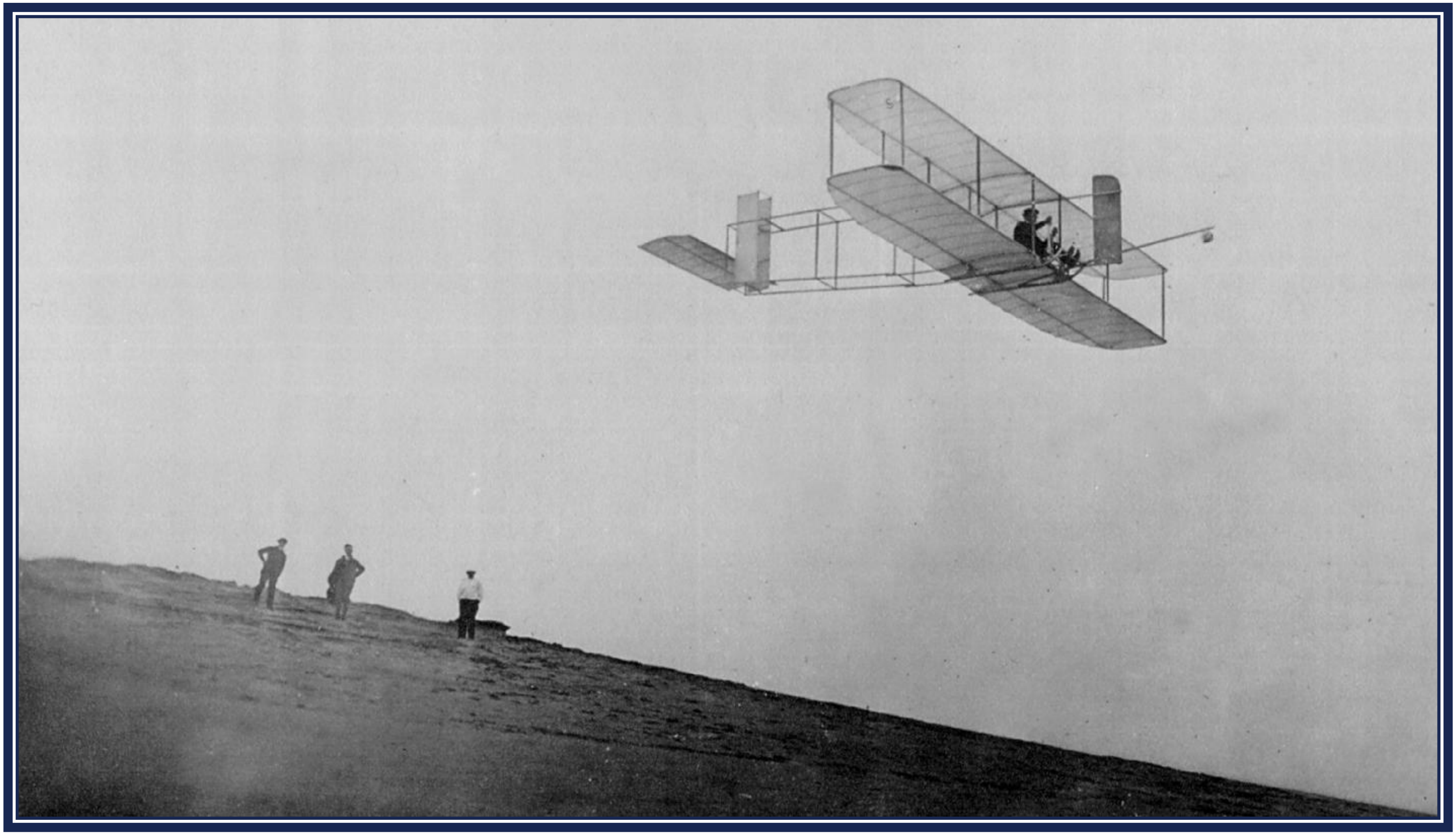


Many, Many Logs



ALERTS &
SIGNATURES

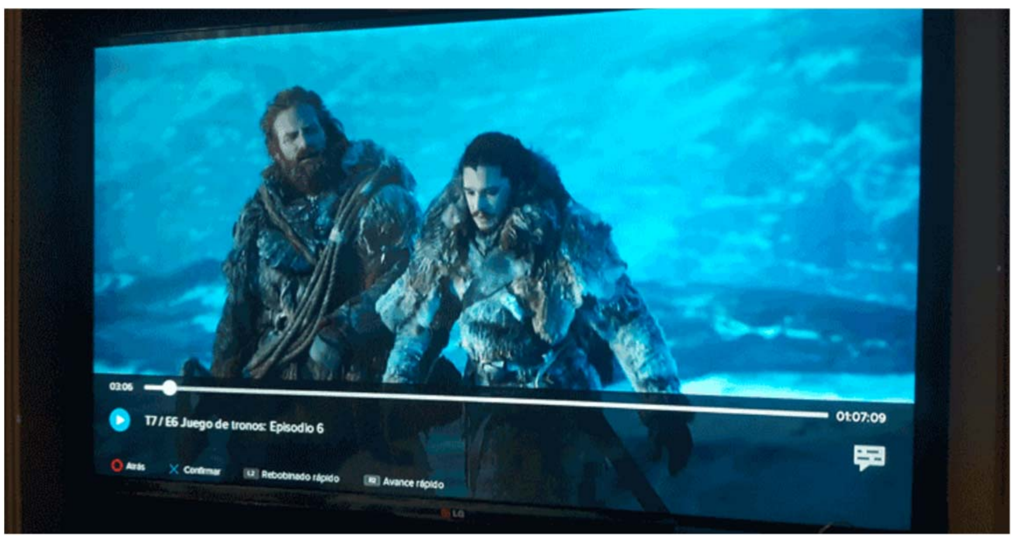
INCIDENT RESPONSE



HBO DATA BREACH #2

August 13, 2017

HBO Spain on-demand accidently broadcast *Game of Thrones* season 7 episode 6 a week before its release date.



GAME OF THRONES

“The error appears to have originated with a third party vendor.”

- *HBO Statement*

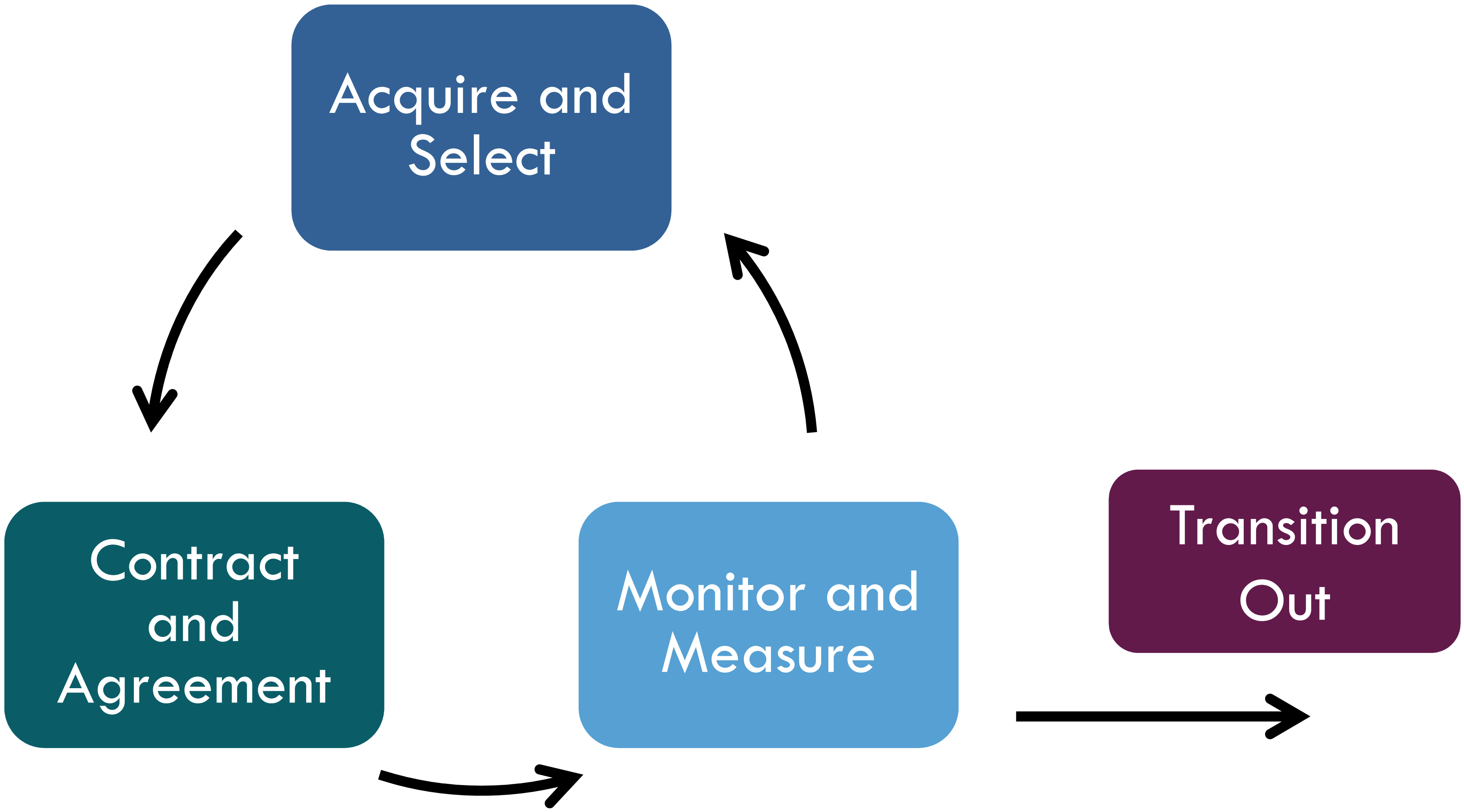
LESSONS LEARNED FROM HBO BREACHES

Common areas of concerns where organizations struggle with cyber security:

1. Monitoring, Detection, and Response

2. **Vendor Management**

THE VENDOR MANAGEMENT CYCLE



IMPROVING VENDOR MANAGEMENT

1. Establish formal vendor management policies and procedures

2. Create listing of all current vendors

3. Rank vendor relationships according to risk

4. Monitor and measure compliance with terms of the contract.

HBO DATA BREACH #3

August 16, 2017

HBO and Game of Thrones official Twitter and Facebook accounts got compromised by hacker group called *OurMine* from Saudi Arabia.

Hackers gained access by using credentials exposed in previous, publicly known data breaches.

LESSONS LEARNED FROM HBO BREACHES

Common areas of concerns where organizations struggle with cyber security:

1. Monitoring, Detection, and Response

2. Vendor Management

3. **Security Awareness Training and Education**

SECURITY AWARENESS TRAINING

Types of Training

- Classroom-Style Training
- Online Training
- Security Awareness Website
- Helpful Hints
- Visual Aids
- Promotions

SECURITY AWARENESS TRAINING

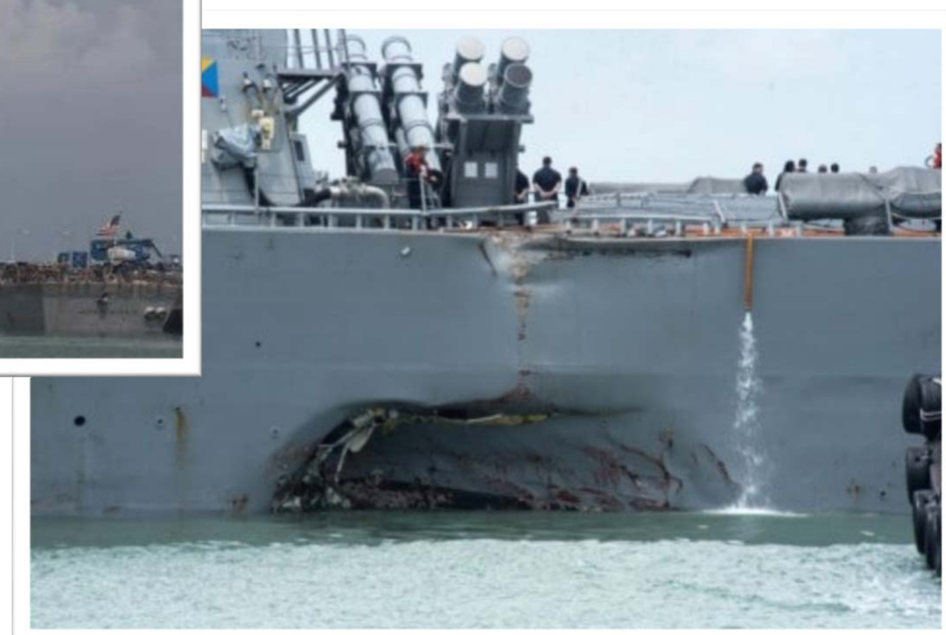
Training Content

- Physical Security
- Desktop Security
- Wireless Networks and Security
- Password Security
- Phishing
- Malware
- File Sharing and Copyright

LESSONS LEARNED FROM HBO (AND THE NAVY)

Incidents and breaches are a reflection of an organization's culture.

Detroit Free Press



Washington Post

2017 COST OF DATA BREACH STUDY

Conducted by IBM and Ponemon – Released in June 2017

$3.62 MILLION

is the average total cost of data breach

$141 DOLLARS

is the average cost per lost or stolen records

27.7 PERCENT

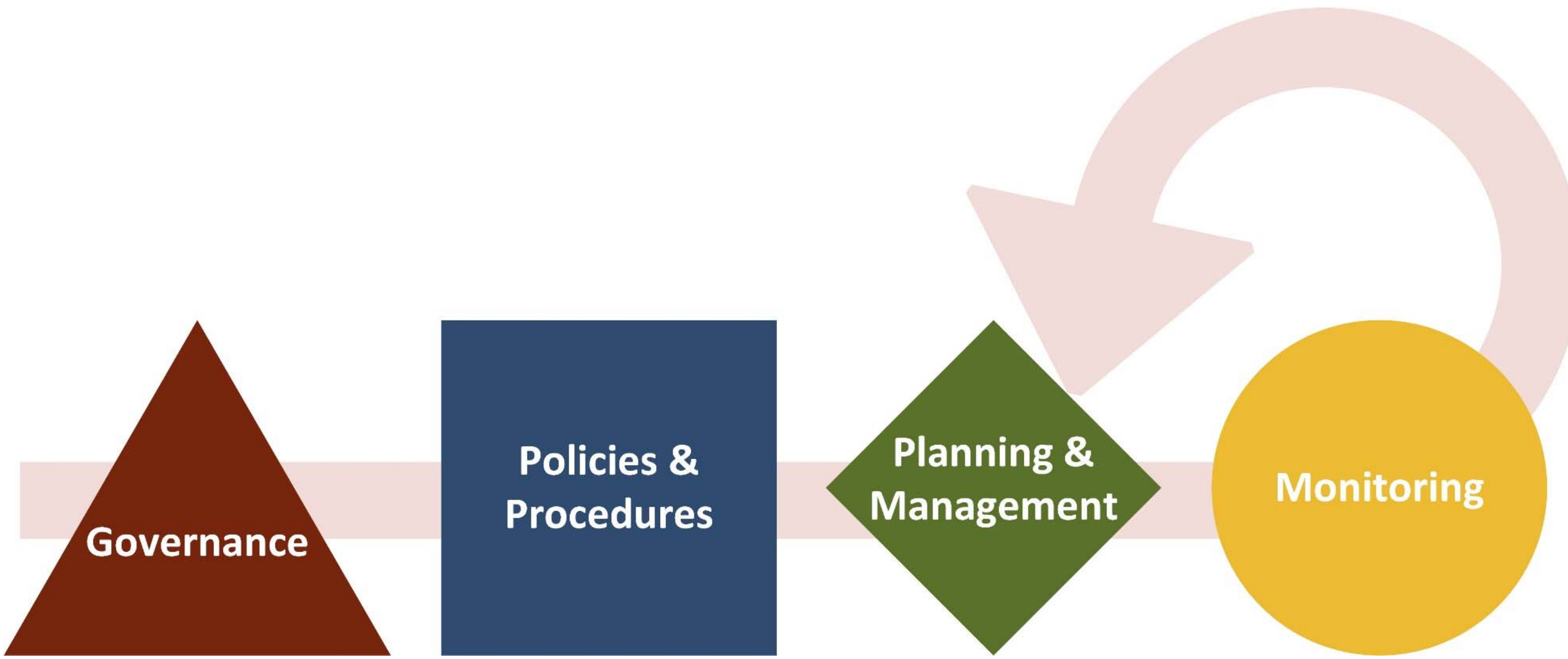
is the likelihood of a recurring material data breach over the next two years

2.1% INCREASE

in the likelihood of a recurring material data breach

GETTING STARTED

ESTABLISHING A CYBER SECURITY PROGRAM



Process for Most Organizations

CYBER SECURITY PROGRAM

- Ownership
- Authority
- Reporting Lines
- Roles & Responsibilities

Some things can't be outsourced.

CYBER SECURITY PROGRAM

- Access Management
- Change Management
- Security Training
- Vendor Management
- Mobile Device Management
- Acceptable Use

Policies & Procedures

If it's not documented…

…it's just a good idea.

CYBER SECURITY PROGRAM

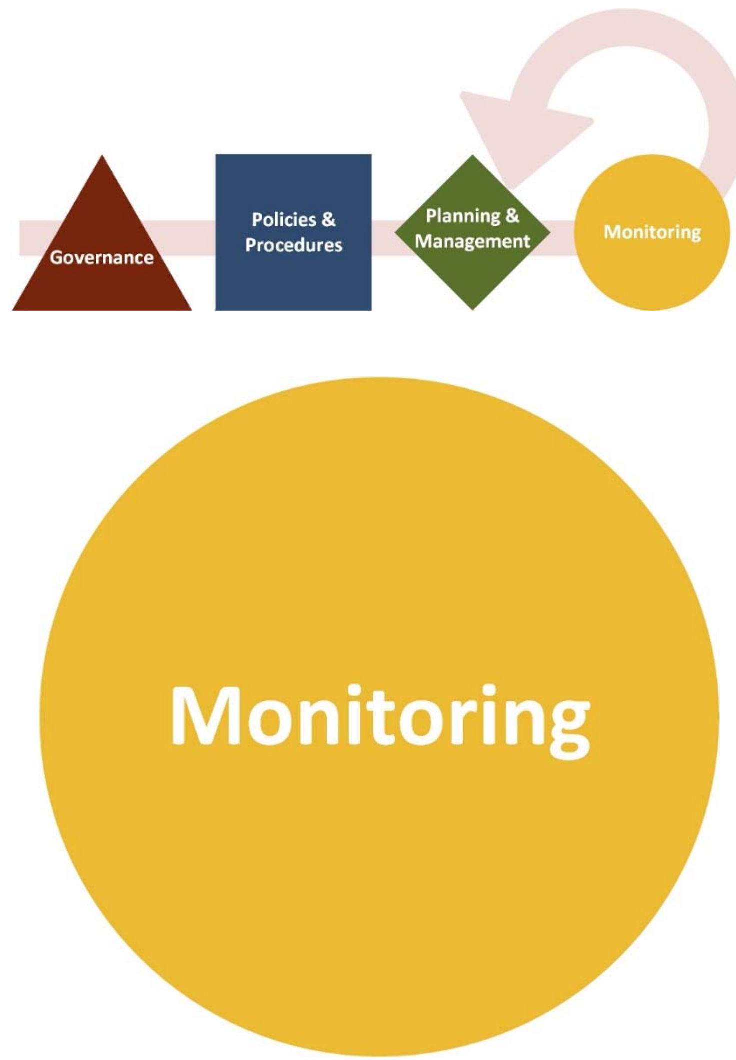
- Conduct Risk Assessment
- Update Strategic Plan
- Review Policies & Procedures
- Assess Cyber Security Liability
- Evaluate IT Outsourcing Activities
- Develop Budget

Involve the right individuals.

Performed Annually

CYBER SECURITY PROGRAM

- Compliance Requirements
- Corrective Action Planning & Execution (Remediation)
- IT Audit
- Penetration Testing



Continue to evaluate your security.

Performed Annually

CONCLUSION

1. Everyone is at risk of being targeted for a cyber attack

2. Be aware of common areas of risk and concern

   - Continuous monitoring
   - Incident response planning
   - Vendor management
   - Security awareness training

3. Establish a program for management of cyber security

COMMON FINANCIAL REPORTING DEFICIENCIES

- Show of hands – how many of you have:
  - Copied language from another government's financial report into your own, knowing the language has nothing to do with your government?
  - Prepared an MD&A using the 'fill in the blank' method?
  - Left financial reporting up to the auditors?

COMMON FINANCIAL REPORTING DEFICIENCIES

- Show of hands – how many of you have:
  - Not bothered to involve decision-makers / governance in the financial reporting process?
  - Not utilized financial statement disclosure checklists to make sure footnotes are complete?
  - Included information in footnotes that was *not essential* (or carried forward from years ago?)

DEFICIENCIES IN TRANSMITTAL LETTER (CAFR ONLY)

- **Common Deficiencies**
  - Incorrect date used
  - Information is copied from other areas of AFR
  - Omissions from GFOA best practices
- **Remedies**
  - Date the transmittal *no earlier* than the report date
  - Follow GFOA best practices
  - Focus on the condition of the government (where its been and where it's headed…)
  - OK to celebrate victories, but try to leave the politics out of it

DEFICIENCIES IN MD&A

- **Common Deficiencies**
  - Using only fill-in the blank analysis
    - Getting increased / decreased wrong in comparison to numbers
  - Not explaining WHY
  - Lack of 2-3 year comparisons
  - Amounts not agreeing to financials (or copying entire financials into MD&A)
  - Copying text from another government / boilerplate
  - Not including currently known facts / decisions
  - Inserting politics / spin

DEFICIENCIES IN MD&A

- **Remedies**
  - Do not fall into the trap of filing in the blanks
    - Consider starting fresh annually
  - Always answer the question "why" not just fill in the blank – but be concise
  - MD&A requires 1 more year than what is presented in government-wide financial statements
  - <u>Summarized</u> information is required in the MD&A, not copies of financials
    - OK to round to thousands for readability
  - Be careful copying from another government – may not apply to yours!
  - Be careful of things happening after the fiscal year that should be disclosed in currently known facts.. (it's all on the internet anyway)
  - Stick only to the facts – don't speculate
  - Have someone skilled in proofreading read it before it goes out!

DEFICIENCIES IN GOVERNMENT-WIDE FINANCIALS

- **Common Deficiencies**
  - Not recognizing deferred inflows of resources vs. deferred / unavailable / some other revenue or vice versa
  - Not recognizing deferred outflows of resources vs. expenses
  - Still using *net assets* vs. **net position**
  - Miscalculating net investment in capital assets
- **Remedies**
  - Keep GASB-65 handy (or keep GASB website bookmarked or have *Codification* on your desk)
    - GASB tells preparers when to use deferred inflows /outflows
  - Do a word search on 'net assets'
  - Utilize proper calculation of net investment in capital assets

NET INVESTMENT IN CAPITAL ASSETS (UTILIZE RIGHT TITLE BY THE WAY…) [GASB COD SEC 2200.118, .709-1-17]

- Capital assets *less*
  - Depreciation
  - Remaining balances of *direct debt* used for construction / acquisition etc. (include retainage, discounts, premiums)
  - Deferred inflows of resources associated with direct debt used for construction / acquisition (derivatives)
- *Plus*
  - Deferred outflows of resources associated with debt (derivatives)
- DO NOT COUNT
  - Debt used to finance discretely presented C/U capital assets or operations
  - Equity interests in joint ventures
- *Significant* unspent proceeds of capital related debt – do not include portion of debt or deferred inflows related to unspent amount

DEFICIENCIES IN FUNDS

- **Common Deficiencies**
  - Carrying forward / miscalculating major funds
  - Not presenting a fund even though there are operations / balances
  - Fund balance issues
    - Reporting restricted improperly
    - Negative assigned fund balance
    - Using 'reserved', 'unreserved', 'undesignated'
    - Showing encumbrances
  - Improper fund classification

DEFICIENCIES IN FUNDS

- **Remedies**
  - Always understand that major fund calculation leads to audit reporting – justify changes, [even if qualitative], prior to auditors arrival
  - Have a good relationship with governance to recognize fund changes
    - Best practice is to have sign offs on fund creation / changes
  - Keep GASB-65 handy (or keep GASB website bookmarked or have *Codification* on your desk)
    - GASB tells preparers when to use deferred inflows /outflows
  - Understand the differences between special revenue, capital projects, enterprise and other funds

DEFICIENCIES IN COMPONENT UNIT REPORTING

- **Common Deficiencies**
  - Misclassifying blended and discretely presented component units
  - Not including a component unit
  - Carrying to primary government <u>all</u> discretely presented component unit note disclosure instead of what is *essential*
- **Remedies**
  - Review all component unit relationships and legislation changes annually
    - Use checklist for blended / discrete based on GASB Cod Sec 2100 (GASB 14 as amended)
  - Question why note disclosure is essential when carrying from a discretely presented component unit to the primary government

SPEAKING OF NOTE DISCLOSURES - DEFICIENCIES IN NOTES

- **Common Deficiencies**
  - Carrying forward notes from years past that have nothing to do with current operations (usually found in debt)
  - Including note disclosure on *non-essential* or immaterial elements (example – inventory)
  - Including all discretely presented component unit note disclosure in the primary government (see previous)
- **Remedies**
  - Focus on the language in the following slide (GASB Cod Sec 2300.102 and .105 (GASB 34, par. 113 and GASB 14, par. 63, as amended)
  - Utilize checklist for disclosure
    - As of GASB-87, 30 elements are either in SSAP and other essential notes
    - 64 more are entity – specific (specific situations)

KEY PARAGRAPHS IN GAAP ON NOTE DISCLOSURE

.102 - The notes to the financial statements **should communicate information essential for fair presentation of the basic financial statements** that is not displayed on the face of the financial statements. As such, the notes form an integral part of the basic financial statements.

- Notes should focus on the primary government—specifically, its governmental activities, business-type activities, major funds, and nonmajor funds in the aggregate.

.105 - Determining which discretely presented component unit disclosures are essential to fair presentation **is a matter of professional judgment** and **should be done on a component unit-by-component unit basis**. A specific type of disclosure might be essential for one component unit but not for another depending on the individual component unit's relationship with the primary government.

DEFICIENCIES IN RSI / SI / STATISTICAL SECTION (CAFR ONLY)

- **Common Deficiencies**
  - Not following GAAP RSI, including
    - Notes where required
    - Presenting 10 years where available
    - Presenting non-GASB required SI in RSI or vice versa
    - RSI / SI / Statistics do not agree to financials
- **Remedies**
  - Use a checklist for RSI (9 potential elements, including MD&A)
  - If notes to RSI are required, limit to elements in GAAP
  - If 10 years are available, present, otherwise disclose
  - If presenting SEFA or other compliance (bond compliance), clearly indicate they are SI
  - Have someone other than you review RSI / SI / statistics

TOOLS YOU SHOULD USE

- *GASB Codification of Governmental Accounting and Financial Reporting Standards* IS YOUR BEST FRIEND
  - Contains all GASB 'category A' GAAP
  - Allows you to stop remembering GASB Statement no. XX is for Y purpose…
  - In a logical order
  - Updated annually
- Checklists are readily available
  - GFOA
  - CCH Wolters Kluwer
  - PPC

GASB *CODIFICATION* ORGANIZATION

- 5 Parts with an appendix
  - General Principles
  - Financial Reporting
  - Measurement
  - Specific Balance Sheet and Operating Statement Items
  - Stand-Alone Reporting – Specialized Units and Activities

GENERAL PRINCIPLES

- GAAP Hierarchy (GASB 76)
- Summary Statement of Principles (NCGA 1 as amended)
- GAAP and Legal Compliance (NCGA 1, GASB 34)
- Fund Accounting (NCGA 1, GASB 54)
- Reporting Capital Assets (GASB 34, 42, 51, 62, 72)
- Reporting Liabilities (GASB 34, GASBI-6, GASB 38, 49)
- Basis of Accounting (NCGA1, many others)
- The Budget and Budgetary Accounting (NCGA1, GASB 34)
- Classification and Terminology (many standards)

FINANCIAL REPORTING / MEASUREMENT

- Defining the Financial Reporting Entity (GASB 14 etc.)
- Comprehensive Annual Financial Report (GASB 34 etc.)
- Additional Financial Reporting Considerations (GASB 56, 62)
- Notes to Financial Statements (aka the Holy Grail…)
- Budgetary Reporting (NCGA 1, GASB 34)
- Cash Flows Statements (GASB 9, 34)
- Segment Information (GASB 34)
- Reporting Entity Component Unit, Presentation and Disclosure (GASB 14 etc)
- Supplemental and Special-Purpose Reporting (GASB 62)
- Statistical Section (GASB 44)
- Interim Financial Reporting (NCGA 1)
- Measurement is only 1 section – Fair Value Measurement (GASB 72)

SPECIFIC BALANCE SHEET AND OPERATING STATEMENT ITEMS / STAND-ALONE REPORTING – SPECIALIZED UNITS AND ACTIVITIES

- Both in alphabetical order
  - Part IV - Bond, Tax and Revenue Anticipation notes to Unemployment Compensation Benefit Plans – 45 sections
    - Not all will apply
  - Part V – For specific elements, primarily in stand-alone reports or specific circumstances
    - Ranges from Bankruptcy to Utilities reporting
    - Separate sections for
      - Colleges and Universities
      - Hospitals
      - Insurance and Investment Pools
      - Pensions / OPEB plans
      - Regulated Operations

WITHIN EACH SECTION, THE FOLLOWING GUIDANCE

Paragraph Range	Guidance Elements
.101-.499	Standards
.501-.599	Definitions (in alphabetical order)
.601-.699	GASB *Technical Bulletins* relating to the Section
.701-.799	GASB *Implementation Guide* questions and answers related to the Section
.801-.899	AICPA Literature cleared by the GASB
.901-.999	Non-authoritative discussion (supplemental guidance and illustrations)

- GASB standards' *Basis for Conclusions* not included even though the *Basis* is important for understanding the standards section
- *Implementation Guide* questions are included – no need to use separate volumes
- Illustrations include *Implementation Guide* illustrations, not just standards' illustrations

THE UNIFORM GUIDANCE AND PROCUREMENT – AKA – CAN WE EVER GET IT RIGHT???

200.302 – *REMINDER* - KEY ELEMENTS OF FINANCIAL MANAGEMENT

- Expend and account for federal awards **in accordance with state laws** that govern non-federal funds – accounting systems must
  - Document compliance with all federal terms, conditions etc., to prepare required reports, including:
    - Records retention
    - Records transfer
    - Storage
    - Access
    - Restriction of public access to records
  - Identify federal awards, including required information (CFDA number, name of agency etc.)
  - Have accurate, current and complete disclosure of financial results
  - Identify the source and application of federally funded activities
  - Effectively control assets / funds etc.
  - Allow comparison of expenditures with budget amounts
  - Have written procedures for payments and allowable costs
- ALL = INTERNAL CONTROLS

KEY DIFFERENCES SPECIFIC TO STATES (PROCUREMENT)

SECTION IN UG	GUIDANCE	STATES	NON-STATES (INCLUDING SUBRECIPIENTS)
317	**States must use the same policies and procedures for procurements as from non-federal funds**	**YES**, unless FAR required	Not Applicable (N/A)
318	General Procurement Standards	N/A	Yes
319	Competition	N/A	Yes
320	Procurement Methods	N/A	Yes
321	SBE / MBE / WBE / Labor Surplus	N/A	Yes
322	Procurement of Recovered Materials	Yes	Yes (political subdivisions only)
323	Contract cost / pricing	N/A	Yes
324	Federal awarding agency / PTE review	N/A	Yes
325	Bonding requirements	N/A	Yes
326	Contract requirements (Appendix II)	Yes	Yes

OTHER KEY DIFFERENCES SPECIFIC TO STATES (PROCUREMENT)

Requirement	Section	STATES ONLY	NON-STATES ONLY
Additional audit procedures imposed by the State / Pass-through entity on subrecipients based on law / risk – could involve major program determination	AICPA GAGAS Guide 2018 pars. 1.10, 7.27 (for separate compliance audits) [Former A-102 requirement]	If required by law / agreement	Potentially if PTE
Designation of specific clusters of programs for subrecipient compliance	AICPA GAGAS Guide 2018, par. 10.29	If required by law / agreement	Not applicable

OTHER KEY DIFFERENCES SPECIFIC TO STATES (PROCUREMENT)

Requirement	Section	STATES ONLY	NON-STATES ONLY
Specific compliance requirements for public agency costs / procurement (PACAP operations, which may include equipment purchases)	200 Appendix VI, (A) [TANF, Medicaid, SNAP, Child Support Enforcement, Foster Care, Adoption Assistance, SSBG typical programs]	YES	No
States must use, manage and dispose of equipment in accordance with State laws and procedures	200.313(b)	YES	No, but all other 200.313 subsections apply.

OTHER IMPORTANT ELEMENTS RELATED TO PROCUREMENT

- The so-called 'grace period' delaying implementation of federal procurement standards **ends for June 30th year ends – 7/1/2018**
  - December year ends ended 1/1/18
  - September 30th – another few months (10/1/18)
- OMB has indicated that this will be the final grace period…
- Only applies to federal awards, but must have consistent policies and procedures… so…
  - Does not apply to indirect cost pools

UNIFORM GUIDANCE REQUIRES (200.318) – NON-STATES

- Documented procedures that provided conformance to applicable federal law and uniform guidance requirements
  - Common question – are there any policies you can send us??
    - Examples on internet but be careful complies with uniform guidance and your entity's operations
- Must have standards of conduct covering conflicts of interest
- Time and materials contracts may be used if suitable – requires a high degree of oversight

UNIFORM GUIDANCE PROCUREMENT METHODS

Method	Threshold
Micro-purchase	Not to exceed $3,500… BE CAREFUL
Small purchase procedures	More than micropurchase, but less than **simplified acquisition threshold** (SAT) ($150,000) (48CFR 2.1) (41 USC 1908)
Sealed bid	Greater than SAT
Competitive proposal	Greater than SAT
Noncompetitive proposal	Greater than micro-purchase

- Micropurchase threshold is at least $10,000 for research programs at DOD, DOD contracts with higher education, research not for profits, independent research institutes (PL 114-328 sec. 217)
- Also at least $10,000 for NSF, NASA, NIST (PL 114-329 sec. 207)
- ***Caution:*** Auditors will be looking for 'break up' purchases just to get around threshold

VARIOUS PROCEDURES

- Small purchase procedure (SAT) is subject to change
  - Price or rate quotes must be obtained from an *adequate* number of *qualified sources* (no definition of adequate or qualified)
- Sealed bids required for construction
  - Must have adequate number of 'known suppliers'
  - Publicly advertised
  - Invitation to bids and opening procedures detailed
- Competitive proposals required when greater than SAT – non-construction
  - RFPs
  - Adequate number of qualified sources
  - Written method for technical evaluations and selection
  - Qualifications-based procurement
- Noncompetitive proposals if single source, inadequate competition, emergency, but needs written approval

SOLID WASTE RECOVERY ACT AND STATES (.322)

- State may have to comply with Section 6002 of the Solid Waste Disposal Act / Resource Conservation and Recovery Act
  - Items designated by EPA in 40 CFR 247 to use only the highest percentage of 'recovered materials' (recycling) practicable
  - Procurement must be above $10,000 in current year for item (or similar items in prior year were more than $10,000)
  - Must maximize energy / resource recovery (aka recycling)

CONTRACT PROVISIONS (.326)

- Contract provisions must apply provisions of Uniform Guidance, Appendix II
  - If greater than SAT – must include remedies for breaches of contracts
  - If greater than $10,000 – must address termination for cause / convenience and basis for settlements
  - Must include Equal Employment Opportunity elements (as applicable)
  - Must include Davis / Bacon (as applicable)
  - Must include Contract Work Hours and Safety Standards Act provisions (as applicable)
  - May be provisions regarding inventions funded by grants, clean air act provisions, federal water pollution control act and others
  - Debarment, suspension language needs to be included
  - Anti-lobbying language (if over $100,000)

BASIC PRINCIPLES OF COST (200.400)

- Sound management principles are a given
- State has responsibility to administer the funds consistently and account for them as such
- Accounting principles must be consistent and cost principles include documentation supporting the accumulation of costs
- Review, negotiation, approval of cost allocation plans will focus on this consistency
- The recipient cannot make a profit off of the federal government

PURCHASING AND CAPITAL EXPENDITURES (200.439)

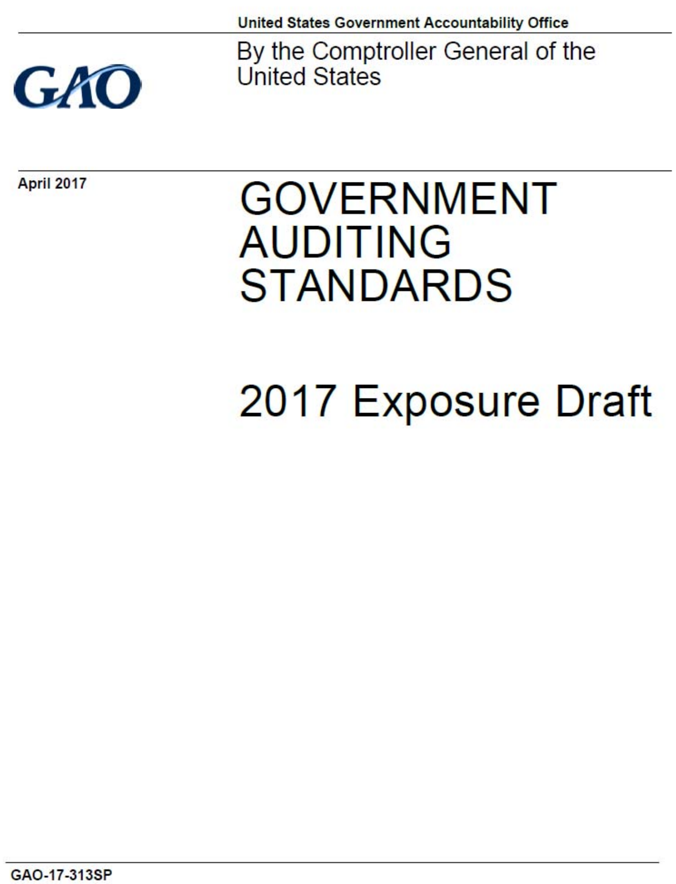
- Definitions of capital expenditures (.13), equipment (.33), 'special-purpose equipment (.89), general-purpose equipment (.48), acquisition cost (.02) and capital assets must be followed (.12) where applicable
  - General-purpose equipment and land are not allowed to be direct charged, unless preapproved by federal agency or PTE
  - Special-purpose equipment (medical / scientific, etc.) *are allowed to be direct charged*
    - $5,000 or more must be preapproved
  - Capital improvements to land, buildings, equipment that improve useful life are unallowable as direct costs unless preapproved
    - Must use depreciation
- If preapproved as a direct cost – charge to the period incurred
- Even if change to capitalization threshold, still depreciate
- Disposal procedures are similar to other capital assets
- Equipment and other capital expenditures are not indirect charges

WHAT'S THE DEAL WITH THE PROPOSED YELLOW BOOK?

ICYMI….

- The “Yellow Book” = GAGAS
- GAGAS = Generally Accepted *Government* Auditing Standards
  - Overlay of Generally Accepted Auditing Standards (GAAS) issued by the Auditing Standards Board
- GAGAS contains the framework for ensuring that auditors possess competence, integrity, objectivity, and independence in planning, conducting, and reporting on their work
- GAGAS ***is required*** when audits of states, local governments, tribal nations and not for profits meeting certain criteria in the Uniform Guidance (Title 2, Code of Federal Regulations, Part 200) (Uniform Guidance or UG)
  - Also required by State Law, Regulation, Outside Grantors, Lenders etc.
- Applying for federal grants ***may*** require GAGAS

PROPOSED REVISIONS



United States Government Accountability Office

GAO

By the Comptroller General of the United States

April 2017

GOVERNMENT AUDITING STANDARDS

2017 Exposure Draft

GAO-17-313SP

- Format and organization of GAGAS
- Auditor preparation of financials **is a *significant threat to independence***
- 3 party arrangements in government
  - State auditor engages independent auditor for separate auditee
- Specialists
- CPE – **Breaking News – stay tuned!**
  - **4 Hours Required CPE each time new version of GAGAS released**
- **Quality control and peer review**
- Clarified definition of waste -**Breaking News – stay tuned!**
- SSAE 18 and SSARS 21 (Reviews) incorporated into GAGAS
- Application of COSO to GAGAS
- **Final issuance expected - Breaking News – stay tuned!**

PROPOSED REVISIONS (CONTINUED)

- Enhanced internal control testing for
  - Financial audits
  - Examinations
  - Performance audits
- New GAGAS provisions for review engagements
- Updated management assertions in examinations and reviews
- Supplemental guidance from 2011 Yellow Book appendix is removed or incorporated into chapters as applicable

CHAPTERS IN THE PROPOSED GAGAS

Chapter 1 – Government Auditing: Foundation and Principles for the Use and Application of Generally Accepted Government Auditing Standards

Chapter 2 – General Requirements for Complying with Government Auditing Standards

Chapter 3 – Ethics, Independence and Professional Judgment

Chapter 4 – Competence and Continuing Professional Education

Chapter 5 – Quality Control and Peer Review

Chapter 6 - Standards for Financial Audits

Chapter 7 - Standards for Attestation Engagements and Reviews of Financial Statements

Chapter 8 – Fieldwork Standards for Performance Audits

Chapter 9 – Reporting Standards for Performance Audits

WHAT IS GOING ON IN THE PROPOSED GAGAS

Chapter 1

- The types of GAGAS users are addressed
- Alignment to Integrated Audits (if necessary) due to SAS-130
- Expanded Descriptions of Attestation Engagements, Reviews of Financial Statements and Performance Audits
- Definitions of common terms used in GAGAS
  - Engaging Party
  - Audited Entity
  - Responsible Party
  - Specialist

TYPES OF GAGAS USERS

- GAGAS includes standards that are used by
  - Auditors
  - Audit organizations that audit government entities (example - state auditors / inspectors general)
  - Entities that receive government awards and other entities
- Types of users that *may* be required or *may elect* to use GAGAS include
  - Contract auditors – focus on government acquisitions and contracts
  - CPA firms
  - Federal Inspectors General
  - Federal Agency Internal Auditors
  - Municipal Auditors – (elected or appointed at cities, county other)
  - State Auditors (includes DC and territories)
  - “Supreme Audit Institutions” – In the US and elsewhere – includes GAO and similar internationally

COMMON DEFINITIONS – USE FOR YOUR REFERENCE

- **Attestation Engagement** – Examination, review, AUP conducted under GAGAS attestation standards related to subject matter or an assertion that is the responsibility of the other party
- **Audit** – Financial or performance audit in accordance with GAGAS
- **Audit Organization** – Government audit entity or Public Accounting or Other Audit Entity that performs GAGAS engagements
- **Audit Entity** – The entity subject to a GAGAS engagement, no matter what type of engagement
- **Auditor** – An individual performing work in a GAGAS engagement *regardless of job title*. May include auditor, IT auditor, analyst, practitioner, evaluator, inspector or similar
- **Control objective –** The aim of specific controls addressing risks related to objectives
- **Engagement** – Financial audit, attestation, review, performance audit in accordance with GAGAS

COMMON DEFINITIONS – USE FOR YOUR REFERENCE

Engagement Team (or Audit Team) – Professional staff members that plan, direct, perform fieldwork or report under GAGAS

Engaging Party – Party requesting or requiring a GAGAS audit

Entity Objective – The audit entity's goals, mission, strategic plan, compliance with laws and regulations

External Audit Organization – Audit organization that issues reports to 3rd parties external to the Audited Entity

Internal Audit Organization – Entity that is accountable to senior management & those charged with governance – does not issue reports to external parties

Responsible Party – Party in a GAGAS engagement responsible for subject matter

Review of Financial Statements – Engagement under GAGAS for a Review (SSARS-21 Section 90)

Specialist – Individual / Organization with expertise other than in auditing but assisting in the engagement

WHAT IS GOING ON IN THE PROPOSED GAGAS

Chapter 2

- Expanded guidance on how GAGAS *does not* incorporate the AICPA's Code of Conduct for audits and attestations
  - Recognizes that CPAs may use or may be required to use the AICPA Code

Chapter 3

- **The big deal – expanded standard on preparation of financial statements by auditors – it's a significant threat and needs to be documented how it is remediated**
  - Auditors should
    - Document the threats and safeguards applied to eliminate & reduce threats to an acceptable level ***OR***
    - ***Decline to perform the service***

Breaking News – Final Version Likely to Contain Requirement for Documentation of Skills, Knowledge & Experience (SKE) and safeguards used

WHAT HAPPENS WHEN A ENGAGING PARTY IS DIFFERENT FROM AUDITED PARTY?

- Common occurrence
  - Independence requirements of GAGAS will apply to the relationship between the **auditors and the responsible party**
    - **Not the auditors and the engaging party**
  - Examples:

Engaging Party	Responsible Party
Legislative Body	Executive Agency required to have a performance audit of program operations. **Auditors must be independent of the executive agency**
State Agency	Local government required to have an examination level attestation by a CPA firm to gauge the validity of information provided to the state agency. **CPA firm must be independent of the local government.**
Government Department	Government agency (state auditor) conducts examination level attestation of contractor compliance with the terms and conditions of agreements between the department and the contractor. **Auditor must be independent of the contractor**

WHAT ABOUT AUDITORS IN GOVERNMENT (STATE AUDITORS ETC.)?

- May work under conditions that do not permit independence in accordance with GAGAS
  - Could have statutory requirements to serve in official roles that have a conflict with independence
  - Civil service statutes permit staff members to seek employment with audited entities (e.g. teach at colleges)
- If exists – may have to modify GAGAS compliance in reporting – modify either:
  - Auditors conducted engagement in accordance with GAGAS except for specific applicable requirements that were not followed *or*
  - Because of the significance of the departures from the requirements – the audit was not conducted in accordance with GAGAS.
- When used – should disclose reasons why and how not following the requirement(s) affected or could have affected the engagement and the assurance provided

OTHER STUFF IN CHAPTER 3

- If State Auditor (or similar) provides professional services
  - Auditors act on behalf of a governing body (legislature)
  - State auditor evaluates actions of a responsible party (management of a state agency)
  - Professional services may include (but not limited to)
    - Fraud investigation
    - Reducing risk of management override of controls,
    - Improving governance
- Auditors cannot set direction or accept responsibility for key processes or controls
  - If yes – there is no management participation threat
  - No threat to 2 party arrangement (auditors to public or auditors to governing body) such as estimating the fiscal impact of legislation at a hearing – no threat to independence in that case

THE BIGGEST DEAL IN CHAPTER 3 – 3.88-3.90

Auditors *should conclude* the following services involving preparation of accounting records *impair independence*

- Determining or changing journal entries, account codes, classifications etc., **without obtaining management's approval**
- **Authorizing** or **approving** entity's transactions
- Preparing or making changes to source documents **without management's approval**

THE BIGGEST DEAL IN CHAPTER 3 – 3.88-3.90

Bottom Lines:

In preparing financial statements based on information in the trial balance – auditors will need to:

- Document threats and safeguards applied to eliminate and reduce threats to an acceptable level *or*
- If cannot reduce - decline to perform the services – **See Previous Breaking News**

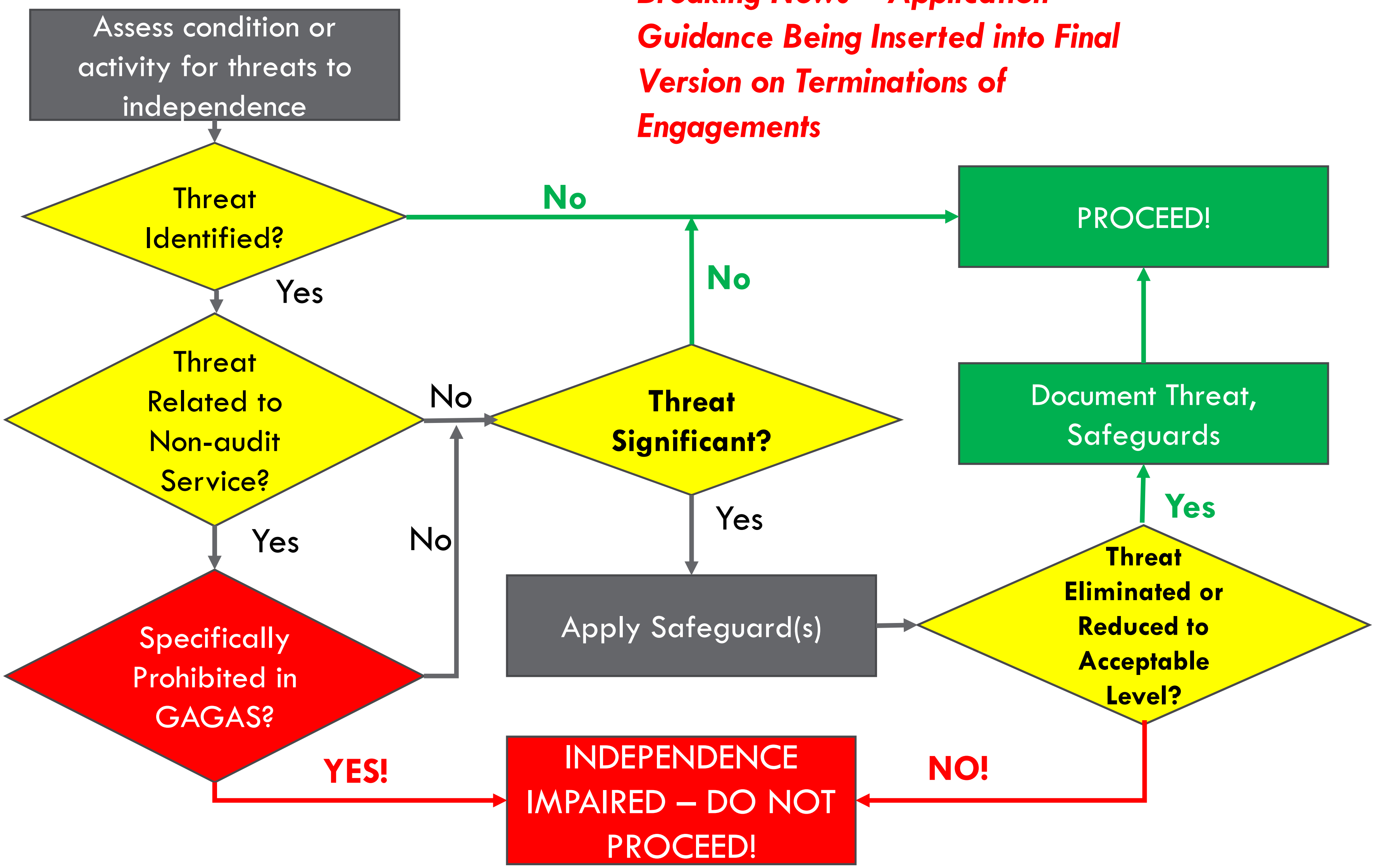
Management is ultimately responsible for the preparation and fair presentation of the financial statements even if auditor drafts

Skills, Knowledge and Experience of the Client May not Be Enough – key paragraph:

3.90 Management is responsible for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework, even if the auditor assisted in drafting those financial statements. Consequently, an auditor's acceptance of responsibility for the preparation and fair presentation of financial statements that the auditor will subsequently audit would impair the auditor's independence.

UPDATED GAGAS CONCEPTUAL FRAMEWORK FOR INDEPENDENCE

Breaking News – Application Guidance Being Inserted into Final Version on Terminations of Engagements



WHAT IS GOING ON IN THE PROPOSED GAGAS

- **Chapter 4 – CPE is the biggest deal for many**
- **GAGAS ... rs of CPE in**
- **Supervi...** ient must be met befo... AGAS engager...
- **Entry-le...** by the end of their ...
- **After ini...** ditors should complete... opic with each revision of the Yellow Book

BREAKING NEWS – Current Yellow Book CPE requirement appearing to be retained

CPE AND GAGAS QUALIFICATION

- CPE should align to relevant GAGAS topics (see following)
- 4 Hours r
  - Should
  - Docume
- 80 Hours ... s (minimum **20 hours**

BREAKING NEWS – Current Yellow Book CPE requirement appearing to be retained

Hours	Sub
24 Hours	Sta ... **cable to aud** ... being conducted – includes the 4 hours of GAGAS topics for GAGAS qualification when applicable
56 Hours	Subject matter or topics that **directly enhance professional expertise to conduct GAGAS engagements**

EXCEPTIONS TO CPE PROVISIONS

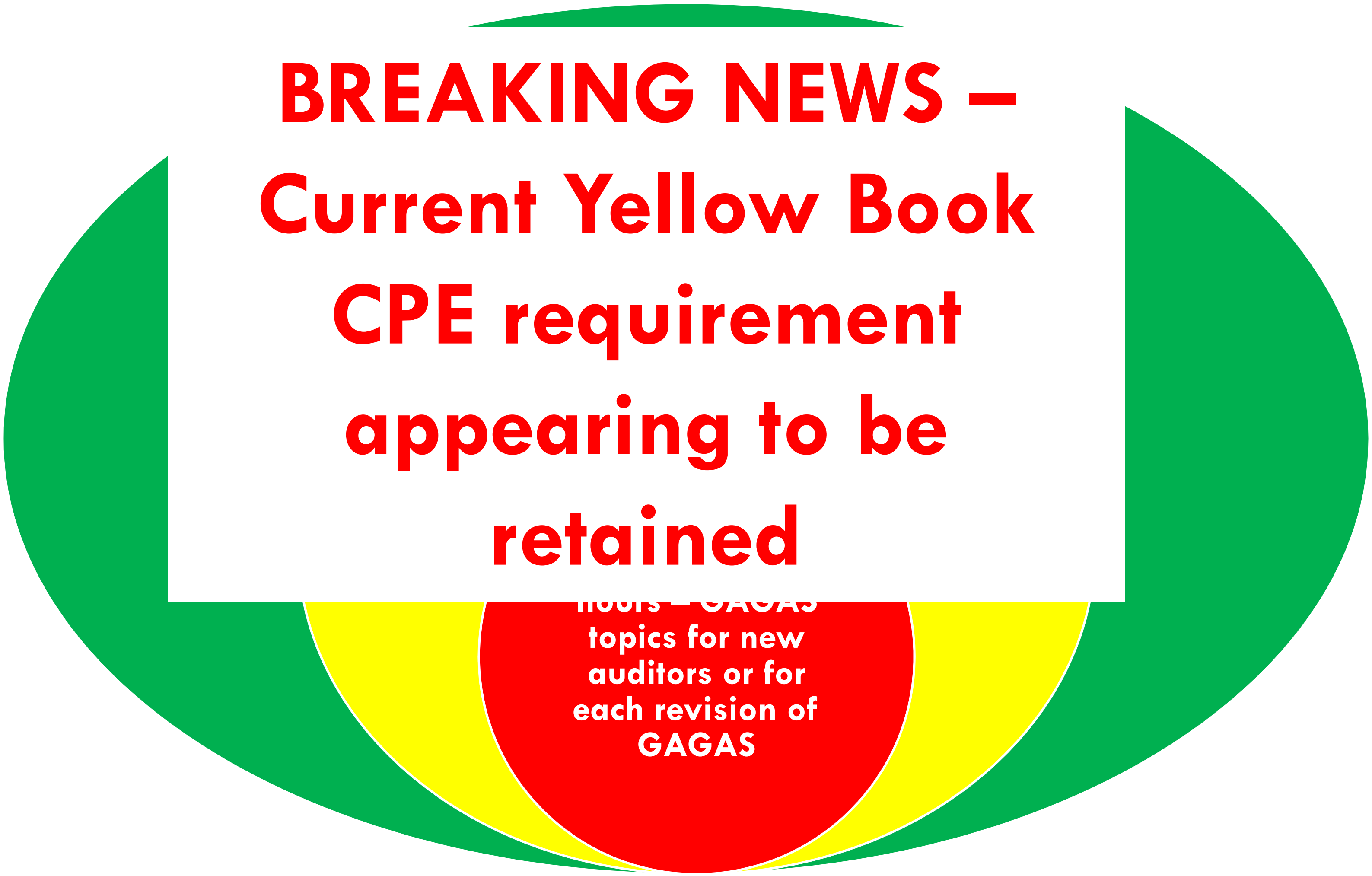
- Exceptions from 56 hour requirement but not 24 if
  - Charg ngagements
  - Are o recting or repor
- Entry lev hours of time to C CPE provisior
- Auditors period can prorate
- Interns m

BREAKING NEWS – Current Yellow Book CPE requirement appearing to be retained

- Over 20 paragraphs of clarifications and application guidance

FOR THOSE WHO NEED A VISUAL AID…

BREAKING NEWS – Current Yellow Book CPE requirement appearing to be retained



COMPETENCY

Addressed by role in the engagement

BREAKING NEWS – Current Yellow Book CPE requirement appearing to be retained

Roles		...ty	Required Level of Proficiency
Entry Level			**Basic level**
Supervisory			**At least an intermediate**
Partners and Directors	**or report on engagements** also **responsible for reviewing engagement quality** prior to issuing the report, for **signing the report,** or both		**At least an advanced**

COMPETENCY OF SPECIALISTS – ALMOST AS BIG OF A DEAL

- Includes guidance for actuaries, appraisers, attorneys, enginee … professi … ts (among others)
  - Quali … ertifications, reput…
    - Relev … gement influe…
  - Sourc … ed to
    - Profe … ding
    - Expe…
    - Auditor's prior experience using their work
    - Knowledge of industry requirements

BREAKING NEWS – Current Yellow Book CPE requirement appearing to be retained

- **Highly controversial** – key question – should GAO set CPE standards for specialists?

PEER REVIEW - THE UNDERLYING ISSUES

- Audit quality is still an issue
  - AICPA has Enhancing Audit Quality Initiative to increase audit quality
- Regulators are scrutinizing Peer Reviews – Focus Areas
  - Oversight of single audit engagements
  - Federal Single Audit Quality Study kicking off soon
  - Federal Quality Control Reviews (QCRs) and Desk Reviews still finding issues
  - Single audits are now a mandatory ('must select') in peer review engagements

Why Were the Changes Proposed?

TOP YELLOW BOOK ISSUES CONTINUE TO BE…

- Engagement team not meeting CPE requirements
- Documentation of Independence
- Failure to meet Yellow Book Peer Review Requirements

Yellow Book Independence Evaluation and Documentation

Engagement Team Selection

Acceptance and Continuance of Single Audit Engagements

Major Program Determination, Percentage of Coverage, SEFA

IC Over Compliance and Compliance Testing (Including Sampling)

Documentation, Documentation, Documentation

Correct Reporting

Correct Reporting of Audit Findings in Both Single Audit Reporting and the DCF

MUSTS OR ELSE…

KEY EXPOSURE DRAFT PROPOSED CHANGES TO PEER REVIEW

- 5.09 - Audit organizations will need to **at least annually** obtain **written affirmation of compliance** with policies and procedures on independence from **all personnel required to be independent**
- 5.12 – Audit organizations must have policies / procedures to only accept engagement if it has reasonable assurance of capability to complete engagement
- 5.20 – 5.41 – Engagement performance, documentation and reporting requirements, review and supervision of engagement work standards updated

KEY EXPOSURE DRAFT PROPOSED CHANGES TO PEER REVIEW

- Key focus areas of engagement performance updated standards:
  - The policies and procedures should require that **experienced engagement team members review the work** of less experienced engagement team members.
    - The audit organization should assign responsibility for each engagement to an engagement team partner or director with authority to assume that responsibility.
  - The audit organization should **establish policies and procedures requiring the audit organization to communicate the identity and role of the engagement partner or director to management** and those charged with governance of the audited entity.

KEY EXPOSURE DRAFT PROPOSED CHANGES TO PEER REVIEW

- Key focus areas of engagement performance updated standards:
  - Policies and Procedures required to **clearly define the responsibilities of the engagement partner or director and communicate them to that individual.**
  - Design procedures to allow for **appropriate consultation to take place on contentious issues**
  - For terminated engagements, auditors should **document the results of the work to the date of termination and why the engagement was terminated** if an engagement is terminated before it is completed and an audit report is not issued.

KEY EXPOSURE DRAFT PROPOSED CHANGES TO PEER REVIEW

- 5.64 – If audit organization affiliated with recognized organization (e.g. State Society) – follow that organization's peer review requirements and additional GAGAS peer review requirements
- 5.65 – If NOT affiliated (also 5.80-5.82)
  - Peer review scope is expanded including documentation of terminated engagements
  - Peer review scope is expanded to include prior peer review reports (if applicable)
  - Future peer review report must be received within 3 years and 6 months from the year-end of the previous peer review

KEY EXPOSURE DRAFT PROPOSED CHANGES TO PEER REVIEW

- Conducting the peer review engagement
  - 5.84 – Written agreement between peer review team and audit organization
  - 5.87 – Review team must possess expertise and leadership to properly supervise team
  - 5.91 – Team must review effectiveness in audit organization's responses to prior corrective action plans

KEY EXPOSURE DRAFT PROPOSED CHANGES TO PEER REVIEW

- Conducting the peer review engagement
  - Peer review team required to determine
    - **Type of peer review rating to issue based on (5.71 & 5.99):**
      - **Observed matter's importance to QC system as a whole**
      - **Nature, causes, patterns and pervasiveness of those matters**
      - **Consideration is both singular and in the aggregate**
    - **Any matters that warrant further consideration by the peer review team and document their evaluation (5.72 & 5.100)**
  - 5.103 – Peer review report will now include a statement that the peer review was conducted in accordance with GAGAS peer review requirements
    - **Pass with Deficiencies or Fails will require written responses to the deficiencies from the audit organization**
      - **Corrective actions already taken**
      - **Target dates for corrective actions (or both)** ***or***
      - **Why corrective action is not considered necessary**

REMAINDER OF DRAFT - FINANCIAL AND PERFORMANCE AUDITS - FOCUS ON WASTE AND ABUSE

- In GAGAS audit, auditors may become aware of waste or abuse that could be quantitatively *or* qualitatively material to the financial statements or data significant to audit objectives
  - Perform procedures to ascertain potential effect
  - Consider potential effect on operations
- **Waste** - act of using or expending resources carelessly, extravagantly, or to no purpose
  - Taxpayers not receiving reasonable value for money in connection with any government-funded activities
  - Involves inappropriate act or omission by parties with control over or access to government resources
    - May not involve violation of law
  - Relates primarily to mismanagement, inappropriate actions or oversight

FOCUS ON WASTE AND ABUSE

- **Abuse** – behavior deficient or improper in comparison to a prudent person considering reasonable necessary business practices given facts and circumstances
  - Excludes fraud and noncompliance with laws etc.
  - Includes misuse of authority for personal interest
  - **Subjective** – auditors **not required** to perform procedures to **detect abuse**, but may be discovered

FINDINGS AND REPORTS

- Expanded requirement to consider potential internal control deficiencies when significant to audit objectives
- GAGAS finding structure is mostly unchanged
- Reporting on Internal Controls, Compliance Provisions of Laws, Regulations, Contracts, Grant Agreements and Instances of Fraud, Waste or Abuse – include
  - Findings on instances of above
  - Fraud that is material quantitatively or qualitatively

BREAKING NEWS – Reporting Requirements for Waste and Abuse to be Removed – emphasis on reporting control deficiencies *that could lead to waste and abuse*

FINDINGS AND REPORTS

- Findings are in writing to audited entity officials when detection of potential instances of
  - Noncompliance with provisions of laws, regulations, contracts, or grant agreements or
  - Fraud, ~~waste, or abuse~~ that have an effect on the financial statements or other financial data significant to the audit objectives that are less than material but warrant the attention of those charged with governance
- For comparative statements, the audit report on internal control and compliance with provisions of laws, regulations, contracts, and grant agreements relates only to the most recent reporting period included

WHAT IS GOING ON IN THE PROPOSED GAGAS

- **Chapter 7**
  - SSAE 18 (*Attestation Standards: Clarification and Recodification*) incorporated by reference
  - SSARS 21 (Section 90) on reviews of financial statements in accordance with GAGAS
    - SSAE 18 and SSARS 21 are beyond the scope of today!
  - Qualification requirements for auditors engaged for SSAE 18 engagements outside the US
  - Waste and internal control provisions similar to Chapter 6

WASTE OR ABUSE FOUND IN AN EXAMINATION

- Similar to Chapter 6 provisions but now would be required in an examination
- Examination report will include information about
  - Noncompliance with provisions of laws, regulations, contracts, or grant agreements that has a material effect on the subject matter or an assertion about the subject matter
  - Fraud that is material, either quantitatively or qualitatively, to the subject matter or an assertion about the subject matter that is significant to the engagement objectives; or
  - ~~Waste or abuse that is material, either quantitatively or qualitatively, to the subject matter or an assertion about the subject matter that is significant to the engagement objectives or the entity's operations.~~
- If less than material – communication to those charged with governance in writing

WHAT IS GOING ON IN THE PROPOSED GAGAS

- **Chapter 8**
  - Revised requirement – management assertions *not required* when conducting a performance audit under GAGAS
  - Updated suitable criteria (attributes and examples)
  - Internal control alignment to COSO and the Green Book
  - ~~Waste and~~ Internal control deficiencies elements similar to Chapter 6
- **Chapter 9**
  - Revised reporting for audit organizations that are independent under IIA standards
  - Report discussion on when internal control is significant
  - New report element when all internal control elements not considered
  - ~~Findings of waste reporting similar to Chapter 6~~

PERFORMANCE AUDITS AND GAGAS

- Includes measurement or evaluation of the subject matter of the engagement and presenting the resulting information as part of, or accompanying, the audit report
  - In a performance audit, assertions by audited entity management with respect to the subject matter of the engagement <u>do not affect the auditors' conclusions</u> on that subject matter
    - Auditors are responsible for measuring or evaluating the subject matter
    - GAGAS **does not require** auditors to obtain management assertions with respect to the subject matter when conducting a performance audit

SUITABLE CRITERIA IN A PERFORMANCE AUDIT

- Identifies required / desired state / expectation for the program or operation
  - Provide context for evaluating findings / conclusions
  - Must be relevant, reliable, objective and understandable within the context of the audit objectives
- Examples
  - Applicable laws and regulations
  - Goals, policies, and procedures
  - Technically developed standards or norms
  - Expert opinions
  - Prior period performance
  - Defined business practices
  - Contracts / grant agreements
  - Benchmarks for performance base don other entities / sectors

PERFORMANCE AUDIT REPORTING IN THE GAGAS ED

- If reporting on internal controls – performance audit focuses on
  - Scope of work on internal control, including
    - Consideration of the concept of accountability for use of public resources and
    - Government authority while assessing audit risk associated with internal control, and
  - Any deficiencies in internal control that are significant within the context of the audit objectives and based upon the audit work performed
- Insignificant deficiencies include in a written report to those charged with governance
- If not reporting on internal controls – must state it in the report
- Fraud, waste, abuse reporting similar to other chapters

WHERE IS IT ALL HEADED?

- 95 comment letters received
- Could finalize in the Summer???
- Proposed effective date not included in exposure draft

BREAKING NEWS – Based on GAO Advisory Council Meeting Minutes – Expected Release Date by June 30, 2018 – Earliest Effective Date: Periods Ending on or After June 30, 2019

RECENTLY ISSUED AUDIT STANDARDS YOU MAY NEED TO KNOW

SAS-132, *THE AUDITOR'S CONSIDERATION OF THE ENTITY'S ABILITY TO CONTINUE AS A GOING CONCERN*

- Replaced SAS-126 – issued in February 2017
- Is effective (became effective for periods ending on or after December 15, 2017)
- Adjustment of audit standards to reflect changes in FASB Standards (ASU-2014-15), but mostly aligns with GASB-56
- Changes definitions and application issues
  - Reasonable period of time
  - Substantial doubt
  - Application of going concern to interim financial statements
  - Disclosures and management's plan of action

SAS-132 – WHAT IS IT TRYING TO ACHIEVE?

- Going Concern Basis of Accounting (n/a in Government)
- Ability to Continue as a Going Concern
- Adequacy of Disclosures
- Report Accordingly

SAS-132 – WHAT IS IT TRYING TO ACHIEVE?

- Auditors will now be required to ask beyond management's normal assessment period
  - Governments – GASB-56 – 12 months beyond <u>the date of the financial statements</u>
  - SAS-132 aligns – period of time required by the applicable financial reporting framework ***or*** if no requirements in framework – **within one year after the date that the financial statements are issued**
- If financial statements are prepared in accordance with a Special Purpose Framework (aka – OCBOA) – consideration still needs to be done

SAS-132- DELAYS IN ISSUING FINANCIALS

- Common occurrence in entities under stress
- Auditor should inquire about the reasons for the delay.
- If the auditor believes that the delay could be related to the evaluation of whether there is substantial doubt about the entity's ability to continue as a going concern, the auditor should
  - Perform additional audit procedures as necessary
  - Consider the effect on the auditor's conclusion regarding the existence of substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time
- So-called 'close-calls' may occur (e.g. State bails out municipal government)
  - Emphasis of matter paragraph in report

SAS-133, *AUDITOR INVOLVEMENT WITH EXEMPT OFFERING DOCUMENTS*

- Issued July 2017
- Effective for exempt offering documents (including bond sales) initially distributed, circulated or submitted on or after June 15, 2018
- Will effect auditors participation in bond sales
- Aligns ‘should’ in standards to ‘must’

WHAT IS AUDITOR INVOLVEMENT?

- The auditor is involved IF
  1. **Auditor's report** (financial statement or review on interim) is **included *or* incorporated by reference** in an exempt offering document

     -AND-

  2. Auditor **performs** one or more of the '**trigger activities**' with respect to the offering document

WHAT IS A TRIGGERING ACTIVITY?

- Trigger activities are
  - Assisting the entity in preparing information included in the offering document
  - Reading a draft of the offering document at the entity's request
  - Issuing a comfort letter
  - Participating in due diligence discussions
  - Issuing an attestation report on information relating to the exempt offering
  - Providing written agreement for the use of the auditor's report in the offering document
  - Updating the auditor's report for inclusion in the offering document

IF THE AUDITOR IS INVOLVED, THEN

- Auditor must use AU-C Section 720 *Other Information in Documents Containing Audited Financial Statements*
  - Reading the information to identify inconsistencies
  - Obtain the information prior to the release date from management / governance
  - Communicate to management/ governance of their responsibility for the information (not the auditor's)
- If inconsistency – auditor must determine if the financial statements need revision
  - Would result in a modified auditor's report, if management refuses to revise
  - If after the auditor's report issued – subsequent events audit occurs (may require pulling financials or disassociation)
- If material misstatements of fact
  - Auditor discusses with management
  - After discussions, if still misstatement, counsel may need to be involved
  - Notify governance and potentially withdraw

OTHER AUDIT EXPOSURE DRAFTS OUT THERE APPLICABLE TO GOVERNMENTS

- *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports*
  - Convergence standard with international auditing standards
  - Required check for consistency of OI with information in AFR
  - Redefines what an annual report is – proposed to include CAFRs and other AFRs that include financial statements and the auditor's report
  - Similar to other AU-Cs, application material on withdrawal from an engagement – may not be permissible under law / regulation
    - Auditor then communicates with those charged with governance on inconsistencies
- Proposed effective date – financial statements beginning after 6/15/2019

OTHER AUDIT EXPOSURE DRAFTS OUT THERE APPLICABLE TO GOVERNMENTS

- *Forming an Opinion and Reporting on Financial Statements – Communicating Key Audit Matters in the Independent Auditor's Report – Modifications to the Opinion in the Independent Auditor's Report – Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*
  - Format of Auditor's Report may change due to convergence and PCAOB changes
  - Order of Report
    - Opinion
    - Basis for Opinion – unless otherwise required by law or regulation
    - Basis of Opinion section would include affirmative independence statement and ethical compliance
  - Requires auditors report similar to edits for AU-C 570 (Going Concern)

OTHER AUDIT EXPOSURE DRAFTS OUT THERE APPLICABLE TO GOVERNMENTS

- *Forming an Opinion and Reporting on Financial Statements – Communicating Key Audit Matters in the Independent Auditor's Report – Modifications to the Opinion in the Independent Auditor's Report – Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report*
  - Communication of Key Audit Matters (KAMs) not applicable for non-issuers, ***unless required by engagement***
  - Expands management's responsibility for preparation of financials
  - Expands description of auditor's responsibility
- Unclear as of now on edits to GAGAS reports
- Opinion units concepts would continue
- Potential need for including auditor's name and signature on reports if required by law or regulation
- Conforming changes to related reporting AU-Cs (705, 706)
- Proposed effective date – financial statements beginning after 6/15/2019

WHAT'S THE DIFFERENCE BETWEEN INTERNAL AUDIT AND FORENSICS AND HOW THEY MAY HELP YOUR GOVERNMENT

YOU MAY NEED AN INTERNAL AUDIT IF…

- Ethical or accuracy lapses have occurred and/or accountability is lacking.
- Specialized expertise is required to accomplish projects beyond regular operations.
- Risks in operations, compliance and reporting are unrecognized or are increasing due to significant changes in the industry, technology, laws and regulations.
- Existing policies and procedures may not be followed.
- Information technology data breaches have occurred or there is significant concern that such risk exists.

YOU MAY NEED AN INTERNAL AUDIT IF…

- Compliance with laws and regulations is a significant organizational risk and noncompliance may become a serious issue if not monitored and evaluated.
- Those charged with governance are focused on the "big picture," but remain concerned about what they may not know about the "little picture" (or vice versa)
- Communications internally have led to morale and turnover issues, while external communication quality has led to an air of skepticism from stakeholders about operations.
- You're just not sure if policies / procedures being followed…

YOU MAY NEED A FORENSIC ENGAGEMENT IF..

- Suspicions exist of fraud or theft.
- Similarly to the above described issue, turnover has occurred and account balances are not what they should be (positively or negatively).
- Accounts that were thought to be in your entity's name are not really owned by your entity.
- Reconciliation procedures result in timing differences or unidentified differences or don't reconcile at all.

YOU MAY NEED A FORENSIC ENGAGEMENT IF..

- Contractors that should have been paid have been unpaid and customers that should have paid have not.
- Theft of personally (or business) identifiable information has occurred (or systems have been "hacked").
- A whistleblower hotline identified issues such as assets stolen or other defalcations
- **Bottom Line**
  - **Internal Audit is PROACTIVE**
  - **Forensic Engagement is REACTIVE**
  - **Both may strengthen internal controls**

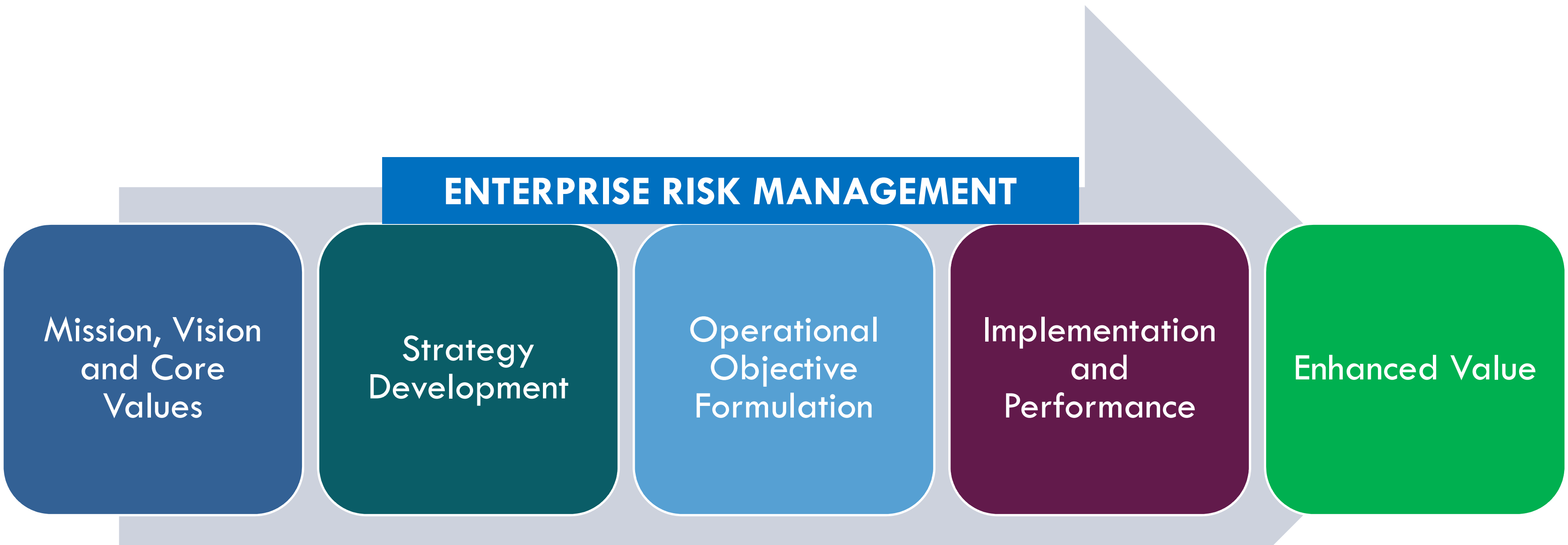
THE NEW COSO ON ENTERPRISE RISK MANAGEMENT

ENTERPRISE RISK MANAGEMENT IS…

- Looking at 'the big picture' of any organization – where we've been, where we're going, what are the risks in getting there?
- Key questions
  - Does our strategy / operations match our appetite for risk-taking?
  - Does our strategy / operations align with mission, vision and core values (ethics)?
  - How do we respond to deviations from both?
  - How do we respond to change?

THE ROLE OF RISK IN STRATEGY SELECTION

UPDATED COSO MODEL OF ERM



5 Interrelated Components:

1. Governance and Culture
2. Strategy and Objective-Setting
3. Performance
4. Review and Revision
5. Information, Communication, Reporting

WHAT ARE IN THE COMPONENTS?

Governance and Culture	**Strategy and Objective Setting**	**Performance**	**Review and Revision**	**Information, Communication and Reporting**
Exercises Board Risk Oversight	Analyzes (Business) Context	Identifies Risk	Assesses Substantial Change	Leverages information and technology
Establishes Operating Structures	Defines Risk Appetite	Assesses Severity of Risk	Reviews Risk and Performance	Communicates Risk information
Defines Desired Culture	Evaluates Alternative Strategies	Prioritizes Risks	Pursues improvement in ERM	Reports on Risk, Culture and Performance
Demonstrates Commitment to Core Values	Formulates (Business) Objectives	Implements Risk Responses	***Where have we seen many of these before???***	
Attracts, Develops and Retains Capable Individuals		Develops Portfolio View		

ANALYZING CONTEXT

- **Context can be understanding our external environment as potential risk categories – for a government they may be:**

Categories	External Issues
Political	Changes in tax policies, laws, political stability
Economic	Interest rates, inflation, availability to sell bonds, GDP growth
Social	Citizen needs or expectations, demographics, age distribution, educational levels, wealth distribution
Technological	Rate of tech change / disruption
Legal	Laws, regulations, court judgments
Environmental	Catastrophes, **climate change**, energy availability / independence

ANALYZING CONTEXT

- **Context can be understanding our *internal* environment as potential risk categories – for a government they may be:**

Categories	Internal Issues
Capital	Availability of cash / resources / borrowing capacity
People	Skills, knowledge, attitudes, relationships, values, culture
Process	Policies, procedures, organizational structure
Technology	Ability to utilize technology to operate

REVIEWING RISK AND PERFORMANCE EXAMPLE

A local economy is largely supported by tourism. Town officials understand the minimum, targeted and maximum levels of tourism needed to support the budget of the Town. The Town Manager has determined how much revenue can be generated through tourism based on hotel reservations and occupancy rates. The goal is approximately 50% occupancy which funds the budget at current levels.

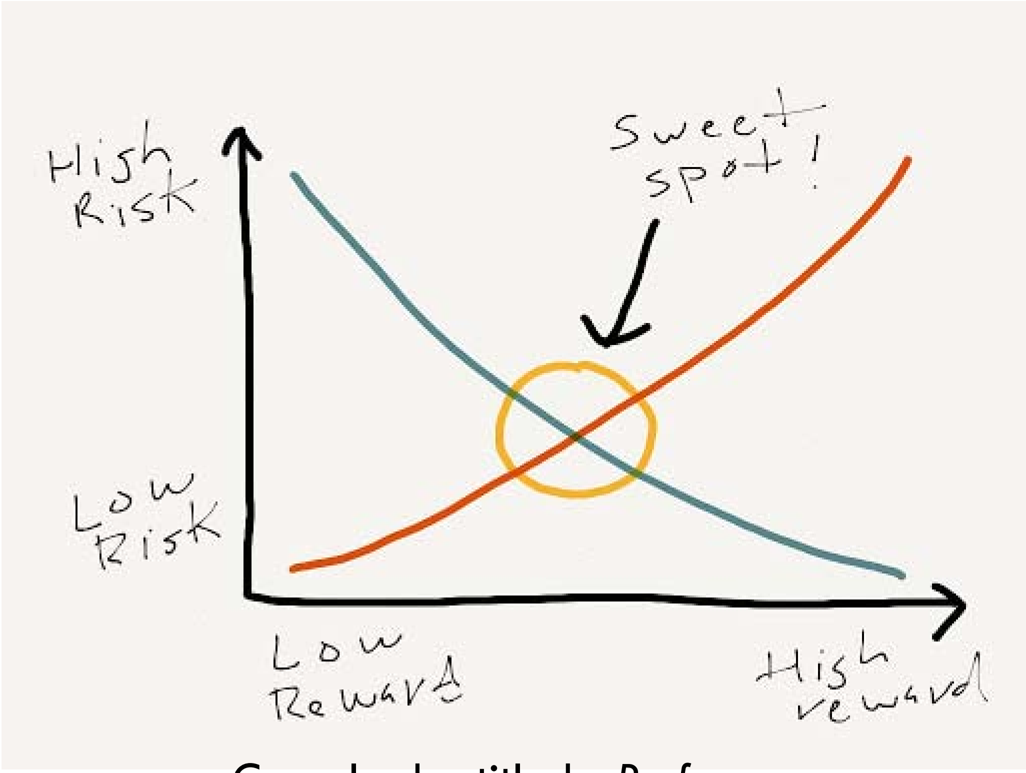
A large resort wants to locate near the Town beach. The operator thinks that the resort can be always at 85% capacity given its location and reputation. The operator is willing to grant the town an additional 10% of taxes for 3 years from opening as a goodwill gesture. However, the Town Manager thinks it will strain the local trolley service, police resources, natural resources, water, sewer capacity and ability for town residents to use the beach. **Would you take the risk?**

WHY DOES THIS MATTER?

- **When any organization integrates ERM with policies / procedures**
  - Results in better information that supports improved decision-making
  - Leads to enhanced performance
- Allows organizations to
  - Anticipate / manage risks more effectively
  - Identify / pursue new opportunities
  - Respond to deviations quickly and consistently
  - Develop and report a holistic view of risk
  - Improve collaboration / teamwork / trust
- Enhances value

WHY DOES THIS MATTER?

- Risks are everywhere – keys include defining the risks and uncertainties and managing them
- Risk and performance are on a curve
  - Do you really want a high-risk taker in your office?
  - Does that risk match your overall operations, core values?
  - Does that risk match your strategy?
  - Does the risk harm our internal environment?
  - Does that risk enhance accountability / transparency?



Can also be titled - *Performance*

ANOTHER EXAMPLE IN ACTION

A City has an abandoned mill that is a burden on the entire area, leading to economic decline, crime, loss of tax base etc.

An entrepreneur wants to buy the mill and land for $1 and start a new business, as long as the City guarantees the entrepreneur's debts up to $30 million and provides a property tax abatement for another $30 million. The business plans to bring in 1,000 jobs in the first 10 years. The entrepreneur wants a State tax abatement for income tax also for 10 years.

Would you do this based on the new COSO ERM?

AND THEN THERE'S ETHICS...

RULES OF TODAY'S FINAL SEGMENT

Please Keep Politics Out of Our Discussion

Understand that we all have different viewpoints, backgrounds and jobs – all are important – meaning

- No subordination of other's opinions

Understand that we live in an era where it is hard to differentiate between 'right' and 'wrong'

Understand that if you are a CPA, you must abide to the *Code of Professional Conduct* – Revised, as applicable to you as a preparer (or as an auditor,) or even as a retiree

- All others in the room, it's a best practice

WHAT IS THE MOST IMPORTANT THING IN YOUR WALLET?

Hint – It May Be Part of All These Things…

Driver's License?

Credit cards?

Money?

Organ donor card / blood type ID?

Medical Insurance ID?

Pictures of spouse / kids / grandkids?

Other items?

ONE OF MY FAVORITE MAXIMS

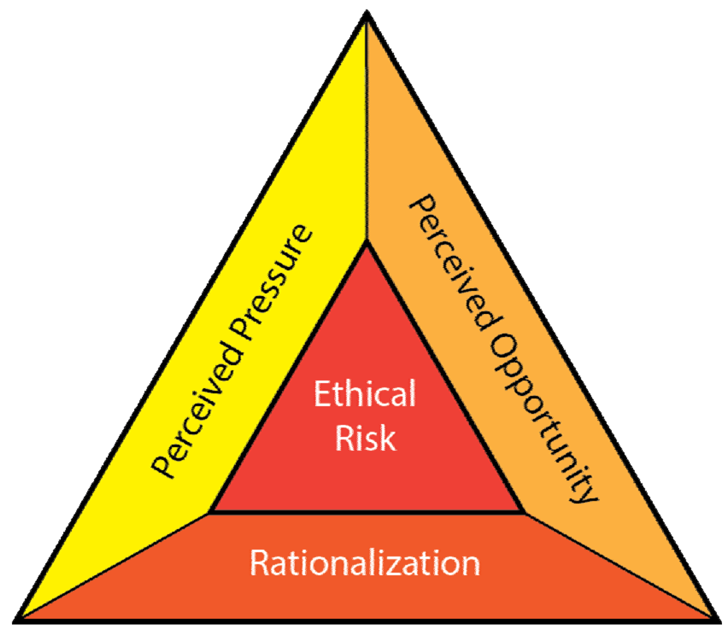
"It takes 20 years to build a reputation and five minutes to ruin it. If you think about that, you'll do things differently."

Who said the above? Was it:

a. Sheryl Sandberg (Facebook)
b. Pat Summitt (Tennessee Volunteers)
c. Warren Buffett (Berkshire Hathaway)
d. Bill Belichick (New England Patriots)

ETHICS CHALLENGES SURROUND US CONSTANTLY

- How many of you have
  - Witnessed someone in the workplace violating your workplace's code of conduct / ethics?
  - Been afraid to report an ethical issue?
  - Thought there might be (or considered) fraud / ethical issues going on in your workplace involving
    - Perceived Pressure
    - Perceived Opportunity
    - Rationalization
- **Beyond your organization, name**
- **some ethical issues lately** (*non-*
- *political please…*)



WHAT HAVE WE LEARNED FROM ETHICAL LAPSES

- Most were 'hiding in plain sight'
  - Bernie Madoff (investment returns far exceeding norms)
  - Airlines (overbooking of seats, unreasonable time period between flights)
  - Enron / Worldcom (overly complex organizational structure)
  - AIG (house of cards investments)
  - BP (cutting corners on safety on oil rigs)
  - New Orleans Saints (bounty-gate)
  - NCAA D-1 teams (various scandals from bribery to harassment to fake courses)
  - Major League Baseball (sign-stealing)
  - Hollywood

A PROBLEM FOR PROFESSIONALS…

- Core Question – Does *Compliance* equal *Ethics?*
- In many ethical lapses
  - A code of conduct was present
  - Ethical training had been given
  - A conduct / compliance function was staffed
  - Employee evaluations included ethics
  - A whistleblower function was part of the organization
  - An audit committee was in place

Source – Arizona State University Study 2014

A PROBLEM FOR PROFESSIONALS…

- Core Question – Does *Compliance* equal *Ethics*?
- The problem was present though…
  - The code of conduct had not been updated / revised in years
  - Ethical training involved reading a manual
  - Conduct / compliance functions reported to management and not to those charged with governance (or an independent body)
  - Employee evaluations were haphazard – checkbox without explanation
  - The whistleblower function was not staffed 24/7/365
  - The audit committee only met once a year and focused on financial auditing and not policy

Source – Arizona State University Study 2014

KEY ITEMS IN THE AICPA *CODE* FOR THOSE IN BUSINESS, INDUSTRY AND GOVERNMENT (BIG)

- Part 0 provisions applicable to those in BIG
  - Basic principles, structure and application
    - Responsibilities, serving the public, integrity, objectivity and independence, due care
  - Definitions
- Part 2 – Members in BIG have 5 major elements of Ethics (beyond an introductory section)
  - Integrity and objectivity
  - General standards
  - Compliance with standards
  - Accounting principles
  - Acts discreditable

CONCEPTUAL FRAMEWORK

- Follows (current) GAO / Yellow Book Framework almost exactly
  - Identification of Threats
  - Evaluation of Significance of Threats
  - Identify and Apply Safeguards
- Threats include six broad categories
  - Adverse Interest
  - Advocacy
  - Familiarity
  - Self-interest
  - Self-review
  - Undue Influence
- Safeguards available through the profession, legislation or regulation

ADVERSE INTEREST AND ADVOCACY

- Adverse Interest can be in many forms – most common
  - The intent to charge the employer with a violation of law / whistleblower situation
  - Financial or other relationship with contractor, customer, taxpayer etc.
  - Lawsuit or potential lawsuit with employer, officer, director or even another employee
- Advocacy is less common but could be a problem if
  - Using information being developed for an official statement (bonds) and then buying them
  - Providing *or failing to provide* information that will influence conclusions by decision-makers

FAMILIARITY AND SELF-INTEREST

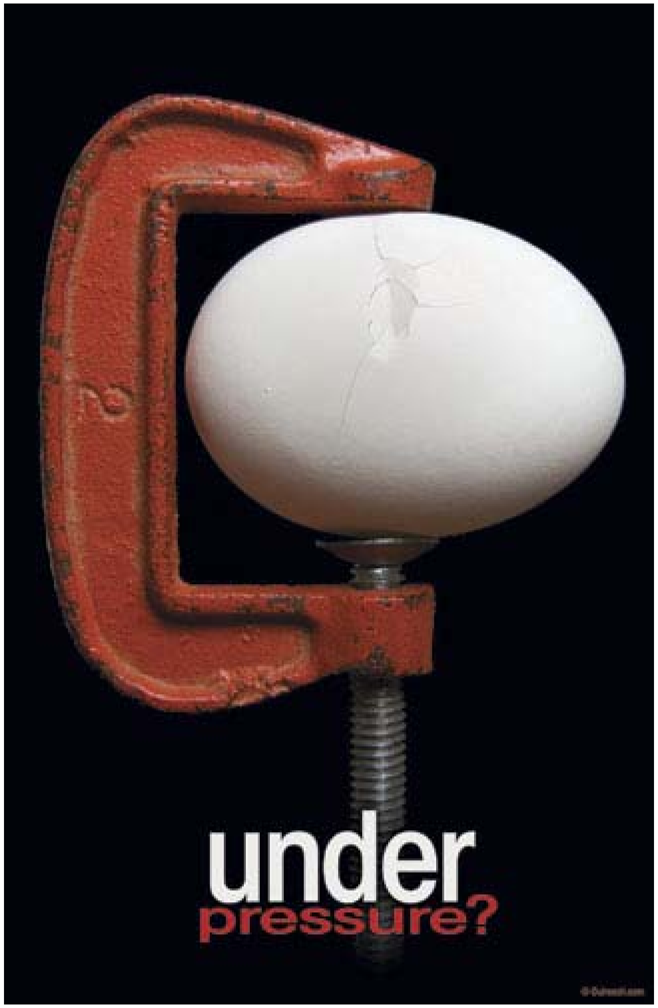
- Familiarity is when you become too sympathetic to interests
    - Immediate family or close relative who is a contractor
    - Acceptance of another's work product with little or no review due to the individual's past work product for an extended period of time
    - Employment of an immediate family member or close relative who is a subordinate
    - Acceptance of gifts or entertainment from a contractor or customer
- Self-interest is similar
    - Financial interest in entity by family or close relative
    - Using financial interest in entity to effect decisions

SELF-REVIEW

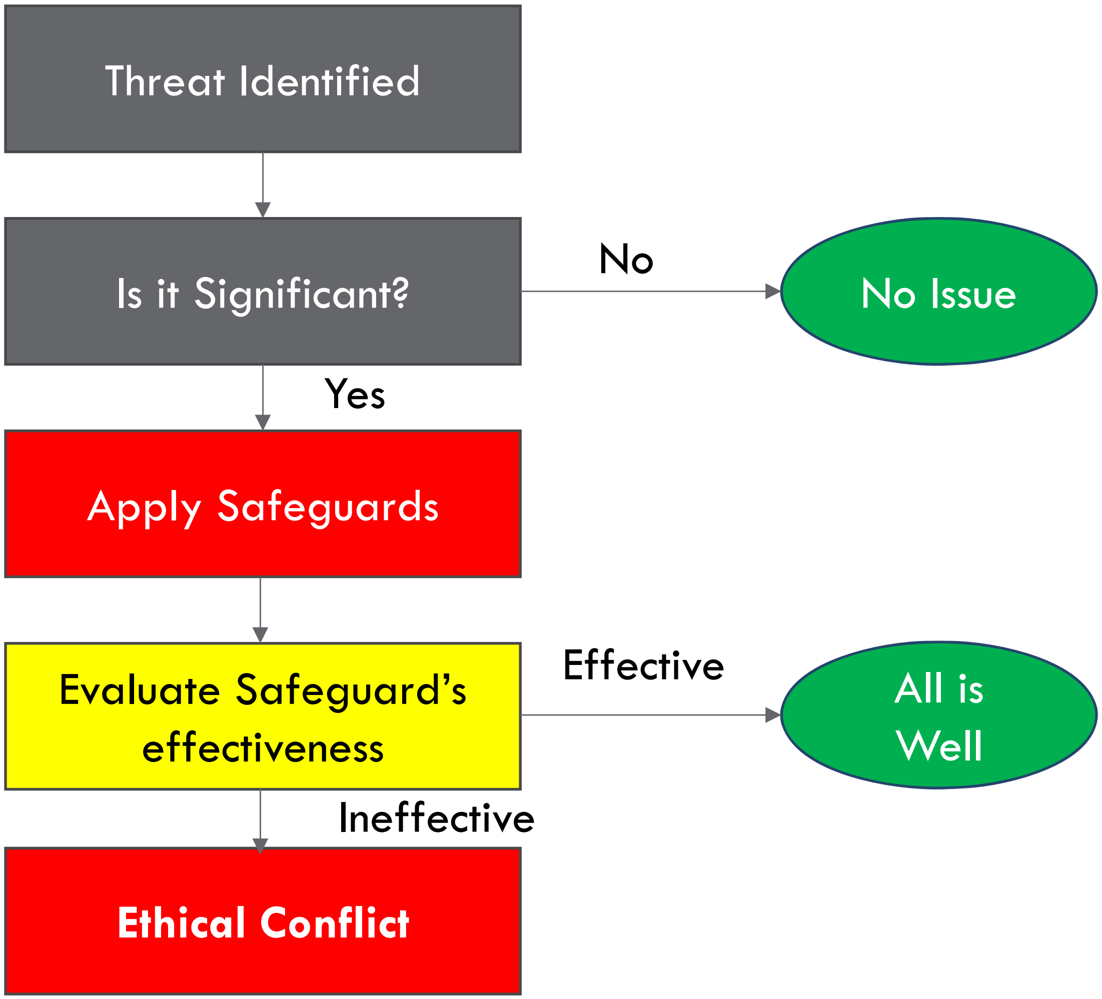
- When not evaluating results of judgments, services performed or supervised
  - Performing internal audit procedures that accept the work of services performed by you in a different position (when you change jobs and perform a review of your own work)
  - Acceptance of work previously performed by you as a basis for providing more services

UNDUE INFLUENCE

- Common – subordinating judgment due to position, reputation, expertise, aggressiveness, dominance, coercion
- Under pressure to
  - Associate with misleading information
  - Deviate from policy
  - Change a conclusion
  - Hire an unqualified person



CONCEPTUAL FRAMEWORK ON THREATS



See next slides on Safeguards and Ethical Conflicts

CATEGORIES OF SAFEGUARDS

- Professional, Legislative, Regulatory
  - Ethics education and training / CPE / Professional Standards
  - Legislative remedies / prohibitions
  - Licensing competencies
  - Whistleblower hotlines or private consultations
- Employer safeguards
  - Tone at the top
  - Code of ethics (as long as it's effective)
  - Audit committee
  - Internal policies regarding disclosure of conflicts, purchasing internal controls etc.
  - Dissemination of ethical compliance policies and procedures
  - HR policies – antidiscrimination, harassment, hiring, retention
  - Monitoring

CATEGORIES OF SAFEGUARDS

- Employer safeguards (continued)
  - Assigning sufficient staff to projects / tasks
  - Segregation of duties
  - Staff training on laws and regulations
  - Effective internal auditing
  - Promotions based on ethics, competency and integrity
  - Enforcement based on integrity

ETHICAL CONFLICTS

- Arise when
  - Obstacles to following an appropriate course of action due to internal or external pressures
  - Conflicts in applying relevant professional and legal standards.
- Consider the following
  - Relevant facts and circumstances, rules, laws, regulations
  - Ethical issues involved
  - Internal procedures
- Need to justify departures if appropriate to follow law
- Should consider consultation and legal counsel
- If can't resolve, discontinue relationship

INTEGRITY AND OBJECTIVITY

- Largest component of part
  - Conflicts of interest
  - Gifts and entertainment
  - Preparing and Reporting information
  - Obligations to Employer's External Accountant
  - Educational Services
  - Application of conceptual framework occurs to resolve ethical conflicts

INTEGRITY AND OBJECTIVITY

- Conflicts of interest may arise in professional services (anything requiring accounting and similar skills)
  - Parties to the conflict include contractors, customers, lenders, others
  - Include
    - Serving in a management or governance position at a contractor, lender etc.
    - Selecting a vendor that is closely related to you
    - Approving investments where you could personally benefit
- Identify conflict in accordance with law, evaluate impact and disclose if required

INTEGRITY AND OBJECTIVITY

- Gifts and Entertainment
  - Violation occurs when offering / accepting beyond applicable laws, regulations, policies etc.
  - Knowing of the violation and demonstrating recklessness in not knowing
  - Evaluate threat, significance and see if it can be reduced to a safe level
- Preparing and reporting information
  - Can't reduce to an acceptable level if materially false and misleading entries in financial statements or records
  - Failing to correct materially false / misleading records
  - Signing, permitting or directing another to sign a document containing false and misleading information
    - Remember – higher standard with bond official statements – SEC involvement

INTEGRITY AND OBJECTIVITY

- Subordination of judgment
  - Could occur in employment OR volunteer basis
  - May exist in difference of opinion in application of GAAP, laws, regulations etc.
  - Evaluate significance and perhaps consult others
  - Do not materially misrepresent facts
    - Violation of laws, regulations etc. – unacceptable
  - If can't reduce threat –again – may have to change jobs
- Obligations to External Accountants
  - Same thing – can't knowingly misrepresent facts or fail to disclose
- Educational Services
  - Performing professional services- must follow Integrity and Objectivity rules

NEW INTERPRETATIONS THAT WILL EFFECT YOU

- Interpretations Under Integrity and Objectivity Rule (ET Sec 2.100.001)
  - Knowing Misrepresentations in the Preparation and Presentation of Information (ET 2.130.010)
  - Pressure to Breach the Rules (ET 2.140.010)

KNOWING MISREPRESENTATIONS IN THE PREPARATION AND PRESENTATION OF INFORMATION

- If responsible for recording, maintaining, preparing, approving or presenting information, should do so in accordance with integrity and objectivity rule
  - Present in accordance with relevant reporting framework (GAAP, regulatory etc.)
  - Prepare or present information in a manner that is not intended to mislead or influence outcomes
  - Prepare or present information without omissions that would render the information misleading
- Do so using professional judgment
  - Represent the facts accurately and completely in all material respects
  - Describe the true nature of transactions or activities
  - Classify and record information in a timely and proper manner
- In making judgment, do not be intentionally misleading

KNOWING MISREPRESENTATIONS IN THE PREPARATION AND PRESENTATION OF INFORMATION

- If relying on the work of others to prepare / present information
  - Use professional judgment to determine if integrity / objectivity followed – consider:
    - Reputation
    - Expertise
    - Objectivity
    - Resources available to the individual / organization
    - The individual / organization's professional / ethical standards
    - Could be from prior association or consulting others
- If information is misleading, apply safeguards to seek to resolve the matter (see framework previously and subordination of judgment)

NEW PRESSURE TO BREAK THE RULES INTERPRETATION

- Threats to integrity / objectivity could be explicit or implicit, from inside the organization or outside
- Do not allow pressure to result in breach of integrity / objectivity rule
- Do not place pressure on others that would result in the break of the integrity / objectivity rule

NEW PRESSURE TO BREAK THE RULES INTERPRETATION

- Examples of pressure include pressure to:
  - Result in Conflicts of interest
  - Report misleading financial results
  - Misrepresent programs or projects to voters from elected officials
  - Misstate to bias decisions
  - Approve / process expenditures that are not legitimate from superiors
  - Reduce extent of work performed from superiors
  - Perform a task without sufficient skills or training or within unrealistic deadlines
  - Offer gifts / entertainment to inappropriately influence judgment / decision-making
  - Accept gifts / entertainment from potential vendors in a bid

TO RESOLVE THE PRESSURE - CONSIDER

- The intent of the individual exerting the pressure
- The application of relevant laws / regulations / standards
- The culture and leadership of the organization (does the government tolerate the behavior)?
- Ethics or HR policies that address the pressure
- Utilize framework and safeguards
- Remember to document the facts, communications and courses of action in addressing the matter

GENERAL STANDARDS

- Members must apply GAAP using
  - Professional competence
    - Possess skills, knowledge and experience or can gain it
  - Due professional care
  - Planning and supervision
  - Sufficient relevant data
  - Conceptual framework applies
  - If preparing financial statements to third parties (including auditors), **best practice is to communicate clearly, preferably in writing** your relationship to the entity and that you are not independent.
    - Pending exposure draft limits preparation standards of historical / prospective financial information ***to those in public practice*** (AR-C 70.01)

COMPLIANCE WITH STANDARDS

- Must comply with GAAP from recognized standard setter (GASB)
- Apply framework if an ethical conflict
- Shouldn't state that financials are in accordance with GAAP unless you know so
- May apply statutory framework, with knowledge that audit report will be modified
  - Watch representation letters!

ACTS DISCREDITABLE

- Don’t commit acts discreditable to the profession!
- Includes (but not limited to)
  - Discrimination and harassment in employment
  - Disclosure of CPA exam questions and answers
  - Failure to file a tax return or pay a tax liability
  - Negligence in preparing financial statements or records
  - Departing from laws, regulations
  - Indemnification or limitation of liability in the performance of an audit
  - Disclosing confidential information unless required to do so by law or court
  - False, misleading or deceptive acts
  - Use of CPA credential falsely
- If you are retired, this is the only ethics standard that applies

QUESTIONS?

THANK YOU

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