

2014 GASB Update
WVDE Office of School Finance
Summer Conference

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Our Agenda

- Recent standards and implementation issues
- Comprehensive Implementation Guide updates
- Accounting and Reporting Problems and “Half-Truths”
- GASB Technical Agenda

GASB Statement No. 65

Items Previously Reported as
Assets and Liabilities

Basic Definitions

- Deferred outflow of resources
 - Consumption of net assets by the government that is applicable to a future reporting period
- Deferred inflow of resources
 - Acquisition of net assets by the government that is applicable to a future reporting period
- Net position
 - Residual of all other elements presented in a statement of financial position
 - $[(\text{Assets} + \text{Deferred Outflows}) \textit{minus} (\text{Liabilities} + \text{Deferred Inflows})]$

Deferred Outflows of Resources

- Grant *paid* in advance of meeting time requirements
- Deferred amounts (debits) from debt refunding (excess of reacquisition price of refunded debt over net carrying amount)
- Decrease in fair value of derivative instrument associated with an effective hedging arrangement

Deferred Inflows of Resources

- Grants *received* prior to meeting of any timing requirement
- Resources received in advance related to an imposed nonexchange transaction (e.g., prepaid property taxes)
- Revenue of a governmental fund not recognized solely because availability requirements have not been met
- Deferred amounts (credits) on current and advance refundings
- Increase in fair value of hedging derivative instrument

Inflows of Resources (Revenues)

- Loan origination fees
- Commitment fees

Outflows of Resources (Expenses)

- Debt issuance costs (except for prepaid insurance)
- Initial direct costs of operating leases by lessor
- Acquisition costs for insurance entities and public entity risk pools
- Loan origination costs

Assets

- Grants *paid in advance* of *eligibility* requirements
- Purchase of future revenues from a government outside of the financial reporting entity
- Prepayments (other than those discussed earlier)
- Pension plan's net position exceeds total pension liability

Liabilities

- Derived tax revenues received in advance
- Premium revenues (applicable to risk pools)
- Grants *received in advance of eligibility requirements*

Other Items

- “Deferred” should only be for deferred outflows and inflows of resources
- Major Fund criteria amended
 - Assets + deferred outflows of resources
 - Liabilities + deferred inflows of resources
- For deferred inflows and deferred outflows of resources – no distinction between current and noncurrent is needed
- Effective date – Fiscal periods beginning after December 15, 2012 (basically, 6/30/14 most common timeframe)

Elements of Net Position

- Net investment in capital assets
 - Includes deferred outflows/inflows that are attributable to capital assets
- Restricted net position
 - Includes unspent related debt proceeds or deferred inflows that are unspent
- Unrestricted net position

GASB Statement No. 67
Financial Reporting for Pension Plans

- GASB Statement No. 67 – Financial Reporting for Pension Plans**
- An amendment of GASB Statement No. 25 (plans) and GASB Statement No. 50 (pension disclosures) for qualifying plans
 - 2 statements required:
 - Statement of Fiduciary Net Position
 - Statement of Changes in Fiduciary Net Position
 - Note disclosures
 - Required Supplementary Information
 - Effective date – fiscal years beginning after 6/15/13

GASB Statement No. 68
Accounting and Financial Reporting for Pensions

Overview of GASB Stmt. No. 68

- Single Employer and agent multiple-employer plans
- Cost sharing plans
- Defined contribution plans
- Note disclosures and RSI
- Effective for FYE 6/30/15

What Does No. 68 *Not* Cover?

- OPEB
 - To be addressed in a future project
 - Continue to follow Nos. 43 and 45
- Pensions that are *not* qualified trusts
- Termination benefits in general

Single Employer/Agent Plans

- Agent multiple-employer plans are basically single employer plans that are aggregated
- Facets to consider
 - Employer liability
 - Employer expense
 - Discount rate
 - Actuarial method
 - Amortization

Employer Liability

- GASB Statement No. 27
 - Liability reported was difference between the ARC and the actual contribution
- GASB Statement No. 68
 - Net pension liability is difference of PV of projected benefits for *past* service and restricted resources held in trust for benefit payments

Employer Expense

- GASB Statement No. 27
 - Pension expense equal to employer's ARC, adjusted for any prior over/under funding of employer contributions
- GASB Statement No. 68
 - Pension expense will incorporate, primarily,
 - Annual service costs
 - Interest on net pension liability
 - Projected earnings on plan investments
 - Changes in benefit terms

Discount Rate

Total pension liability is the PV of projected benefits earned for past service.

- GASB Statement No. 27
 - Discounting based on estimated long-term investment yield for plan
- GASB Statement No. 68
 - Discounting based on a single blended rate of the long-term expected rate of return (for as long as net position is expected to pay current benefits) *and* a yield/index rate on tax-exempt bonds (for any period after that)

Actuarial Method

- GASB Statement No. 27
 - Employers choose from six different actuarial cost methods for both accounting/reporting and funding
- GASB Statement No. 68
 - Employers will use one single method for accounting/reporting (entry age method), regardless of funding method used

Amortization

Changes in benefit terms, demographic assumptions, differences in estimates and actual assumptions, and differences in expected and actual investments affects net pension liability.

- GASB Statement No. 27
 - Effect of such changes amortized for up to 30 yrs.
- GASB Statement No. 68
 - Much shorter amortization period (some immediate, some closed period equal to average remaining service life of members, some closed five year periods)

Cost-Sharing Plans – Employer Liability

- GASB Statement No. 27
 - Liability only reported to the extent that employers fail to make all or a portion of their ARC
- GASB Statement No. 68
 - Liability represents the employer’s proportionate share of the *net pension liability* for the entire plan (collective of all employers participating)

Cost-Sharing Plans – Pension Expense

- GASB Statement No. 27
 - Pension expense is based on the contractually-required contribution to the plan (the ARC)
- GASB Statement No. 68
 - Pension expense is the employer’s proportionate share of total pension expense for all employers participating in the plan

Defined Contribution Plans

- GASB Statement No. 68 does not change current accounting and reporting guidance for defined contribution plans
 - Pension expense = required contribution
 - Liability only for difference in required and actual contributions

Note Disclosures

- Description of plan and benefits provided
- Assumptions used to measure net pension liability
- Description of any benefit changes/changes in assumptions
- Discount rate assumptions
- Net pension liability and deferred outflows/inflows of resources

Note Disclosures (continued)

- In addition, single and agent multiple-employer plans would disclose
 - Beginning balance of net pension liability
 - Ending balance of net pension liability
 - Effect of changes/differences during the period

Required Supplementary Information

- Actuarially determined annual pension contribution
- Amount of contribution made
- Difference between determined and made
- Payroll of covered employees
- Ratio of actual employer contributions to covered payroll
- Various additional RSI for single and agent-multiple employer plans

GASB Statement No. 69

Government Combinations and Disposal of Government Operations

Scope and Definitions

- Definition of operation – integrated set of activities for the purpose of providing identifiable services with associated assets and liabilities
- Statement applies to the following:
 - Government merger – combination of 2 or more legally-separate entities with no consideration and at least one entity ceases to exist after merger
 - Government acquisition – govt. acquires another entity or operation for consideration
 - Transfer of operations – operation transferred to a new or existing entity – no consideration
 - Disposals of government operations

Scope and Definitions (cont.)

- Statement does not apply to:
 - Arrangements that do not constitute an operation – e.g., donating an asset
 - Ownership of equity interests
 - Combinations in which a government acquires an organization that continues to exist as a separate legal entity

Government Mergers – New Governments

- Merger date begins initial reporting period
- Assets, liabilities, deferrals, etc. for new entity shown at that time – should be recognized according to governmental GAAP
- Amounts based on carrying values before merger - carrying values may require adjustment to align accounting principles or for impairments
- Changes in balances of amounts based on accounting estimates should be brought forward to merged entity and run through operations

Government Mergers – Continuing Governments

- Merger date is the beginning of the reporting period in which the merger occurs
- Assets, liabilities, deferrals, etc. for continuing entity shown at that time – should be recognized according to governmental GAAP
- Amounts based on carrying values before merger - carrying values may require adjustment to align accounting principles or for impairments
- Changes in balances of amounts based on accounting estimates should be brought forward to merged entity and run through operations
- Eliminations should be made in inter-entity transactions before the merger according to provisions of GASB 34

Government Acquisitions

- Acquisition date is the date on which the acquiring party obtains control of assets and obligations for liabilities
- Assets, liabilities, deferrals, etc. should be recognized according to governmental GAAP
- Do not recognize deferred outflows of resources (goodwill) being obtained from past acquisitions
- Amounts based on acquisition values – market-based entry price adjusted from conforming values to governmental GAAP

Government Acquisitions (cont.)

- Consideration must be present and recognized – consideration must be something other than assuming the negative position of the acquired entity
- If consideration provided exceeds net position acquired – deferred outflow of resources – deferred outflow amortized in future periods in a systematic and rational manner
- Consideration provided < net position acquired
 - Reduce values of noncurrent assets
 - May need to recognize a contribution
 - Amount would be reported as a Special Item

Transfers of Operations

- Reported at date of transfer of assets and obligations
- Recognize assets, liabilities, deferrals, etc. at transfer date in conformity with governmental GAAP
- Reported as a Special Item
- Evaluate transferred assets for impairment
- Reporting for Governmental Funds under the current financial resources / modified accrual MFBA

Disposals of Government Operations

- Recognize gains or losses from disposals, if applicable – Special Item at effective date of disposal
- Gain or loss should not include costs of normal operations – only costs directly associated with disposal (includes termination benefits, contract termination costs, etc.)
- In Governmental Funds – Special Item includes net fund balance being disposed of

Other Items

- New disclosures required for government mergers and transfers of operations, government acquisitions, and disposals of government operation
- Implementation date – FY beginning after 12/15/13
- Provisions applied on a prospective basis

GASB Statement No. 70
*Accounting and Financial Reporting
for Nonexchange Financial
Guarantees*

Objectives of Statement

- Objective is to establish additional guidance regarding the recognition and disclosure of financial guarantees made and received by state and local governments
- Covers financial guarantees that are nonexchange transactions
- Does not apply to guarantees of special assessment debt
- Does not apply to exchange and exchange-like transactions

Evaluating Nonexchange Financial Guarantees

- Governments issuing guarantees should consider qualitative factors in evaluating whether the government will be required to make a payment in relation to the guarantee
 - Initiation of process of bankruptcy or re-organization
 - Breach of debt contract provisions, defaults, etc.
 - Indicators of significant financial difficulty
 - For guarantees issued to groups of individuals or entities – consider qualitative factors and historical experience of likelihood of having to make payment to one or more members of group

**Recognition – Economic Resources /
Accrual MFBA**

- When qualitative factors and historical data make it more likely than not (> 50%) that a government has to make a payment under a guarantee
 - Recognize an expense and a liability
 - Discounted present value of best estimate of future cash flows
 - If no best estimate, but there is a range – use present value of minimum of range

**Recognition – Current Financial
Resources / Modified Accrual MFBA**

- When qualitative factors and historical data make it more likely than not (> 50%) that a government has to make a payment under a guarantee
 - Recognize an expenditure and a fund liability to the extent that the liability will be liquidated with expendable available resources
 - Recognition when liabilities are due and payable

Other Items

- New disclosures required by governments both making and receiving guarantees for nonexchange transactions
- Implementation date – FY beginning after 6/15/13
 - Retroactive restatement generally required
 - Prospective disclosures allowed for cumulative amounts in relation to financial guarantees of nonexchange transactions paid or received

Most Recent Additions to the Arsenal

- GASB Statement No. 71 – *Pension Transition for Contributions Made Subsequent to the Measurement Date-an amendment of GASB Statement No. 68*

Overview of the GASB's Comprehensive Implementation Guides

CIG Background

- GASB updates/expands guidance for its *Comprehensive Implementation Guide (CIG)* annually
 - *Currently* Level "d" GAAP in accordance with GASB Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*
 - 2013/14 edition reflects guidance issued through June 30, 2013

**2013-2014
Comprehensive Implementation
Guide**

Basics About the CIG

- Updated through June 30, 2013

- Overall, 15 new questions have been added
 - NOT including questions related to the incorporation of the new implementation guide for GASB Statement No. 67, *Financial Reporting for Pension Plans*

- Many questions amended to incorporate recent statements

4.11.6 – Tax Levy Authority

Scenario

- Charter school cannot levy taxes
- Funding formula includes allocation of portion of sponsoring school district’s tax levy

Question

- Is the levy allocation equivalent to the sponsoring government effectively approving their levy for fiscal dependency purposes?

4.11.6 (cont.)

Answer

- No – since the Charter School does not have levying power to begin with, this does not create an implicit ability to do so. There is obviously a financial burden, but not fiscal dependency. Dependency would be evidenced by the Charter only being able to levy with approval.

4.30.9 - Blending

Scenario

- State government creates financing authority to issue debt for itself and local schools (25%)
- State has pledged to repay ALL the debt (even that portion related to the school financing)

Question

- How should the financing authority be reported in the State’s financial statements?

4.30.9 (cont.)

Answer

- Financing authority should be blended because
 - the Authority’s debt is going to be repaid “entirely, or almost entirely” by the State.

This criteria was added to the list of blending requirements with GASB Statement No. 61, “The Financial Reporting Entity: Omnibus”.

4.30.10 - Blending

Scenario

- Assume, in the previous example, that the debt attributable to the Schools was to be repaid with a tax levy and not by the State

Question

- Would this change how the financing authority would be reported?

4.30.10 (cont.)

Answer

- Since the 25% portion attributable to the Schools would be considered a substantial portion of the overall debt, the State would NOT be expected to repay the debt “entirely, or almost entirely”. Therefore, assuming the other facts remain the same, the financing authority would be discretely presented.

7.23.16 – Net Investment in Capital Assets

Scenario

- An entity has several enterprise funds, one of which is a financing authority and is a blended component unit of the primary government
- Authority issues debt and loans proceeds to other enterprise fund, which purchases capital

Question

- Who has the capital-related debt?

7.23.16 (cont.)

Answer

- The enterprise fund that borrowed the funds carries the capital assets and reports an interfund loan.
- The authority reports the debt and an interfund receivable.
- The fact that the loan is to a separate legal entity (albeit blended component unit) is critical.
- The enterprise fund has “capital-related” debt, not the financing authority.

7.77.5 – Required Statements-
Fiduciary Funds

Scenario

- A PERS (considered a special purpose government engaged in fiduciary activities only) administers multiple pension and OPEB plans

Question

- What are the external reporting requirements for the PERS?

7.77.5 (cont.)

Answer

- There must be separate info on each plan within the basic financial statements
- While there are no government-wide statements, the traditional “fund type” reporting in the fund financials is modified
 - Present by individual fund, or
 - Combining statements within the basics

10.15.9 – Termination of Hedge Accounting

Scenario

- An interest-rate swap with an original fixed rate of 5% is re-negotiated at a later date to a rate of 3%
- Hedges are considered terminated if any critical terms are changed.

Question

- In this case, has the hedge terminated and, if so, what are the ramifications?

10.15.9 (cont.)

Answer

- The rate of interest is definitely a “critical term” in an interest-rate swap hedging arrangement. Therefore, the hedge is terminated and the previously deferred amount would be recognized as income (in this case) for the period.

10.16.4 – Hedging Derivative Instruments

Scenario

- Derivatives involve a *reference* rate and *notional* rate. The notional amount should approximate the amount of the associated asset/liability.
- Assume a portion of the related outstanding bond issue is refunded; the notional amount of the hedging interest rate swap is not.

Question

- Is the hedging relationship affected?

10.16.4 (cont.)

Answer

- Yes. The notional amount is no longer appropriately consistent with the hedged bonds. An amount equal to the debt that remains outstanding would remain a hedge. The balance would be classified as a separate investment derivative. The amount previously deferred would be recognized as income of the period.

10.16.5 – Hedging Derivative Instruments

Scenario

- A finance agency issues mortgage-backed bonds and enters into an interest rate swap. The notional amount of the swap estimates level of prepayments.
- Assume actual level of prepayments differ.

Question

- What affect would this have on the arrangement?

10.16.5 (cont.)

Answer

- Similar to earlier refunding scenario – a piece is no longer part of a qualifying hedge. The amount equal to the debt outstanding would continue to be a hedge. The balance would have to be reclassified as a separate investment derivative and a share previously deferred would have to be recognized as income for the period.

10.16.6 – Hedging Derivative Instruments

Scenario

- An interest-rate swap is used to hedge mortgage-backed bonds. The contract contains a call option that allows the issuing entity to adjust the notional amount, as needed. They do so for prepayments.

Question

- Is this an action that terminates the hedge?

10.16.6 (cont.)

Answer

- No. The option itself (thus the ability to exercise it) was part of the original agreement. Therefore, it is not considered a “critical term” in the agreement that has been breached.

Z.54.63 – Fund Balance Classification

Scenario

- Governing body sets aside a portion of fund balance for the specific purpose of paying for appropriated expenditures at the beginning of the new fiscal year; this portion of fund balance “cannot be used for any other purpose”

Question

- Should this portion of fund balance be considered “committed” fund balance?

Z.54.63 (cont.)

Answer

- The amount set aside can be used for any purpose – it is mainly a timing restriction. Thus, the limitation is not *how* the resources can be spent, but *when*. This is more of a minimum fund balance policy – it is not a true commitment. The action is irrelevant for classification – it would be part of unassigned fund balance.

Z.60.1 – Service Concessions

Scenario

- A service concession arrangement (SCA) is evidenced by the government remaining in control of the type and level services to be provided, as well as to whom. This is typically explicit in the contract.

Question

- Is it possible to have an SCA that does not explicit identify this in the contract?

Z.60.1 (cont.)

Answer

- Yes – control is often assured even in the absence of specific language use in the contract. For example, the purpose and intent of golf courses, toll roads, etc. are sufficiently clear.

Z.63.1 – Deferred Outflows/Inflows

Scenario

- Assume that a deferred outflow arose from an effective hedging arrangement, as did a deferred inflow from a similar arrangement.

Question

- Can these deferred outflows and inflows be netted?

Z.63.1 (cont.)

Answer

- No – assets and liabilities may not be netted unless there is “right of legal offset”. The same principle applies to deferred outflows and deferred inflows.

Z.65.1 – Items Previously Reported...

Scenario

- A governmental entity enters into a debt refunding transaction and the difference between the carrying amount of the *refunded* debt and the amount paid to refund the debt creates a deferred outflow of resources (could easily be a deferred inflow, too)

Question

- How does the deferred amount affect the note disclosures for long-term debt changes?

Z.65.1 (cont.)

Answer

- First, the deferred outflow created by this transaction is not a liability and it does not affect the carrying value of the refunded debt. Therefore, the changes in long-term liabilities note disclosure would not be affected.

Z.69.1 – Government Combinations

Scenario

- A government dissolves and ceases to exist.
- All of its operations form the basis of a new governmental entity
- No consideration is exchanged in the event.

Question

- Is this a government combination (i.e., merger or acquisition) or a transfer of operations?

Z.69.1 – Government Combinations

Answer

- A merger or acquisition requires there be two legal entities entering into the combination, so it does *not* qualify.
- The dissolution of a *single* entity that allows the creation of a new legal entity is simply a transfer of operations. There is no requirement for the *original single* entity to continue to exist.

Z.69.2 – Government Combinations

Scenario

- The GASB guidance requires that an impairment be recognized for capital assets acquired via a merger that will not be used.

Question

- How should the impairment be reported?

Z.69.2 (cont.)

Answer

- The impairment itself would *not* be reported in the financial statements themselves, at least not directly.
- The assets would be reported at their adjusted value (net of the impairment adjustment) and the notes should disclose the difference and explain it

**Common Accounting and
Financial Reporting Problems**

*Governmental "Half-Truths"
(as defined by GFOA)
and other Technical Issues*

Focus of the Session

- Summarization of governmental accounting “half-truths”, as identified by the GFOA in recent issues of *GAAFR Review*
- Clarifications of several technical issues
- Variety of common accounting and financial reporting issues

Governmental Accounting “Half-Truths”

Number of Funds Principle

- Misconception that the “number of funds principle” from NCGA Statement No. 1, *Governmental Accounting and Financial Reporting Principles*, really means “the fewer the funds, the better”
- Better summarization: “use *all* the funds and fund types needed, but *only* the funds and fund types needed – no more, no less”

**“Blending” of Fiduciary-type
Component Units**

- Fiduciary-type component units are aggregated into the fiduciary fund types of the primary government
- Looks and smells like “blending”, although the terms “blending” and “discrete presentation” technically refer to the government-wide treatment
- Governments should refrain from describing such arrangements as “blending”, but rather “including the fiduciary fund statements”

Liabilities in Governmental Funds

- Governmental fund liabilities recognized when “normally..liquidated with..available resources”
- GASB Interpretation 6 defines *normally* in the context of general government practice
- Thus, salaries and wages, vendor payables, and similar items that governments generally liquidate when incurred should be reported as liabilities

Operating Subsidies vs. Transfers

- Subsidies between a primary government and its *blended* component units are properly reported as transfers
- The term “transfer” is an *interfund* concept
- Thus, subsidies between a primary government and any *discretely presented* component units should be reported as an expenditure or expense

Special vs. Extraordinary Items

- Extraordinary items must meet *two* criteria (unusual and infrequent) and special items must only meet one of these
- Thus, some have concluded that is all that is needed for a special item
- Additional criteria has to be met for a special item – *subject to management control*

Treatment of Long-term Borrowing in Governmental Funds

- “Outside” long-term borrowing in a governmental fund is treated as an OFS
- “Internal” long-term borrowing is treated as a fund liability in a governmental fund (this distinction applies only to borrowings *within* the primary government)
- Long-term borrowing between a governmental fund and a discretely presented component unit should be treated as “outside”

Transactions with Discrete Component Units

- As a general rule, transactions between a PG and a discretely presented component unit is treated like an outside party transaction. Of course...there is an exception...the sale/purchase of capital assets/financial assets
- With such transactions *within the financial reporting entity*, the transferee (recipient) should be recognized at the transferors carrying value

**Application of Refunding Debt
Proceeds as OFU**

- Applying the proceeds of refunding debt is reported as an OFU
- However, this is only for *advance* refundings, where the proceeds are being placed in escrow
- If it is a *current* refunding, where the proceeds are immediately being applied to refund debt, the use should be reported as an expenditure

**Voluntarily Declaring a Fund
to be "Major"**

- Major fund reporting is appropriate for governmental funds and enterprise funds only
- Within the governmental fund category or the enterprise fund type, any fund may be "declared" to be a major fund
- This option is *not* available for internal service funds or fiduciary funds, where major fund reporting is not appropriate

**Interest Capitalization in
Proprietary Funds**

- Interest capitalization is required in *enterprise funds*
- Although they use the same measurement focus and basis of accounting, interest capitalization is not allowed in internal service funds
- Financing costs must be excluded from functional costs for the governmental activities, thus interest cannot be capitalized for internal service funds that may be allocated therein

**Netting Disaster Losses
Against Recoveries**

- Insurance recoveries are netted against losses, if the loss and recovery occur in the same year (for government-wide, proprietary fund and fiduciary fund reporting)
- FEMA grants, however, are not netted and the loss and receipt of FEMA funds are reported as separate events

Private vs. Public Sector Cash Flows

- Private – operating/financing/investing activities
- Public – operating/noncapital financing/capital financing/investing activities
- Operating for private means anything on the operating statement; for public, it only means the operating category
- Interest is NOT investing in the public sector, but the purchase of capital assets would be

**Governmental Funds and
Capital Assets**

- Governmental funds do not report capital assets
- However, capital assets are only such if used in operations
- Thus, capital assets that are simply being held for re-sale (e.g., foreclosures), should be reported as financial assets in the governmental fund (properly captioned)

Various Technical Issues

Using the term “Deferred Revenue”

- Historically, revenue recognition occurs at a later point because
 - Revenue generation is not complete (e.g., grant eligibility not met)
 - Revenue is associated with a *future* period (e.g., prepaid taxes)
 - Revenue is not yet available

“Deferred Revenue” (cont.)

- If revenue generation is not complete, a liability is reported (e.g., unearned revenue or due to grantors)
- If other situations exist, proper reporting would be *deferred inflow of resources*
- The term “deferred revenue” is acceptable for the latter, but not in situations where the revenue is reported as a liability
- Other options are recommended.....

What Constitutes a Commitment?

- Various questions in past Implementation Guides to deal with question
- Resolution? Ordinance? – The guidance says the “most binding” action.
- Some governments say both are equally binding, and that it is theoretically possible, but highly unlikely (thus, governments should refrain from such references)

Obsolete Terminology to Describe Fund Balance

- Reserved, unreserved, designated are no longer appropriate fund balance references or classifications
- ALL references should be modified
 - Letter of transmittal
 - MD&A
 - Note disclosures

Inadequate Analysis of Significant Changes in Financial Position

- The MD&A should include an analysis of significant changes in financial position
 - Governmental activities
 - Business-type activities
 - Individual major funds
- MD&A still lacking in any real analysis or reasons for change in the verbiage

Failure to Describe Significant Capital Asset and Long-term Debt Activity

- MD&A still lacking in its description of significant capital asset and long-term debt activity
- Not unusual for it to be completely missing
- The MD&A should be consistent with the type of information that is included in the note disclosures

Incorrect Reporting of Shared Taxes

- *Shared* taxes are technically *not* a tax from the recipient government's perspective
 - *Levied* taxes NEVER reported as program revenue
 - *Shared* taxes are often appropriately reported as program revenue
 - *Shared* taxes that are not restricted but are general revenues should be *intergovernmental* and not part of general tax revenues

Inadequate Disclosure for Encumbrances

- GASB 54 prohibited encumbrances from being reported as a component or subcomponent of fund balance on the balance sheet
- Instead, "significant encumbrances should be disclosed in the notes...by major funds and nonmajor funds in the aggregate..."
- While balance sheets not a major problem, governments still tend to retain their pre-GASB 54 disclosures and not as part of significant commitments or at the required fund level of detail

Inadequate Disclosure for Special Revenue Funds

- "...one or more specific restricted or committed revenues should be the foundation for a special revenue fund."
- Other resources may supplement but should not supplant
- Disclosure should be made regarding "...which revenues and other resources are reported in each of these funds."

Failure to Provide Adequate Disclosure for Assigned Fund Balance

- Note disclosures should identify "...the body or official authorized to assign amounts to a specific purpose..." and describe "...the policy established by the governing body pursuant to which that authorization is given..."
- Reviewers are noting significant deficiencies in both requirements

Incomplete Information on Funded Status of Postemployment Benefits

- Governments that offered defined benefit plans (retirement or OPEB) are required to include multi-year trend information on funding progress as RSI
- Also required to disclose funding progress data in the notes
- *Both* require (1) covered payroll and (2) employer's unfunded actuarial liability as a % of covered payroll
- This info is often absent from the RSI and/or notes.

Incorrect Amounts Reported in the Schedule of Direct/Overlapping Debt

- There should be consistency between debt capacity schedules and the basic financial statements
 - Amounts should include discounts, premiums, and other adjustments
 - Deep-discount debt should agree with accreted amounts reported in the basic financial statements

GASB Agenda

GASB Statement No. 55

The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments

GASB Statement No. 55 (cont.)

- Basically copied existing GAAP hierarchy standards from the AICPA's Auditing Standards to the GASB standards as to allow for ease of access
- New statement did not establish new hierarchy or change existing hierarchy
- Effective upon issuance

The GAAP Hierarchy

- GASB Statements and Interpretations
- GASB Technical Bulletins and AICPA audit guides and SOPs *if cleared by GASB*
- AICPA Practice Bulletins *if cleared by GASB*
- Implementation Guides published by GASB staff, as well as other generally accepted practices (e.g., *The Blue Book*)

Proposed Changes to the GAAP Hierarchy

GAAP Hierarchy

- Project to modify the GAAP hierarchy, currently as per GASB Statement No. 55, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments*
- Exposure Draft and Proposed Revised CIG planned for December 2013
- Comment Period – 2014
- Final standard anticipated June 2015

What direction is this going?

- GAAP hierarchy will be reduced to two authoritative and one nonauthoritative levels
- First level will be GASB Statements
 - Guidance must be formally approved by the Board and publicly exposed for comment without limitations
- Second level will be primarily Technical Bulletins, approved AICPA guidance, and newly revised CIG
 - Guidance must be cleared by the Board and publicly exposed for comment without limitations

Direction (cont.)

- Nonauthoritative level includes
 - GASB Concepts Statements
 - Widely recognized and prevalent practices
 - FASB Accounting Standards Codification
 - Other accounting literature

What are the practical effects?

- The Implementation Guides will now be subject to an exposure period
- GASB Interpretations will no longer be considered authoritative. The GASB plans to incorporate them via referencing.

Practical Effects (cont.)

- *If guidance for a transaction or event is not specified within a source of authoritative GAAP, a governmental entity should first consider accounting principles for similar transactions and then may consider other accounting literature.*

Practical Effects (cont.)

- *If the guidance for a transaction or event is not specified within a source of authoritative GAAP or cannot be analogized to similar transactions within a source of GAAP, governments should not select an accounting policy from a nonauthoritative source that conflicts with or contradicts authoritative GAAP.*

Main Topical Areas

- Conceptual Framework
- Fair Value Measurement and Application
- Economic Condition Reporting
- Fiduciary Responsibilities
- OPEB

Conceptual Framework – Recognition and Measurement Approaches

- Two primary objectives
 - Develop recognition criteria for *whether* information should be reported in financials and *when*
 - Consideration of the measurement approach or approaches that should be used in governmental financial statements
- Ultimately resulting in a Concepts Statement
- ED (2Q13); Final CS (2Q14)

Introduction / Background

- Measurement Focus – what items should be reported as elements of financial statements
- Basis of Accounting – when should those items be reported
- Measurement Approach – should items be valued at the original amount or remeasured at the financial statement date

Objectives

- Recognition issues
 - Economic resources measurement focus
 - Current financial resources measurement focus
 - Deferred inflows and outflows of resources
- Current financial resources measurement focus
 - Does not have cohesive conceptual foundation
 - Some items are not “current” – long-term receivables
 - Some items are not “financial” – inventories
 - Reporting complex transactions – derivatives
- Measurement approaches

Measurement Approaches

- Act of assigning dollar amounts to financial statement elements
- 2 approaches:
 - Initial transaction date based – amount assigned is when asset acquired or liability incurred with appropriate subsequent modifications (e.g., depreciation)
 - Current financial statement date based – amount measured (or re-measured) at current financial statement date
- Only relevant for assets and liabilities
- Concepts apply to both measurement focuses
- Only a single approach can be applied to each asset and liability

Initial Amounts

- Historical cost, fair value for donations + ancillary charges for assets
- Liabilities recorded at amount of resources required to satisfy the liability
- GASB proposes using initial amounts for assets used directly in providing services
 - Lower cost of obtaining information
 - Remeasured values less needed because assets will not be sold or exchanged since they are being used to provide services

Remeasured Amounts

- Establishes new carrying amounts for assets and liabilities at financial statement date
- Results in reporting of remeasurement gains and losses
- Remeasured amounts may be more relevant in assessing financial position and ability to meet obligations
- Measurement may be more difficult
- GASB believes that remeasured amounts are more appropriate for:
 - Assets that will be converted to cash (cash and investments)
 - Variable payment liabilities (e.g., compensated absences, pollution remediation obligations)

Fair Value

Measurement and Application

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Proposed Definition of Fair Value

- The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.
 - An exit price
 - Based on the principal or the government's most advantageous market

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Valuation Approaches and Techniques

- Valuation technique used to measure fair value should be appropriate to the circumstances and should maximize the use of relevant observable inputs (assumptions that market participants would use in pricing an asset or liability)
- Three basic approaches
 - Market approach – Uses prices and other relevant information generated by market transactions involving identical or similar assets, liabilities, or group of assets and liabilities
 - Cost approach – Amount that would be required currently to replace the service capacity of an asset
 - Income approach – Converts expected future amounts (for example, cash flows) to a single current amount (that is, discounted)

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Hierarchy of Inputs

- Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities that the government access at the measurement date
- Level 2: Inputs, other than quoted prices included in Level 1, that are observable (either directly or indirectly)
 - Market quotes for similar assets
 - Yield curves that are observable at commonly quoted intervals
- Level 3: Unobservable inputs
 - Midmarket consensus price for a swap that uses data that are not directly observable and cannot be corroborated by the observable market data.

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Proposed Fair Value Application

- Applies to most investments
- Definition of an investment
 - A security or other asset that a government holds primarily for the purpose of income or profit and its present service capacity is based solely on its ability to generate cash or to be sold to generate cash
- Investment asset
 - Service capacity
 - Refers to a government’s mission to provide services
 - Held primarily for income or profit
 - Acquired first and foremost for future income and profit

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Investment Exemptions

- Money market investments and participating interest-earning investment contracts that have a remaining maturity at time of purchase of one year or less, reported by governments other than external investment pools
- Investments in 2a7-like pools
- Investments in common stock that meet the criteria for applying the equity method
- Non-participating interest earning investment contracts
- Unallocated insurance contracts
- Synthetic guaranteed investment contracts that are fully benefit responsive

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Application of Acquisition Value

- Capital assets acquired through a nonexchange transaction
- Donated capital assets
- Donated works of art, historical treasures, and similar assets
- Capital assets received through a service concession arrangement

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Note Disclosures

- Supplements current disclosure requirements
- Disclosures should be organized by type or class of asset or liability
 - Table or narrative format
- Specific disclosures
 - Fair value measurement at the end of the reporting period
 - Level of the fair value hierarchy within which the fair value measurements are categorized in their entirety (Level 1, 2, or 3)
 - Description of the valuation technique(s) and the inputs used in the fair value measurement
- Additional disclosures for Level 3 measures and investments where the value is based on net asset value per share

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Timeline

- Exposure Draft to be released in later in May 2014
- Comment deadline—August 15, 2014

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Economic Condition Reporting – Financial Projections

- Should guidance be provided for additional info related to economic condition via financial projections for external financial reporting
- Project currently on hold

Fiduciary Responsibilities

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Proposed Fiduciary Definition

- A government that controls assets either:
 - as a trustee for the sole benefit of its own employees or recipients other than the financial reporting entity, or
 - for which it does not have administrative or direct financial involvement over the assets used to provide benefits to individuals that are not part of its citizenry, or organizations or other governments that are not part of the financial reporting entity.

Fiduciary Fund Reporting

- Fiduciary activities continue to be reported as basic financial statements in GPEFRs
 - Pension (and other employee benefit) trust funds, investment trust funds, and private-purpose trust funds of governments meeting the proposed definition of a fiduciary continue to be reported in GPEFRs
- The classification of fiduciary activities be determined by the presence or the lack of presence of a trust agreement or equivalent arrangement

Custodial Funds

- An expanded fund type be established that includes any fiduciary arrangement that is not governed by a formal trust agreement or equivalent arrangement—CUSTODIAL FUNDS
 - Funds previously classified as agency funds
 - Trust funds for which there is no trust agreement or equivalent arrangement
- Custodial funds of governments meeting the proposed tentative definition of a fiduciary be reported in GPEFRs
- A commitment be recognized and reported as a liability only when the event giving rise to the liability has occurred
 - Otherwise..... The commitment should be recognized and reported as net position restricted for beneficiaries for ALL FIDUCIARY FUNDS

Timeline

- Issues to be deliberated
 - Events that give rise to a liability
 - Issues related to stand-alone business-type activities engaging in fiduciary activities
 - Note disclosures
- Due Process
 - Preliminary Views in December 2014

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OPEB

- Board planning to improve accounting and financial reporting requirements to existing OPEB guidance
 - Similar to recent changes to Pension guidance
- ED anticipated 2Q14
- Final anticipated 2Q15
